PROBIOMICS LIMITED

A.B.N. 97 084 464 193

ANNUAL REPORT
FOR THE YEAR ENDED
30 JUNE 2006

CORPORATE INFORMATION

Directors

Bryan Martin Gardiner (Chairman)

Patrick Douglas Ford

Ronald Penny

Company Secretary

Paul Beatty Magoffin

Corporate Head Office

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Australian Technology Park
1 Central Avenue
EVELEIGH NSW 1430
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Registered Office

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Principal Solicitors

Clavey Legal,
Ashton Chambers,
189 St George's Terrace,
PERTH WA 6000

Patent & Trade Mark Attorney

Spruson & Ferguson
Patent and Trade Mark Attorneys
Level 35, St Martins Tower, 31 Market Street,
SYDNEY NSW 2000

Bankers

National Australia Bank Limited
Macquarie Investment Management Limited

Auditors

Ernst & Young
Ernst & Young Centre,
680 George Street,
SYDNEY NSW 2000

Share Register

Computershare Investor Services Pty Ltd
Level 12, 565 Bourke Street,
Melbourne Victoria 3001
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Internet Address

www.probiomics.com.au

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CHIEF EXECUTIVE OFFICER’S REVIEW OF OPERATIONS FOR THE PERIOD

Dear Shareholder,

We have spent the past year completing a 2-year overhaul of the company.

Revenue for the year is up 18.1% notwithstanding that we only recorded sales of proTract® in Australia for the first 5 months to November when the distribution agreement was terminated. This had a considerable negative impact, as those sales in the previous year accounted for approximately 35% of total revenue. However, this action will enable us to complete a replacement agreement with a top-5 global pharmaceutical company which should have a positive impact on revenue during the next year.

Operational expenditure for the year has reduced by 42%. All product marketing obligations are now borne by our distribution partners. The cost of future clinical trials will be shared by our distribution partners, and research projects will be outsourced.

The operating loss (after tax) for the period is down 53% to $1.88 million. We expect this loss to reduce further in the coming year primarily due to an increase in revenue.

Our focus for the next year is to complete distribution agreements for our products in Australian and global markets. We will continue negotiations with some of the world’s largest companies for the licensing of PCC® in infant formula, functional foods, and Over The Counter (“OTC”) products for pharmacy and grocery. Such agreements take time to conclude, however the fact that we have the attention of such companies is an independent validation of our technology, and the integrity of our intellectual property.

Some specific objectives for the coming financial year include:

- Completion of a distribution agreement with a top-5 global pharmaceutical company for proTract® in Australia and New Zealand
- Completion of a collaboration agreement with a top-5 global consumer products company for the development and distribution of PCC®-based respiratory and skin OTC products globally.
- Completion of an agreement with a top-5 global pharmaceutical company for the incorporation of PCC® in an infant formula range.
- Australian supermarket launch of a range of PCC® functional food products by a top-5 Australian food company
- Completion of a clinical trial to determine if PCC acts as an adjuvant for the influenza vaccine;
- Finalisation of litigation with the previous Australian distributor of proTract®.
- Completion of the molecular discovery project
- Development of a probiotic polymer for application of PCC ®in dry foods
- Development of proprietary enumeration and viability assays techniques.

On behalf of the Directors and myself, I thank my management team and assure shareholders that we will continue to work to add value to your company.

Kim Slatyer

Chief Executive Officer

28th September 2006

DIRECTORS' REPORT

Your directors submit their report for the year ended 30 June 2006.

DIRECTORS

The names and details of the Company's directors in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

Names, qualifications, experience and special responsibilities

Mr Bryan Martin Gardiner, Chairman	Mr Gardiner was appointed to the Board on 17th February 2005 and was elected Chairman on 20th May 2005. Mr Gardiner is a member of the Audit Committee and the Remuneration Committee. Mr Gardiner is a practising solicitor who was admitted to the Supreme Court in Western Australia in December 1970. He has had over thirty years' experience in commercial law and has been a partner in a medium-sized law firm, in-house counsel, a senior solicitor with a major national firm and now practices as a consultant to a Perth firm, Clavey Legal. Mr Gardiner is the Chairman of the Western Australian Land Valuers Licensing Board. He is a director of the Immunologenics Research Foundation (Inc) which specializes in DNA research in Western Australia. Mr Gardiner is a director of Tutt Bryant Group Ltd, the shares of which are quoted on the ASX. Mr Gardiner was a director of Tat Hong Holdings Limited until October 2005 when he resigned to become a director of its Australian subsidiary, Tutt Bryan Group. He has not been a director of any other public companies during the past three years.
Mr Patrick Douglas Ford	Mr Ford was appointed to the Board on 17th May 2005. Mr Ford is Chairman of the Audit Committee and is also a member of the Remuneration Committee of the Board. Mr Ford is a Sydney based stockbroker with Taylor Collison Limited. He has an extensive history of capital raising and supplying advice to the Australian Biotechnology sector. He holds a Bachelor of Commerce degree from the University of Canberra. Mr Ford has not been a director of any other listed company during the past three years.
Professor Ronald Penny	Professor Penny was appointed to the Board on 17th February 2005. Professor Penny is a member of the Audit Committee and the Remuneration committee of the Board. Professor Penny is one of Australia's leading immunologists. He graduated with Honours from the University of Sydney in 1960 following which he undertook further studies in haematology, oncology and immunology in the UK and the USA. Professor Penny set up the first Clinical Immunology Unit in NSW at the Royal Prince Alfred Hospital. In 1979 he was the recipient of the first Doctorate of Science awarded to a member of a clinical department by the University of NSW followed by a Personal Chair in Clinical Immunology in 1988. Professor Penny has published over 350 medical and scientific papers in prestige national and international journals. Professor Penny is currently Emeritus Professor of Medicine, University of NSW, Senior Clinical Advisor, NSW Health, Chairman of the Justice Health Board and Chairman of the NSW Blood Products Advisory Committee and is a director of publicly listed Cryosite Limited. Professor Penny has not been a director of any other listed public company during the past three years.

COMPANY SECRETARY

Paul Beatty Magoffin **FCPA, FCIS**	Mr Magoffin has been Company Secretary of Probiomics Limited since August 2003. He is a Fellow of CPA Australia and also a Fellow of Chartered Secretaries Australia. Mr Magoffin has had over 15 years experience as a public company secretary. He also has a similar length of experience as a financial controller of various sized public companies in a number of industries ranging from oil & gas exploration, heavy engineering and property development to manufacturing.

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 Probiomics Limited were:

Director	Number of Shares	Class	Listed Options over Ordinary Shares	Unlisted Employee Options
Bryan Martin Gardiner	nil	n/a	nil	nil
Patrick Douglas Ford	3,435,999	Ordinary	nil	nil
Ronald Penny	nil	n/a	nil	250,000

Refer to note 24 for further information on directors' remuneration, shares and options holdings.

EARNINGS PER SHARE

	Cents
Basic loss per share	(1.33)
Diluted loss per share	(1.33)

DIVIDENDS

No dividends have been paid or have been recommended during the year.

PRINCIPAL ACTIVITIES

The principal activities during the year of the company and its controlled entities were:

- The manufacture and distribution under contract, of probiotic products,
- The further testing and development of the company's products by the conduct of clinical trials.

There have been no significant changes in the nature of these activities during the year.

OPERATING AND FINANCIAL REVIEW

Group Overview

Vasse Research Institute Pty Limited was formed in 1998. It changed its name to VRI BioMedical Pty Limited in December 1999 and to VRI BioMedical Limited when it converted to a public company in March 2000. The company listed on the Australian Stock Exchange in December 2000.

The company changed its name to Probiomics Limited in April 2005 to better reflect its focus on its probiotic products.

During the year the company deregistered most of its subsidiaries as they were no longer required. The only subsidiaries retained were: Sphere Animal Health Pty Ltd., Candivax Pty Ltd, Pneumobiotics Pty Ltd and Probiadd Pty Ltd.

Operating results for the year

A review of operations for the year is contained in the Chief Executive Officer's report on page 3 of this annual report.

The results for the year are summarised below.

	2006	
Business segment	**Revenues**	**Results**
	$	**$**
Probiotic product sales	1,684,644	(2,265,251)
Non-segment and unallocated revenues	106,873	106,873
Consolidated entity sales and (loss) from ordinary activities before income tax expense	1,755,321	(2,158,378)

Liquidity and Capital Resources

The consolidated cash flow statement shows a decrease in cash in the year ended 30 June 2006 of $194,059 (2005 increase $134,857). The decrease in cash inflow in comparison with the prior year is caused by a number of factors. The company raised less capital in 2005/06, $2,089,834 compared to $2,944,762 in 2004/2005, however this was offset by lower operating activities which absorbed $2,263,179 (2005: $2,790,811). This reduction in operating activities in comparison to 30 June 2005 was due largely to the company's ability to reduce costs in the current financial year.

Share issues during the year

There were two share issues during the year to fund the company's operations.
In August 2005 12,588,000 shares were issued to institutional and sophisticated investors by a private placement at $0.08 per share which raised $1.0m. In December the company undertook a share purchase plan to all shareholders that raised $1.2m and 16,039,843 shares were issued.

Capital expenditure

There was an increase in the purchase of property, plant and equipment for 30 June 2006 to $58,724 from $19,094 in the previous year although this included a motor vehicle for $40,000 that was sold again prior to year end. No capital expenditure commitments existed at balance sheet date.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

There were no significant changes in the state of affairs of the company during the year.

GOING CONCERN

The financial report has been prepared on a going concern basis. The ability of the company and consolidated entity to continue as going concerns is dependent on the generation of sufficient income to cover costs and the completion of an additional capital raising within the coming months. The directors believe there is no reason to doubt that these sources of funds will become available. The company has completed a capital raising of $1,025,000 in August 2006, however, should losses continue and/or the future capital raising not be successful, or not at an amount and timing necessary to meet its future operational plans, or it is unable to successfully exploit its intellectual property, the company and consolidated entity may be unable to continue as going concerns. No adjustments have been made relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the company and consolidated entity not continue as going concerns.

The company has no debt to financial institutions.

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

Subsequent to the end of this reporting period the company raised $1,025,000 (before costs of $51,250) by way of a placement of 20,500,000 shares to sophisticated investors at $0.05 per share. This capital will provide the company with working capital and will allow it to continue to develop its products. The placement has not been recognised in the financial statements for the year ended 30 June 2006.

On 15 August 2006 the company announced that it was calling a general meeting of shareholders to ratify the above placement of shares, to approve the granting of two options to a client of Tolhurst Noall Limited to purchase two tranches of shares and to issue options to a Director. The first tranche of options for the client of Tolhurst Noall is for 17m shares at $0.05 per share is exercisable by 30 September 2006 and the second tranche of 18m shares at $0.08 per share is exercisable by 30 April 2007. The meeting was held on 21 September 2006 and all resolutions as detailed above were approved by shareholders.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Other than matters referred to elsewhere in this report, further information as to likely developments in the operations of the consolidated entity and the expected results of operations have not been included in this report because the directors believe it would be likely to result in unreasonable prejudice to the consolidated entity.

ENVIRONMENTAL REGULATION AND PERFORMANCE

The company's operations are not subject to any particular environmental regulations.

SHARE OPTIONS

Unissued shares

As at the date of this report, there were 4,110,000 unissued ordinary shares under option. The options are unlisted and were issued pursuant to the company's Employee Share Option Plan. Refer to note 13 (d) for further details of the options outstanding.

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

Shares issued as a result of the exercise of options

During the financial year no employees or shareholders have exercised their options to acquire fully paid ordinary shares. Since the end of the financial year, no options have been exercised.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

During the financial year the company has paid premiums in respect of a contract insuring all the directors and officers of the company and its subsidiaries.
The total amount of insurance contract premium paid was $13,848 (2005: $89,675).

REMUNERATION REPORT

This report outlines the remuneration arrangements in place for directors and executives of Probiomics Limited (the company).

Remuneration philosophy

The performance of the company depends upon the quality of its directors and executives. To prosper, the company must attract, motivate and retain highly skilled directors and executives.

Remuneration Committee

The Remuneration Committee of the Board of Directors of the company is responsible for determining and reviewing compensation arrangements for its directors, the chief executive officer (CEO) and the senior management team.

The Remuneration Committee assesses the appropriateness of the nature and amount of remuneration for directors and senior executives 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.

Remuneration Structure

In accordance with best practice corporate governance, the structure of non-executive director and executive remuneration is separate and distinct.

Non-executive director remuneration

Objective
The Board of Directors recognises that the success of the company will depend, largely, upon the quality of its directors and its senior management. For this reason the Remuneration Committee reviews the remuneration arrangements for all senior employees to ensure that it attracts and keeps motivated, highly skilled and appropriately qualified directors and executives.

Structure
The Company's Constitution and the ASX listing rules specify that the aggregate remuneration of non-executive Directors shall be determined from time to time by a general meeting of shareholders. An amount not exceeding the amount determined by shareholders in general meeting is then available to be split between the Directors as agreed between themselves. The latest determination was at the Annual General Meeting held on 28th November 2003 when shareholders approved an aggregate remuneration amount of $250,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned between Directors is reviewed annually. The Board takes into account the fees paid to non-executive directors of comparable companies when undertaking the annual review process.

Each director receives a fee for being a director of the company. The Chairman receives a higher fee in recognition of the additional time commitment required of a Chairman.

Non-executive directors have long been encouraged by the Board to hold shares in the company (purchased by the director on market). It is considered good governance for directors to have a stake in the company on whose board they sit.

The remuneration of non-executive directors for the period ending 30 June 2006 is detailed in Table 1 of this report.

Senior manager and executive director remuneration

Objective

The company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the company so as to ensure total remuneration is competitive by market standards.

Structure

In determining the level and make-up of executive remuneration, the Remuneration Committee reviews market conditions to ensure that the remuneration offered is sufficient to attract executives of the highest calibre.

All employees are engaged under the company's standard terms and conditions of employment and at present there are no contracts with any employees.

All employees are paid a basic salary only and at present there are no short-term incentive nor long-term incentive arrangements with any employee.

Fixed remuneration

The fixed remuneration of all employees is reviewed by the Remuneration Committee as is considered necessary.

Table 1: Director remuneration for the year ended 30th June 2006

		Primary benefits	**Post employment**	**Equity**	**Other**	**Total**
		Directors fees	Superannuation	Options (a)	Directors' & Officers' Insurance	
		$	$	$	$	$
B M Gardiner	**2006**	**55,000**	**4,950**	**-**	**1,978**	**61,928**
Chairman	2005	15,000	1,012	9,000	8,115	33,127
P D Ford	**2006**	**48,750**	**4,388**	**-**	**1,978**	**55,116**
Non-executive	2005	-	-	-	8,115	8,115
R Penny	**2006**	**45,000**	**4,050**	**-**	**1,978**	**51,028**
Non-executive	2005	15,000	1,012	9,000	8,115	33,127

Table 2: Remuneration of the four most highly paid executive officers of the consolidated entity for the year ended 30th June 2006

		Primary benefits	**Post employment**	**Equity**	**Other**	**Total**
		Salary	Superannuation	Options (a)	Directors' & Officers' Insurance	
		$	$	$	$	**$**
K R Slatyer	**2006**	**150,000**	**13,500**	**-**	**1,978**	**165,478**
Chief Executive	2005	158,481	17,638	-	45,615	221,734
R W French	**2006**	**143,846**	**12,946**	**-**	**1,978**	**158,770**
Innovation & Business Development Manager	2005	168,060	15,125	-	8,115	191,300
P B Magoffin	**2006**	**135,000**	**12,150**	**-**	**1,978**	**149,128**

CFO and Company Secretary	2005	131,732	11,855	-	8,115	151,702
P L Conway Chief Scientist	**2006** 2005	**91,667** 91,667	**8,250** 8,250	**18,000** -	**7,978** 14,115	**125,895** 114,032

Table 3: Options granted as part of remuneration for the year ended 30 June 2006.

	Grant date	Number granted	Value per option at grant date (a)	Number exercised	Value of options lapsed during year	Total value of options granted, lapsed and exercised during year	% remuner-ation consisting of options for year
B M Gardiner	8 Oct 05	250,000	Nil	Nil	9,000	(9,000)	N/a
P D Ford	-	-	-	-	-	-	N/a
R Penny	8 Oct 05	250,000	Nil	Nil	9,000	(9,000)	N/a

Employee Option Plan

An employee option plan is established whereby Probiomics Limited may, at the discretion of the Directors grant options to purchase ordinary shares in the Company to certain eligible employees. The options are granted for no consideration and are generally for a term of two years with the exercise price being determined at the discretion of the Directors. Generally the options can be exercised at any time during the term of the option period but are not transferable and are not quoted on ASX. Currently there are two employees and one director who hold valid options. No performance conditions are attached to the options as they are considered to be part of the employee's remuneration package.

(a) Options have been valued using the Black-Scholes Pricing Analysis method which takes account of factors such as the options' exercise price, the current level of volatility of the underlying share price, the market price of the underlying shares at the time the options were issued and the expiry date of the options.

Refer to note 13 for assumptions used.

The terms 'director' and 'officer' have been treated as mutually exclusive for the purposes of this disclosure.

Executives are those employees who are directly accountable and responsible for the operational management and strategic direction of the Company and the consolidated entity. The four listed above are the only employees in that category.

The above amounts do not include expenses incurred by Directors and their related entities and executive officers that were reimbursed by the Company.

DIRECTORS' MEETINGS

The numbers of meetings of directors (including meetings of committees of directors) held during the year and the number of meetings attended by each director were as follows:

		Meetings of Committees	
	Directors' Meetings	**Audit and Risk Management**	**Remuneration**
Number of meetings held:	6	2	0
Number of meetings attended:			
B M Gardiner	6	2	-
P D Ford	6	2	-
R Penny	5	-	-

Committee membership

As at the date of this report, the Company had an Audit Committee and a Remuneration Committee, of the Board of Directors.

Members acting on the Board committees during the year were:

Audit and Risk Management	**Remuneration**
Patrick Ford (Chairman)	Bryan Gardiner (Chairman)
Bryan Gardiner	Patrick Ford
Ron Penny	Ron Penny

AUDITOR INDEPENDENCE DECLARATION TO THE DIRECTORS OF PROBIOMICS LIMITED

We have obtained the independence declaration from our auditors, Ernst & Young, a copy of which is included on page 46 of this annual report.

NON-AUDIT SERVICES

The following non-audit services were provided by the entity's auditor, Ernst & Young. 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 nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Ernst & Young received the following amounts for the provision of non-audit services.

Tax compliance services	$8,000

Signed in accordance with a resolution of the Directors.

Bryan Gardiner
Chairman

Sydney 28th September 2006

CORPORATE GOVERNANCE STATEMENT

The Board of Directors of Probiomics Limited is responsible for the corporate governance of the consolidated entity. The Board guides and monitors the business affairs of the company on behalf of the shareholders by whom they are elected and to whom they are accountable.

The format of the Corporate Governance Statement changed in 2004 due to the introduction of the Australian Stock Exchange Corporate Governance Council's ('the Council's') "Principles of Good Corporate Governance and Best Practice Recommendations" ('the Recommendations'). In accordance with the Council's recommendations, the Corporate Governance Statement must now contain certain specific information and must disclose the extent to which the company has followed the guidelines during the period. Where a recommendation has not been followed, that fact must be disclosed together with the reasons for the departure.
Probiomics Limited's Corporate Governance Statement is now structured with reference to the Corporate Governance Council's principles and recommendations, which are as follows:

Principle 1. Lay solid foundations for management and oversight
Principle 2. Structure the Board to add value
Principle 3. Promote ethical and responsible decision making
Principle 4. Safeguard integrity of financial reporting
Principle 5. Make timely and balanced disclosure
Principle 6. Respect the rights of shareholders
Principle 7. Recognise and manage risk
Principle 8. Encourage enhanced performance
Principle 9. Remunerate fairly and responsibly
Principle 10. Recognise the legitimate interests of stakeholders

Probiomics Limited's corporate governance practices were in place throughout the year ended 30 June 2006 unless stated otherwise and were generally compliant with the Council's best practice recommendations. Departures from the above principles and the reasons why are explained under the following headings.

Role of Board and management

While the company has formal policies and procedures that are disseminated to all employees and Directors it does not have a formal statement of matters that are delegated to management specifically. The Board of Directors is of the opinion that in a company of this size, fewer than 20 employees, such a statement would be unnecessarily formal. Also, as the chief executive attends all Board meetings the distinction between the Board and management is not sufficient to warrant a formal statement of the segregation of duties.

Structure of the Board

The skills, experience and expertise relevant to the position of director held by each director in office at the date of the Annual Report is included in the Directors' Report on page 4. Directors of Probiomics Limited are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the exercise of their unfettered and independent judgement.

In the context of director independence "materiality" is considered from both the company and the individual director's perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal to or less than 5% of the appropriate base amount. It is presumed to be material (unless there is qualitative evidence to the contrary) if it is equal to or greater than 10% of the appropriate base amount. Qualitative factors considered include whether a relationship is strategically important, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors which point to the actual ability of the director in question to shape the direction of the company's loyalty.
In accordance with the definition of independence above and the materiality thresholds set, the following directors of Probiomics Limited are considered to be independent.

Name	**Position**
Bryan Martin Gardiner	Chairman & Non-Executive Director
Patrick Douglas Ford	Non-Executive Director
Ronald Penny	Non-executive Director

There are procedures in place, agreed by the Board, to enable directors, in furtherance of their duties, to seek independent professional advice at the company's expense.

The term in office of each director as at the date of this report is as follows:-

Name	Term in office
B M Gardiner	1 year & 7 months
P D Ford	1 year & 4 months
R Penny	1 year & 7 months

Nominations Committee

The company did not have a separate nominations committee during the year. All nominations for appointment as a director are considered by the whole Board.

Promoting ethical and responsible decision making

The company has a written code of conduct that is disseminated to all employees and Directors however at present it has not been released publicly. The company's share trading policy for Directors and employees has been posted on the company's web site.

Safeguarding the integrity of financial reporting

Audit and Risk Management Committee

The Board has an established audit committee. It is the Board's responsibility to ensure that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, 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 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 committee.

The committee also provides the board with additional assurance regarding the reliability of financial information for inclusion in the financial reports.

The members of the Audit and Risk Management Committee during the year were:

P D Ford	Chairman
B M Gardiner	
R Penny	

Qualifications of Audit Committee members

Mr Ford holds a Bachelor of Commerce degree and is a stock broker with extensive experience of financial and accounting matters.

Mr Gardiner is a practising solicitor with many years of experience in the area of corporate law.

Professor Penny is an Immunologist and has served on numerous public sector and public company Boards.

For details of the number of meetings of the Audit Committee held during the year and the attendees at those meetings, refer to page 9 of the Directors' Report.

The Chief Executive Officer, Mr Slatyer and the Chief Financial Officer, Mr Magoffin have stated in writing to the Board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results, that they are in accordance with relevant accounting standards and that the company's internal control systems are effective

The committee does not have a formal charter.

The audit committee reviews the efficiency and effectiveness of the external auditors on a regular basis and determines from those reviews whether the external auditors should be retained. The company requires that the external auditors rotate their audit engagement partners every five years.

The rights of shareholders

The company does not have a formal strategy to promote effective communications with shareholders as the date of this report because all material matters affecting the company that are market sensitive are released through the ASX which makes them available publicly to all shareholders. Matters that are not necessarily market sensitive but of interest to shareholders are released by way of regular shareholders' update letters.

Participation at shareholders' meetings is encouraged but at present the company does not have a formal strategy for this.

Recognition and management of risk.

The company's Audit Committee also acts as the Risk Management committee so the members are the same as detailed above.

Due to the relatively simple structure of the company and its current operations there has not been the necessity to establish a formal policy on the management of risk nor a risk profile. The Board as a whole meets sufficiently often to assess these matters.

Encouragement of enhanced performance

No formal evaluation process has yet been conducted of Board members as all Directors have been Directors for less than two years and this is insufficient time to evaluate their performance.
A formal evaluation process is conducted for all employees including the Executive Director and Chief Financial Officer/Company Secretary but the process is not published as it is considered to be a confidential evaluation of individuals and publishing it would not be appropriate.

Fair and responsible remuneration

It is the company's objective to provide maximum stakeholder benefit from the retention of a high quality Board and executive team by remunerating directors and key executives fairly and appropriately with reference to relevant employment market conditions. The expected outcomes of the remuneration structure are:-

• retention and motivation of key executives, and
• attraction of quality management to the company

A full discussion of the company's remuneration philosophy and framework and the remuneration received by directors and executives in the current period is contained in the remuneration report of the Directors' Report on pages 7, 8 and 9.

There is no scheme to provide retirement benefits, other than statutory superannuation, to non-executive directors.

The Board is responsible for determining and reviewing compensation arrangements for the Directors themselves, the Executive Director and the executive team. The Board has established a remuneration committee, comprising three Directors.
Members of the Remuneration Committee throughout the year were:

B M Gardiner	Chairman
P D Ford	
R Penny	

For details of the number of meetings of the Remuneration and Nominations Committee held during the year and the attendees at those meetings, refer to page 9 of the Directors' Report.

The committee does not have a formal charter as there are fewer than 20 employees to consider in the context of remuneration and such a formality is not considered an efficient use of the Directors' time.

Recognising the legitimate interests of stakeholders

The company has a written code of conduct which has been disseminated to all employees and directors. The code has not been published.

Income Statement

FOR THE YEAR ENDED 30 JUNE 2006

	NOTES	CONSOLIDATED		PROBIOMICS LIMITED	
		2006	2005	**2006**	2005
		$	$	$	$
Sale of goods	4(a)	**1,684,644**	1,388,812	**1,684,644**	1,388,812
Finance revenue	4(a)	**23,308**	57,366	**23,308**	57,366
Revenue		**1,707,952**	1,446,178	**1,707,952**	1,446,178
Cost of sales		**(1,293,637)**	(1,048,802)	**(1,293,637)**	(1,048,802)
Gross profit		**414,315**	397,376	**414,315**	397,376
Other income	4(b)	**83,565**	69,957	**83,565**	69,957
Research & development expenses	4(f)	**(606,116)**	(697,962)	**(606,116)**	(697,962)
Intellectual property expenses		**(93,094)**	(307,650)	**(93,094)**	(307,650)
Marketing expenses		**(338,484)**	(947,985)	**(338,484)**	(947,985)
Administrative and corporate expenses	4(d)/4(e)	**(1,612,968)**	(2,515,282)	**(1,612,968)**	(2,515,282)
Finance costs	4(c)	**(5,596)**	-	**(5,596)**	-
Loss before income tax		**(2,158,378)**	(4,001,546)	**(2,158,378)**	(4,001,546)
Income tax rebate	5	**280,397**	-	**280,397**	-
Loss after tax attributable to members of the parent		**(1,877,981)**	(4,001,546)	**(1,877,981)**	(4,001,546)
Basic loss per share (cents per share)	6	(1.33)	(3.81)	(1.33)	(3.81)
Diluted loss per share (cents per share)	6	(1.33)	(3.81)	(1.33)	(3.81)

Balance Sheet

AS AT 30 JUNE 2006

	NOTES	CONSOLIDATED		PROBIOMICS LIMITED	
		2006	2005	**2006**	2005
		$	$	$	$
ASSETS					
Current Assets					
Cash and cash equivalents	8	**209,427**	403,486	**209,427**	403,486
Trade and other receivables	9	**679,138**	381,044	**679,138**	381,044
Inventories	10	**92,188**	364,160	**92,188**	364,160
Prepayments		**3,956**	23,491	**3,956**	23,491
Government grants		**9,836**	-	**9,836**	-
Total current assets		**994,545**	1,172,181	**994,545**	1,172,181
Non-current assets					
Other financial assets	11	**-**	-	**100**	410
Property, plant and equipment	12	**78,775**	129,001	**78,775**	129,001
Total non-current assets		**78,775**	129,001	**78,875**	129,411
TOTAL ASSETS		**1,073,320**	1,301,182	**1,073,420**	1,301,592
LIABILITIES					
Current liabilities					
Trade and other payables	15	**626,130**	1,039,922	**626,230**	1,040,332
Provisions	17	**33,362**	66,653	**33,362**	66,653
Government grants		**-**	9,012	**-**	9,012
Total current liabilities		**659,492**	1,115,587	**659,592**	1,115,997
Non-current liabilities					
Provisions	17	**3,245**	7,631	**3,245**	7,631
TOTAL LIABILITIES		**662,737**	1,123,218	**662,837**	1,123,628
NET ASSETS		**410,583**	177,964	**410,583**	177,964
EQUITY					
Contributed equity	18	**24,990,320**	22,900,486	**24,990,320**	22,900,486
Reserves	18	**122,520**	101,754	**122,520**	101,754
Accumulated losses	18	**(24,702,257)**	(22,824,276)	**(24,702,257)**	(22,824,276)
TOTAL EQUITY		**410,583**	177,964	**410,583**	177,964

Statement of Changes in Equity

FOR THE YEAR ENDED 30 JUNE 2006

	Issued Capital $	Retained Earnings $	Reserves $	Total Equity $
CONSOLIDATED AND PARENT				
At 1 July 2004	19,955,725	(18,822,730)	32,137	1,165,132
Cost of issue of shares	(154,989)	-	-	(154,989)
Total income and expense for the period recognised directly in equity	(154,989)	-	-	(154,989)
Loss for the period	-	(4,001,546)	-	(4,001,546)
Total income and expense for the period	(154,989)	(4,001,546)	-	(4,156,535)
Issue of shares	3,099,750	-	-	3,099,750
Cost of share-based payments	-	-	69,617	69,617
At 30 June 2005	22,900,486	(22,824,276)	101,754	177,964
At 1 July 2005	22,900,486	(22,824,276)	101,754	177,964
Cost of issue of shares	(120,188)	-	-	(120,188)
Total income and expense for the period recognised directly in equity	(120,188)	-	-	(120,188)
Loss for the period	-	(1,877,981)	-	(1,877,981)
Total income and expense for the period	(120,188)	(1,877,981)	-	(1,998,169)
Issue of shares	2,210,022	-	-	2,210,022
Cost of share-based payments	-	-	20,766	20,766
At 30 June 2006	24,990,320	(24,702,257)	122,520	410,583

Cash Flow Statement

FOR THE YEAR ENDED 30 JUNE 2006

	NOTES	CONSOLIDATED		PROBIOMICS LIMITED	
		2006	2005	**2006**	2005
		$	$	**$**	$
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from customers		**1,396,586**	1,636,450	**1,396,586**	1,636,450
Payments to suppliers and employees		**(4,037,199)**	(4,553,255)	**(4,037,199)**	(4,553,255)
Receipt of government grants		**73,729**	68,628	**73,729**	68,628
Receipt of tax rebate on R&D expenditure		**280,397**	-	**280,397**	-
Interest received		**23,308**	57,366	**23,308**	57,366
NET CASH FLOWS USED IN OPERATING ACTIVITIES	8	**(2,263,179)**	(2,790,811)	**(2,263,179)**	(2,790,811)
CASH FLOWS FROM INVESTING ACTIVITIES					
Proceeds from sale of property, plant & equipment		**38,010**	-	**38,010**	-
Acquisition of property, plant & equipment		**(58,724)**	(19,094)	**(58,724)**	(19,094)
NET CASH FLOWS (USED IN) INVESTING ACTIVITIES		**(20,714)**	(19,094)	**(20,714)**	(19,094)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from issue of ordinary shares		**2,210,022**	3,099,750	**2,210,022**	3,099,750
Payment of share issue costs		**(120,188)**	(154,988)	**(120,188)**	(154,988)
NET CASH FLOWS FROM FINANCING ACTIVITIES		**2,089,834**	2,944,762	**2,089,834**	2,944,762
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**(194,059)**	134,857	**(194,059)**	134,857
ADD OPENING CASH AND CASH EQUIVALENTS BROUGHT FORWARD		**403,486**	268,629	**403,486**	268,629
CLOSING CASH AND CASH EQUIVALENTS CARRIED FORWARD	8	**209,427**	403,486	**209,427**	403,486

Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2006

1. CORPORATE INFORMATION

The financial report of Probiomics Limited (the Company) for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors on 29th September 2006.

Probiomics Limited is a company limited by shares incorporated in Australia whose shares are publicly listed on the Australian Stock Exchange.

The nature of the operations and principal activities during the year of the company and its controlled entities were

• The manufacture and distribution under contract, of probiotic products,

• The further testing and development of the company's products by the conduct of clinical trials.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of accounting

The financial report is a general purpose financial report which has been prepared in accordance with the *Corporations Act 2001* and Australian Accounting Standards. The financial report has also been prepared on an historical cost basis.

The financial report is presented in Australian dollars.

Going concern

The financial report has been prepared on a going concern basis. As the Group has incurred substantial operating losses for some years the ability of the company and consolidated entity to continue as going concerns is dependent on the generation of sufficient income to cover costs and the completion of additional capital raising within the coming months. The directors believe that there is no reason to doubt that these sources of funds will become available. The company completed a capital raising of $1,025,000 in August 2006. However, should losses continue and/or the future capital raising not be successful, or not at an amount and timing necessary to meet future operational plans or it is unable to successfully exploit its intellectual property, the company and controlled entity the company may be unable to continue as a going concern. No adjustments have been made relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the company and consolidated entity not continue as a going concern.

(b) Statement of compliance

The financial report complies with Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards (AIFRS). Compliance with AIFRS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards (IFRS).

This is the first financial report based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly except for the adoption of AASB 132 *Financial Instruments: Disclosure and Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement.* The company has adopted the exemption under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* from having to apply AASB 132 and AASB 139 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances in the 30 June 2005 financial report and at transition to AIFRS are detailed in note 26.

Australian Accounting Standards that have recently been issued or amended but are not yet effective and that have not been adopted for the annual reporting period ending 30 June 2006 are as follows:

AASB Amend-ment	Affected Standard (s)	Nature of change to accounting policy	Application date of standard	Application date for Group
2004-3	AASB 1 *First-time adoption of AIFRS* AASB 101 *Presentation of Financial Statements* AASB 124 *Related Party Disclosures*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006
2005-1	AASB 139 *Financial Instruments: Recognition and Measurement*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006
2005-4	AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 1 *First-time adoption of AIFRS*,	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006

2005-5	AASB 1 *First-time adoption of AIFRS* and AASB 139 *Financial Instruments: Recognition and Measurement*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006
2005-9	AASB 139 *Financial Instruments: Recognition and Measurement* and AASB 132 *Financial Instruments: Disclosure and Presentation*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006

AASB Amend-ment	**Affected Standard (s)**	**Nature of change to accounting policy**	**Application date of standard**	**Application date for Group**
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*	No change to accounting policy required. Therefore no impact.	1 January 2007	1 January 2007
2006-1	AASB 121 *The Effects of Change in Foreign Currency Rates*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006

New or revised Standard/ UIG Affected Standard (s)	**Nature of change to accounting policy**	**Application date of standard / interpretation**	**Application date for Group**
AASB 119 *Employee Benefits*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006
AASB 7 *Financial Instruments: Disclosures*	No change to accounting policy required. Therefore no impact.	1 January 2007	1 January 2007
UIG 4 *Determining whether an Arrangement contains a Lease*	No change to accounting policy required. Therefore no impact.	1 January 2006	1 January 2006
UIG 8 *Scope of AASB 2*	No change to accounting policy required. Therefore no impact.	1 May 2006	1 May 2006
UIG 9 *Reassessment of Embedded Derivatives*	No change to accounting policy required. Therefore no impact.	1 June 2006	1 June 2006

(c) Basis of consolidation

The consolidated financial statements comprise the financial statements of Probiomics Limited and its subsidiaries as at 30 June each year (the Group).

The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full.

Subsidiaries are fully 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. The subsidiaries have been dormant for the entire current year.

Investment in subsidiaries are held in Parent at cost.

(d) Significant accounting judgements, estimates and assumptions

(i) *Significant accounting estimates and assumptions:*

Share-based payment transactions:

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by the Black-Scholes model, using the assumptions detailed in note 13.

(e) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Risks and rewards of ownership are considered passed to the buyer at the time of delivery of the goods to the customer.

(ii) Interest income
The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for interest income applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

Accounting policies applicable for the year ending 30 June 2005
Revenue is recognised when the Group's right to receive payment is established.

(f) Government grants

Government grants are recognised when there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

When the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

(g) Borrowing costs

Borrowing costs are recognised as an expense when incurred.

(h) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased asset, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised as an expense in profit and loss.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Lease incentives are recognised in the income statement as an integral part of the total lease expense.

(i) Cash and short term deposits

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity date of three months or less.

For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(j) Trade and other receivables

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other receivables applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Trade receivables, which generally have 30-90 day terms, are non-interest bearing and are recognised and carried forward at original invoice amount less an allowance for any uncollectible amounts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

An allowance for doubtful debts is made when there is objective evidence that the Group will not be able to collect the debts. Bad debts are written off when identified.

Accounting policies applicable for the year ending 30 June 2005

Trade receivables were recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts was made when collection of the full amount was no longer probable. Bad debts were written off as incurred.

(k) Inventories

Inventories are valued at the lower of cost and net realisable value.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:
Raw materials – purchase cost on a first-in first-out basis; and

Finished goods and work-in-progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

(l) Foreign currency translation

Both the functional and presentation currency of Probiomics Limited and its Australian subsidiaries is Australian dollars ($). Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rate ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate of exchange ruling at the balance sheet date.

All exchange differences in the consolidated financial report are taken to profit or loss with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in profit or loss.

Tax charges and credits attributable to exchange differences on those borrowings are also recognised in equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the initial transaction.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date the fair value was determined.

(m) Income tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:-

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the taxable temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, and the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised, except:
- when the deferred income tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; or

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

•when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is recognised only to the extent that it is probable that the temporary difference will reverse in the foreseeable future and the taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax to be utilised.

Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset or the liability is settled, based on tax rates, and tax laws, that have been enacted or substantively enacted at the balance sheet date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss.

Deferred tax assets and deferred tax liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

(n) Other taxes

Revenues, expenses and assets are recognised net of the amount of GST except:
• where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of an asset or as part of the expense items as applicable; and
• receivables and payables, which are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included in the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financial activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.
Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(o) Property, plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts that are eligible for capitalisation when the cost of replacing the parts is incurred. Similarly, when each major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement only if it is eligible for capitalisation.

Depreciation is calculated on a diminishing-value basis over the estimated useful life of the assets as follows:-

Plant and equipment – ranging from 2 to 20 years
Office equipment – ranging from 2 to 14 years

The assets’ residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at each financial year end.

(i) De-recognition and disposal

An item of property, plant and equipment is de-recognised upon disposal or when no further future economic benefits are expected from its use or disposal.

Any gain or loss arising on de-recognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the asset, is included in profit or loss in the year the asset is de-recognised.

(ii) Impairment
The carrying value of plant and equipment are reviewed for impairment at each reporting date.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(p) Investments and other financial assets

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for investments and other financial assets applicable for the years ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Financial assets in the scope of AASB 139 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, when allowed and appropriate, re-values this designation at each financial year end.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the marketplace.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are de-recognised or impaired, as well as through the amortisation process.

Accounting policies applicable for the year ending 30 June 2005

All non-current investments were carried at the lower of cost and recoverable amount.

Recoverable amount

Non-current financial assets measured using the cost basis were not carried at an amount above their recoverable amount and when a carrying value exceeded this recoverable amount, the financial asset was written down to its recoverable amount.

(q) Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is amortised over the period of expected benefits from the related project.

The carrying value of an intangible asset arising from development expenditure is tested for impairment annually when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period.

(r) Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset’s recoverable amount. An asset’s recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and the asset’s value in use cannot be estimated to be close to its fair value. In such cases the asset is tested for impairment as part of the cash-generating unit to which it belongs. When the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount.
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 its time value of money and the risks specific to the asset. Impairment losses relating to continuing operations are recognised in those expense categories consistent with the function of the impaired asset unless the asset is carried at revalued amount, in which case the impairment loss is treated as a revaluation decrease.

An assessment is made at each reporting date also as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(s) Trade and other payables

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other payables applicable for the years ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Trade payables and other payables are carried at amortised costs and represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services.

Accounting policies applicable for the year ending 30 June 2005
Trade payables and other payables are carried at costs which is the fair value of the consideration to be paid in the future for the goods and services received, whether or not billed to the Group.

(t) Provisions

Provisions are recognised when the Group has a present obligation, legal or constructive, as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

When the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability.

When discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

(u) Employee leave benefits

(i) Wages, salaries, annual leave and sick leave
Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date are recognised in current provisions in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. The Group does not provide for sick leave as it has no obligation to pay accumulated sick leave not taken when employees leave the Group's employment.

(ii) Long service leave
The liability for long service leave is recognised in non-current provisions and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currencies that match as closely as possible the estimated cash outflows.

(v) Pensions and other post-employment benefits

The Group provides only superannuation that is required under government legislation. The cost is expensed as it is incurred.

(w) Share –based payment transactions

(i) Equity-settled transactions
The Group provides benefits to employees, including directors, of the Group in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions')
The plan in place to provide these benefits is the Employee Share Option Plan (ESOP) which provides benefits to directors and senior executives by way of options to purchase fully paid shares.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using a binomial model, details of which are given in note 13.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Probiomics Limited ('market conditions') if applicable.
The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('vesting date').

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date, reflects (i) the extent to which the vesting period has expired and (ii) the Group's best estimate of the number of equity instruments that will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performances conditions being met as the effect of these conditions is included in the determination of fair value at grant date. The income statement charge or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is only conditional upon a market condition.

If the terms of an equity-settled award are modified, as a minimum, an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification that increases the total fair value of the share-based payment arrangements, as measured at the date of modification.

If an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award and designated as a replacement award on the date that it is granted, the cancelled and new award are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect, if any, of outstanding options is reflected as additional share dilutions in the computation of earnings per share (see note 6).

(x) 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.

(y) Earnings per share
Basic earnings per share is calculated as net profit attributable to members of the parent, adjusted to exclude costs of servicing equity (other than dividends) and preference share dividends, divided by the weighted average number of ordinary shares, adjusted for any bonus element.

Diluted EPS is calculated as net profit attributable to members of the parent, adjusted for:

- costs of servicing equity (other than dividends) and preference share dividends;
- the after tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and
- other non-discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares;

divided by the weighted average number of ordinary shares and dilutive potential ordinary shares, adjusted for any bonus element.

3. SEGMENT INFORMATION

The Group operates in only one primary and business segment – the biotechnology segment.

Geographical segments
The Group's geographical segments are determined based on the location of the Group's assets.

The following tables present revenue and profit information and certain asset and liability information regarding geographical segments for the years ended 30 June 2006 and 30 June 2005.

	Australia		**USA**		**SE ASIA**		**Consolidated**	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005
Revenue								
Sales to external customers	**66,805**	622,886	**1,301,400**	717,285	**316,439**	48,641	**1,684,644**	1,388,812
Other revenues from external sources	**106,873**	127,323	**-**	-	**-**	-	**106,873**	127,323
Segment revenue	**173,678**	750,209	**1,301,400**	717,285	**316,439**	48,641	**1,791,517**	1,516,135
Total expenses							**3,949,895**	5,517,681
Loss for year							**2,158,378**	4,001,546
Other segment information								
Segment assets	**981,132**	1,098,159	**92,188**	203,023	**-**	-	**1,073,320**	1,301,182
Capital expenditure	**58,724**	19,094	**-**	-	**-**	-	**58,724**	19,094
Segment liabilities	**662,737**	1,123,218	**-**	-	**-**	-	**662,737**	1,123,218
Segment depreciation	**37,768**	34,939	**-**	-	**-**	-	**37,768**	34,939

The consolidated entity does not perform an analysis of costs and expenses by segment. All costs and expenses are measured on a combined basis and are not allocated between segments.

	CONSOLIDATED		**PROBIOMICS LIMITED**	
	2006	2005	**2006**	2005
	$	$	**$**	$
4. REVENUES AND EXPENSES				
Revenues from continuing operations				
(a) Revenue				
Sale of goods	**1,684,644**	1,388,812	**1,684,644**	1,388,812
Finance revenue – interest received and receivable	**23,308**	57,366	**23,308**	57,366
	1,707,952	1,446,178	**1,707,952**	1,446,178
(b) Other income				
Government grants	**83,565**	69,957	**83,565**	69,957

Government grants have been received to partly fund research and development expenditure. There are no unfulfilled conditions or contingencies attaching to these grants.

(c) Finance costs

Finance charges payables under finance leases and hire purchase contracts	**5,596**	-	**5,596**	-

	CONSOLIDATED		PROBIOMICS LIMITED	
	2006	2005	**2006**	2005
	$	$	**$**	$
(d) Depreciation, foreign exchange differences included in the income statement				
Included in Administration and corporate expenses				
Depreciation	**37,768**	34,939	**37,768**	34,939
Net foreign exchange losses	**3,024**	16,783	**3,024**	16,783
Loss on disposal of property, plant and equipment	**33,172**	14,186	**33,172**	14,186
Included in Administration and Corporate expenses				
(e) Employee benefits expense				
Wages and salaries	**529,676**	1,072,824	**529,676**	1,072,824
Share-based payments expense	**20,766**	69,617	**20,766**	69,617
Redundancy costs	**13,596**	54,436	**13,596**	54,436
Annual leave provision (reduction)	**(33,291)**	(13,547)	**(33,291)**	(13,547)
Long service leave provision (reduction)	**(4,386)**	(3,791)	**(4,386)**	(3,791)
(f) Research and development expense				
Wages and salaries	**245,449**	168,349	**245,449**	168,349

5. INCOME TAX

The major components of income tax expense/(benefit) for the years ended 30 June 2006 and 30 June 2005 are:				
Income statement				
Current income tax				
Current income tax charge	**-**	-	**-**	-
Research and development rebate received in respect of the year ended 30 June 2005	**280,397**	-	**280,397**	-
Deferred income tax	-	-	-	-
Relating to origination and reversal of temporary timing differences	-	-	-	-
Income tax rebate reported in the income statement	**280,397**	-	**280,397**	-
A reconciliation of income tax expense applicable to accounting profit before income tax at the statutory income tax rate, to income tax expense at the Group's effective income tax rate for the years ended 30 June 2006 and 30 June 2005 is as follows:				
Accounting loss before income tax	**2,158,378**	4,001,546	**2,158,378**	4,001,546
At the Company's statutory income tax rate of 30% (2005: 30%)	647,514	1,200,464	647,514	1,200,464
Expenditure not allowable for income tax purposes	11,117	11,278	11,117	11,278
Losses not brought to account	(939,028)	(1,211,742)	(939,028)	(1,211,742)
Income tax rebate reported in accounts	(280,397)	-	(280,397)	-
Effective income tax rate	(13%)	0%	(13%)	0%
Research and Development rebate received in respect of the year ended 30 June 2005	(280,397)	-	(280,397)	-
Income tax rebate reported in income statement	(280,397)	-	(280,397)	-

As at 30 June 2006 the consolidated entity has not brought to account a future income tax benefit (at 30%) of $6,789,293 made up of tax losses of $6,769,901 and timing differences of $19,392 (2005: $6,236,668 – tax losses $6,206,507, timing differences of $30,161) as realisation of the benefit is not probable.

The future income tax benefit will be obtained only if:

(a) future assessable income is derived of a nature and of an amount sufficient to enable the benefit to be realised,
(b) the condition for deductibility imposed by tax legislation continue to be complied with, and
(c) no changes in tax legislation adversely affect the consolidated entity in realising the benefit.

Tax consolidation

Probiomics Limited and its 100% owned Australian subsidiaries have formed a tax consolidation group with effect from 1 July 2004. The head entity of the tax consolidated group is Probiomics Limited.

6. EARNINGS PER SHARE

The basic earnings per share amounts are calculated by dividing net loss for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The diluted earnings per share is the same as the basic earnings per share, as the share options are anti-dilutive in nature.

The following reflects the income and share data used in the basis and diluted earnings per share computations:

	CONSOLIDATED	
	2006	2005
	$	$
Net loss attributable to ordinary equity holders of the parent from continuing operations	**1,877,981**	4,001,546
	2006 Number	2005 Number
Weighted average number of ordinary shares for basic and diluted earnings per share	**132,446,078**	104,764,195
Number of options not included in diluted EPS calculation	**4,110,000**	3,500,000

7. DIVIDENDS PAID AND DECLARED

No dividends have been paid or declared in the reporting period and the company has a nil franking account balance.

	CONSOLIDATED		PROBIOMICS LIMITED	
	2006	2005	**2006**	2005
	$	$	**$**	$
8. CASH AND CASH EQUIVALENTS				
Cash at bank and on hand	**209,427**	403,486	**209,427**	403,486
Reconciliation of net loss after tax to net cash flows from operations				
Net profit/(loss)	**(1,877,981)**	(4,001,546)	**(1,877,981)**	(4,001,546)
Adjustments for:				
Depreciation	**37,768**	34,929	**37,768**	34,929
Net (profit)/loss on disposal of property, plant and equipment	**33,172**	14,186	**33,172**	14,186
Cost of share options	**20,766**	59,486	**20,766**	59,486
Changes in assets and liabilities				
(Increase)/decrease in inventories	**271,972**	75,776	**271,972**	75,776
(Increase)/decrease in trade and other receivables	**(298,094)**	1,041,986	**(298,094)**	1,041,986
(Increase)/decrease in prepayments	**19,535**	64,630	**19,535**	64,630
(Decrease)/increase in trade and other payables	**(413,792)**	(85,479)	**(413,792)**	(85,479)
(Decrease)/increase in provisions	**(37,677)**	(3,791)	**(37,677)**	(3,791)
Decrease/(Increase) in government grants	**(18,848)**	9,012	**(18,848)**	9,012
Net cash flows from operating activities	**(2,263,179)**	(2,790,811)	**(2,263,179)**	(2,790,811)
9. TRADE AND OTHER RECEIVABLES				
Trade receivables	**611,203**	261,772	**611,203**	261,772
Other receivables	**67,935**	119,272	**67,935**	119,272
	679,138	381,044	**679,138**	381,044
Australian dollar equivalent of amounts receivable in foreign currencies not formally hedged.				
United States dollars	**240,535**	4,572	**240,535**	4,572

10. INVENTORIES

Raw materials (at cost)	**92,188**	171,178	**92,188**	171,178
Finished goods (at cost)	-	192,982	**-**	192,982
	92,188	364,160	**92,188**	364,160

Inventory write-downs recognised as an expense totalled $75,532 (2005: nil) for the Group. The expense is included in the cost of sales line item in the Income Statement.

	Percentage of equity held by the company	**CONSOLIDATED**		**PROBIOMICS LIMITED**	
		2006 $	2005 $	**2006** $	2005 $
11. OTHER FINANCIAL ASSETS					
Shares in Controlled Entities at cost					
- Convergent BioScience Pty Ltd	100%	**-**	-	**-**	100
- Sphere Animal Health Ltd	100%	**-**	-	**100**	100
- VRI Diagnostics Pty Ltd	100%	**-**	-	**-**	100
- VRI Therapeutics & Vaccines Pty Ltd	100%	**-**	-	**-**	100
- Vasse Research Institute Pty Ltd	100%	**-**	-	**-**	10
		-	-	**100**	410

During the reporting period the company deregistered Convergent BioScience Pty Ltd., VRI Diagnostics Pty Ltd., VRI Therapeutics Pty Ltd., and Vasse Research Institute Pty ltd. The carrying amounts of the investments in those companies were expensed.

12. PROPERTY, PLANT & EQUIPMENT

Plant and equipment				
At 1 July 2005 net of accumulated depreciation & impairment	**129,001**	159,033	**129,001**	159,033
Additions	**58,724**	19,094	**58,724**	19,094
Disposals	**(71,182)**	(14,187)	**(71,182)**	(14,187)
Depreciation charge for the year	**(37,768)**	(34,939)	**(37,768)**	(34,939)
At 30 June 2006 net of accumulated depreciation & impairment	**78,775**	129,001	**78,775**	129,001
At 30 June 2006				
Cost or fair value	**240,983**	286,324	**240,983**	286,324
Accumulated depreciation	**(162,208)**	(157,323)	**(162,208)**	(157,323)
Net carrying amount	**78,775**	129,001	**78,775**	129,001

13. SHARE BASED PAYMENT PLANS

Employee Share Option Plan

An employee option plan is established whereby Probiomics Limited may, at the discretion of the Directors grant options to purchase ordinary shares in the Company to certain eligible employees. The options are granted for no consideration and are generally for a term of five years with the exercise price being determined at the discretion of the Directors. Generally the options can be exercised at any time during the term of the option period but are not transferable and are not quoted on ASX. Currently there are two employees who hold valid options.

The following table sets out the number (No.) and the weighted average exercise prices (WAEP) of and movements in share options issued during the year:

13. SHARE BASED PAYMENT PLANS (continued)

	2006 ***No.***	***2006*** ***WAEP***	*2005* *No.*	*2005* *WAEP*
Outstanding at the beginning of the year	**3,500,000**	**$0.60**	3,930,000	$0.69
Granted during the year	**3,500,000**	**$0.25**	2,250,000	$0.25
Expired during the year	**(2,890,000)**	**$0.25**	(2,680,000)	$0.67
Outstanding at the end of the year	**4,110,000**	**$0.39**	3,500,000	$0.60
Exercisable at the end of the year	**4,110,000**		3,500,000	

The outstanding balance as at 30 June 2006 is represented by:
• 360,000 options over ordinary shares with an exercise price of $0.75 each, exercisable by 23 November 2006
• 750,000 options over ordinary shares with an exercise price of $0.75 each, exercisable by 14 January 2008, and
• 3,000,000 options over ordinary shares with an exercise price of $0.25 each, exercisable by 31 July 2007

The weighted average remaining contractual life for the share options outstanding as at 30 June 2006 is between 1 and 2 years (2005: 1 and 3 years).

The range of exercisable prices for options outstanding at the end of the year was $0.25 to $0.75 (2005: $0.25 to $0.75)

The weighted average fair value of options granted during the year was $0.006 (2005: $0.022)

The fair value of the equity-settled share options granted under the option plan is estimated as at the date of grant using a Black-Scholes model taking into account the terms and conditions upon which the options were granted.

The following table lists the inputs to the model used for the years ended 30 June 2006 and 30 June 2005.

	2006	2005
Expected volatility %	**60**	60
Risk-free interest rate %	**6**	5
Expected life of options (years)	**2**	2
Option exercise price	**$0.25**	$0.25
Weighted average share price at grant date ($c)	**$0.078**	$0.155

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome. No other features of options granted were incorporated into the measurement of fair value.

The fair vale of the cash-settled options is measured at the grant date using the Black-Scholes option pricing model taking into account the terns and conditions upon which the instruments were granted. The services received and a liability to pay for those services are recognised over the expected vesting period. Until the liability is settled it is remeasured at each reporting date with changes in fair value recognised in profit or loss.

The carrying amount of the liability relating to the share-based payments at 30 June 2006 is $122,520 (2005: $101,754).

14. PENSIONS AND OTHER POST-EMPLOYMENT BENEFIT PLANS

The Group provides only that superannuation that is legally enforceable in Australia. The current rate is 9% of wages and salaries. (2005: 9%).

15. TRADE AND OTHER PAYABLES

	CONSOLIDATED		PROBIOMICS LIMITED	
	2006	2005	**2006**	2005
	$	$	$	$
Trade payables (i)	**551,375**	873,820	**551,375**	873,820
Accrued expenses	**28,034**	26,254	**28,034**	26,254
GST liability	**3**	14,215	**3**	14,215
Employee superannuation payable	**22,498**	39,407	**22,498**	39,407
PAYG payable	**24,220**	79,186	**24,220**	79,186
Other payables	**-**	7,040	**100**	7,450
	626,130	1,039,922	**626,230**	1,040,332
(i) Trade payables are non-interest bearing and are generally settled on 60 day terms.				
Australian dollar equivalents of amounts payable in foreign currencies not formally hedged:				
United States Dollars	**169,249**	165,874	**169,249**	165,874

16. INTEREST-BEARING LOANS AND BORROWINGS

The Group has no interest-bearing loans or borrowings.

17. PROVISIONS

Current				
Employee annual leave				
At 1 July	**66,653**	80,200	**66,653**	80,200
Arising during year	**29,852**	55,550	**29,852**	55,550
Utilised	**(63,143)**	(69,097)	**(63,143)**	(69,097)
At 30 June	**33,362**	66,653	**33,362**	66,653
Non-current				
Employee long service leave				
At 1 July	**7,631**	11,422	**7,631**	11,422
Arising during the year	**-**	-	**-**	-
Utilised	**-**	-	**-**	-
Unused amounts reversed	**(4,386)**	(3,791)	**(4,386)**	(3,791)
At 30 June	**3,245**	7,631	**3,245**	7,631

18. CONTRIBUTED EQUITY AND RESERVES

Ordinary shares – issued and fully paid	**24,990,320**	22,900,486	**24,990,320**	22,900,486

Effective 1 July 1998, the Corporations legislation in place abolished the concepts of authorised capital and par value of shares. Accordingly the Parent does not have authorised capital nor par value in respect of its issued shares.

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

	Number of shares	$	**Number of shares**	$
Movement in ordinary shares on issue				
1 July 2004	**83,973,127**	19,955,725	**83,973,127**	19,955,725
Issued on 20 July 2004 for cash	**21,000,000**	2,100,000	**21,000,000**	2,100,000
Issued 13 May 2005 for cash	**8,331,250**	999,750	**8,331,250**	999,750
Cancelled by a selective reduction in capital	**(260,000)**	-	**(260,000)**	-
Transaction costs on share issue	**-**	(154,989)	**-**	(154,989)
30 June 2005	**113,044,377**	22,900,486	**113,044,377**	22,900,486
Issued 26 August 2005 for cash	**12,588,000**	1,007,040	**12,588,000**	1,007,040
Issued 13 December 2005 for cash	**16,039,843**	1,202,982	**16,039,843**	1,202,982
Transaction costs on share issues	**-**	(120,188)	**-**	(120,188)
At 30 June 2006	**141,672,220**	24,990,320	**141,672,220**	24,990,320

18. CONTRIBUTED EQUITY AND RESERVES (cont.)

Share options
The company has an Employee Share Option Plan (ESOP) under which options to subscribe for the company's shares have been granted to certain executives and other employees (refer note 24)

Retained earnings
Movements in retained earnings were as follows:

	CONSOLIDATED		PROBIOMICS LIMITED	
	2006	2005	**2006**	2005
	$	$	**$**	$
Balance 1 July	**(22,824,276)**	(18,822,730)	**(22,824,276)**	(18,822,730)
Loss for the year	**(1,877,981)**	(4,001,546)	**(1,877,981)**	(4,001,546)
Balance 30 June	**(24,702,257)**	(22,824,276)	**(24,702,257)**	(22,824,276)

Reserves
Movements in reserves were as follows:

Balance 1 July	**101,754**	32,137	**101,754**	32,137
Share-based payment	**20,766**	69,617	**20,766**	69,617
Balance 30 June	**122,520**	101,754	**122,520**	101,754

This reserve is a share-based payment reserve.

19. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 2 to the financial statements.

Foreign currency risk

The Group has transactional currency exposures. Such exposure arises from sales or purchases by the Parent company in currencies other than the Group's functional currency which is Australian dollars (A$).

Approximately 93% of the Group's sales were denominated in currencies other than A$, whilst approximately 24% of cost of sales are denominated in A$. The remaining operating expenses are all in A$.

The Group does not hedge its foreign currency transactions as both sales and cost of sales are in the same currency (US$), hence there is a natural US$ to A$ hedge in place.

Credit risk
The Group trades only with recognised, creditworthy third parties.

It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures.

In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

There is considerable concentration of credit risk within the Group since the Group has only a few major customers at this stage of its development.

With respect to credit risk arising from other financial assets of the Group, which comprise cash and cash equivalents, the Group's exposure to credit risk arises from default of the counter party, with a maximum exposure equal to the carrying amount of these instruments.

Since the Group trades only with recognised third parties, there is no requirement for collateral security.

Liquidity risk
The Group's policy is to maintain a comfortable level of liquidity through the continual monitoring of cash reserves and the raising of additional capital as required. The Group has no borrowings.

20. FINANCIAL INSTRUMENTS

Fair values

Set out below is a comparison by category of the carrying amounts and fair values of all of the Group's financial instruments recognised in the financial statements.

	Carrying amount		Fair value	
	2006	2005	**2006**	2005
	$	$	**$**	$
CONSOLIDATED				
Financial assets				
Cash	**209,427**	403,486	**209,427**	403,486
Trade receivables	**611,203**	261,772	**611,203**	261,772
Other financial assets (current)	**67,935**	119,272	**67,935**	119,272
Financial liabilities				
Trade payables	**551,375**	873,820	**551,375**	873,820
Other financial liabilities (current)	**74,755**	166,102	**74,755**	166,102

	Carrying amount		Fair value	
	2006	2005	**2006**	2005
PARENT				
Financial assets				
Cash	**209,427**	403,486	**209,427**	403,486
Trade receivables	**611,203**	261,772	**611,203**	261,772
Other financial assets (current)	**67,935**	119,272	**67,935**	119,272
Financial liabilities				
Trade payables	**551,375**	873,820	**551,375**	873,820
Other financial liabilities (current)	**74,855**	166,512	**74,855**	166,512

Interest rate risk

The following table sets out the carrying amount, by maturity, of the financial instruments exposed to interest rate risk.

	CONSOLIDATED				**PARENT**			
YEAR ENDED 30 JUNE 2006	**Less than one year**	**Two to five years**	**Greater than five years**	**Weighted average effective interest rate**	**Less than one year**	**Two to five years**	**Greater than five years**	**Weighted average effective interest rate**
		$'000	**$'000**	**%**	**$'000**	**$'000**	**$'000**	**%**
Floating rate								
Cash and cash equivalents	**209,427**	**-**	**-**	**3.5%**	**209,427**	**-**	**-**	**3.5%**
Interest-bearing liabilities	-	-	-	-	-	-	-	-

	CONSOLIDATED				PARENT			
YEAR ENDED 30 JUNE 2005	Less than one year $'000	Two to five years $'000	Greater than five years $'000	Weighted average effective interest rate %	Less than one year $'000	Two to five years $'000	Greater than five years $'000	Weighted average effective interest rate %
Floating rate								
Cash and cash equivalents	403,486	-	-	2.9%	403,486	-	-	2.9%
Interest-bearing liabilities	-	-	-	-	-	-	-	-

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until maturity of the instrument. The other financial instruments of the Group and Parent that are not included in the above tables are non-interest bearing and are therefore not subject to interest rate risk.

21. COMMITMENTS AND CONTINGENCIES

The Group has no lease or other financial commitments.

Legal claims

(i) As at the date of this report the company is in a legal dispute with an ex-consultant who commenced proceedings in 2003 for the recovery of alleged fees owing of $135,000. If the action is successful through the Court process, the company would be liable to pay these fees plus estimated legal costs of between $60,000 and $70,000 plus interest and the claimant's costs.

The Directors are of the opinion, based on legal advice, that the matter will be defended successfully so no provision has been recognised in the financial statements at 30 June 2006.

(ii) Probiomics Limited has commenced proceedings against the ex-distributor of proTract for the recovery of goods held on behalf of the company by the distribution company and also for full payment of amounts owing by that company. The Directors are of the opinion, based on legal advice, that the action will be successful and no provision has been made for non-recovery of the debt in the financial statements. The distribution company's contract was terminated during the period and that company has made a cross-claim against Probiomics Limited seeking damages of $750,000 for breach of contract including wrongful termination. The figure of $750,000 is the maximum that can be claimed in the Court in which the claim was lodged. The particulars received to date in respect of the cross-claim indicate the actual amount of the claim to be substantially less than $750,000. The Directors are of the opinion, based on legal advice, that the cross-claim will not be successful so no provision has been made in the financial statements at 30 June 2006 for the cross-claim. In addition, the Company is owed $193,348 by the distribution company which is acknowledged as owing by that company but remains unpaid until the matter is resolved. The directors are confident of collecting this outstanding debt.

22. EVENTS AFTER BALANCE SHEET DATE

(i) Subsequent to the reporting date the company raised $1,025,000 (before costs of $51,250) by way of a placement of 20,500,000 shares to sophisticated investors at $0.05 per share. This capital will provide the company with working capital and will allow it to continue to develop and market its products. The placement has not been recognised in the financial statements for the year ended 30 June 2006.

(ii) On 15 August 2006 the company announced that it was calling a general meeting of shareholders to ratify the above placement of shares, to approve the granting of two options to a client of Tolhurst Noall Limited to purchase two tranches of shares and to issue options to a Director. The first tranche of options for the client of Tolhurst Noall is for 17 million shares at $0.05 per share is exercisable by 30 September 2006 and the second tranche of 18 million shares at $0.08 per share is exercisable by 30 April 2007. The meeting was held on 21 September 2006 and all resolutions as detailed above were approved by shareholders.

23. AUDITORS REMUNERATION

The auditor of Probiomics Limited is Ernst & Young.

	Consolidated		**Probiomics Limited**	
	2006	2005	**2006**	2005
	$	$	**$**	$
Amounts received and receivable by Ernst & Young (Australia) for:				
- an audit or review of the financial reports of the entity and any other entity in the consolidated entity	**66,950**	59,163	**66,950**	59,163
- other services in relation to the entity and any other entity in the consolidated entity				
- Tax compliance	**8,000**	19,935	**8,000**	19,935
- Special audits required by regulators	**-**	12,100	**-**	12,100
	74,950	91,198	**74,950**	91,198

24. DIRECTOR AND EXECUTIVE DISCLOSURES

(a) Details of Key Management Personnel

(i) Directors

B M Gardiner	Chairman
P D Ford	Non-executive director
R Penny	Non-executive director

(ii) Executives

K R Slatyer	Chief Executive Officer
P B Magoffin	Chief Financial Officer & Company Secretary
P W French*	Manager – Innovation & Business Development
P L Conway**	Chief Scientist

*Dr French became a part-time employee from 1st May 2006.
** A/Prof Conway's contract was terminated on 7th June 2006.

There have been no changes of the CEO or other key management personnel after the reporting date and the date that the financial report was authorised for issue.

(b) Compensation of Key Management Personnel

(i) Compensation policy
The performance of the Group depends upon the quality of its directors and executives. To prosper, the Group must attract, motivate and retain highly skilled directors and executives.

To this end, the Group provides competitive rewards to attract high calibre executives.

(A) Remuneration Committee
The Remuneration Committee of the Board of Directors is responsible for determining and reviewing compensation arrangements for the directors, the chief executive officer and the executive team. The Remuneration Committee assesses 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.
Salaries are reviewed periodically by the Committee but there is no specific link to company performance as the company has, until recently, been engaged mainly in research and development and linking remuneration to R&D outcomes would be inappropriate in the company's view.

(B) Compensation Structure
In accordance with best practice corporate governance, the structure of non-executive directors and executive compensation is separate and distinct.

(C) Non-executive director remuneration

Objective
The Board of Directors recognises that the success of the company will depend, largely, upon the quality of its directors and its senior management. For this reason the Remuneration Committee reviews the remuneration arrangements for all senior employees to ensure that it attracts and keeps motivated highly skilled and appropriately qualified directors and executives.

Structure
The Company's Constitution and the ASX listing rules specify that the aggregate remuneration of non-executive Directors shall be determined from time to time by a general meeting of shareholders. An amount not exceeding the amount determined by shareholders in general meeting is then available to be split between the Directors as agreed between themselves. The latest determination was at the Annual General Meeting held on 28th November 2003 when shareholders approved an aggregate remuneration amount of $250,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned between Directors is reviewed annually. The Board takes into account the fees paid to non-executive directors of comparable companies when undertaking the annual review process.

Each director receives a fee for being a director of the company. The Chairman receives a higher fee in recognition of the additional time commitment required of a Chairman.

24. DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

(D) Executive remuneration

Objective

The entity aims to reward executives with a level and mix of compensation commensurate with their position and responsibilities within the entity so as to reward executives with compensation that is competitive by market standards.

Structure
In determining the level and make-up of executive remuneration, the Remuneration Committee seeks to ensure that the levels being offered to the Group's executives are competitive with the market place.

None of the named directors and officers' remuneration contains a component 'at risk'.

(ii) Remuneration of Key Management personnel of the parent and consolidated entity
Details of the nature and amount of each element of the emolument of each Director of the Company and each of the four executive officers of the Company and the consolidated entity receiving the highest emolument for the financial year are as follows:

		Short-term		**Post - employment**	**Share-based payments**	**Other**	**TOTAL**
Directors		Directors fees	Salary	Superannuation	Options		
B M Gardiner	**2006**	**55,000**	**-**	**4,950**	**-**	**1,978**	**61,928**
	2005	15,000	-	1,012	9,000	8,115	33,127
R Penny	**2006**	**45,000**	**-**	**4,050**	**-**	**1,978**	**51,028**
	2005	15,000	-	1,012	9,000	8,115	33,127
P D Ford	**2006**	**48,750**	**-**	**4,388**	**-**	**1,978**	**55,116**
	2005	-	-	-	-	8,115	8,115
TOTAL	**2006**	**148,750**	**-**	**13,388**	**-**	**5,934**	**168,072**
TOTAL	2005	30,000	-	2,024	18,000	24,345	74,369

		Short-term		**Post-employment**	**Share-based payments**	**Other**	**TOTAL**
Executives		Directors fees	Salary	Superannuation	Options		
K R Slatyer	**2006**	**-**	**150,000**	**13,500**	**-**	**1,978**	**165,478**
	2005	15,000	143,481	17,638	-	45,615	221,734
P B Magoffin	**2006**	**-**	**135,000**	**12,150**	**-**	**1,978**	**149,128**
	2005	-	131,732	11,855	-	8,115	151,702
P W French	**2006**	**-**	**143,846**	**12,946**	**-**	**1,978**	**158,770**
	2005	-	168,060	15,125	-	8,115	191,300
P L Conway	**2006**	**-**	**91,667**	**8,250**	**18,000**	**7,978**	**125,895**
	2005	-	91,667	8,250	-	14,115	114,032
TOTAL	**2006**	**-**	**520,513**	**46,846**	**18,000**	**13,912**	**599,271**
TOTAL	2005	15,000	534,940	52,868	-	75,960	678,768

24. DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

(c) Compensation options: Granted and vested during the year (Consolidated)
During the financial year options were granted as equity compensation benefits under the Employee Share Option Plan (ESOP) to Directors as disclosed below. The options were issued free of charge. Each option entitled the holder to subscribe for one fully paid ordinary share in the entity at an exercise price of $0.25. The options expired on 30th June 2006 and none were exercised. There are no cash settlement alternatives. For further details relating to the options, refer to note 13.

	Vested	**Granted**	**Terms and conditions of each grant**					
30 June 2006	Number	Number	Grant date	Fair Value per option at grant date (note 13)	Exercise price per option (note 13)	Expiry date	First exercise date	Last exercise date
Directors								
B M Gardiner	250,000	250,000	20 Jan 06	-	$0.25	30 June 06	20 Jan 06	30 June 06
R Penny	250,000	250,000	20 Jan 06	-	$0.25	30 June 06	20 Jan 06	30 June 06
Executives								
P L Conway	3,000,000	3,000,000	1 Aug 05	$0.006	$0.25	31 July 07	1 Aug 06	31 July 07
TOTALS	3,500,000	3,500,000						

	Vested	**Granted**	**Terms and conditions of each grant**					
30 June 2005	Number	Number	Grant date	Fair Value per option at grant date (note 19)	Exercise price per option (note 19)	Expiry date	First exercise date	Last exercise date
Directors								
B M Gardiner	500,000	500,000	8 Apr 05	$0.018	$0.25	30 June 06	8 Apr 05	30 June 06
R Penny	500,000	500,000	8 Apr 05	$0.018	$0.25	30 June 06	8 Apr 05	30 June 06
G C Wild*	500,000	500,000	26 Nov 04	$0.044	$0.25	30 June 06	26 Nov 04	30 June 06
G C Wild*	250,000	250,000	25 May 05	$0.007	$0.25	30 June 06	25 May 05	30 June 06
V Garland*	500,000	500,000	8 Apr 05	$0.018	$0.25	30 June 06	8 Apr 05	30 June 06
TOTALS	2,250,000	2,250,000						

* These directors resigned prior to 30 June 2005.

(d) Option holdings of Key Management Personnel

						Vested at 30 June 2006		
30 June 2006	*Balance at beginning of period 1 Jul 05*	*Granted as remuneration*	*Options exercised*	*Options lapsed*	*Balance at end of period 30 Jun 06*	*Total*	*Exercisable*	*Not-exercisable*
Directors								
B M Gardiner	500,000	250,000	Nil	750,000	Nil	-	-	-
R Penny	500,000	250,000	Nil	750,000	Nil	-	-	-
P D Ford	-	-	-	-	-	-	-	-
Executives								
K R Slatyer	-	-	-	-	-	-	-	-
P B Magoffin	-	-	-	-	-	-	-	-
P W French	750,000	-	Nil	-	750,000	750,000	750,000	-
P L Conway	500,000	3,000,000	Nil	140,000	3,360,000	3,360,000	3,360,000	-
TOTALS	2,250,000	3,500,000	-	1,640,000	4,110,000	4,110,000	4,110,000	-

24. DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

30 June 2005	*Balance at beginning of period 1 Jul 04*	*Granted as remuneration*	*Options exercised*	*Options lapsed*	*Balance at end of period 30 Jun 05*	*Vested at 30 June 2005* *Total*	*Exercisable*	*Not-exercisable*
Directors								
B M Gardiner	-	500,000	Nil	-	500,000	500,000	500,000	-
R Penny	-	500,000	Nil	-	500,000	500,000	500,000	-
P D Ford	-	-	Nil	-	-	-	-	-
Executives								
K R Slatyer	-	-	-	-	-	-	-	-
P B Magoffin	-	-	-	-	-	-	-	-
P W French	750,000	-	Nil	-	750,000	750,000	625,000	125,000
P L Conway	500,000	-	Nil	-	500,000	500,000	500,000	-
TOTALS	1,250,000	1,000,000	-	-	2,250,000	2,250,000	2,250,000	125,000

(e) Shareholdings of Key Management Personnel (consolidated)

Shares held in Probiomics Limited

30 June 2006	Balance 1 July 2005	Class	Granted as Remuneration	Net change - Other	Balance 30 June 2006
Directors					
Bryan Martin Gardiner	nil	n/a	nil	nil	nil
Patrick Douglas Ford (i)	3,435,999	Ordinary	nil	nil	3,435,999
Ronald Penny	nil	n/a	nil	nil	nil
Key Management Personnel					
Kim Robert Slatyer (ii)	3,246,834	Ordinary	nil	(373,000)	2,873,834

30 June 2005	Balance 1 July 2004	Class	Granted as Remuneration	Net change - Other	Balance 30 June 2005
Directors					
Bryan Martin Gardiner	nil	n/a	nil	nil	nil
Patrick Douglas Ford	3,302,667	Ordinary	nil	133,332	3,435,999
Ronald Penny	nil	n/a	nil	nil	nil
Key Management Personnel					
Kim Robert Slatyer	5,892,002	Ordinary	nil	(2,645,168)	3,246,834

(i) Mr Ford has a beneficial interest in Diskdew Pty Limited which owned 3,269,333 shares at balance date.
(ii) Mr Slatyer has a beneficial interest in Trivenia Pty Limited which owned 2,543,667 shares at balance date.

(f) Loans to Key Management Personnel (consolidated)

No loans have been made to any Director or Key Management Personnel.

(g) Other transactions and balances with Key Management Personnel

There were no other transactions with Key Management personnel during the year.

25. RELATED PARTY DISCLOSURES

Probiomics Limited is the ultimate Australian parent company.

Transactions with Directors.

(i) During the year Probiomics Limited was provided services, on normal commercial terms and conditions, by Taylor Collison Pty Limited, totalling $121,551. Mr Patrick Ford is an employee of Taylor Collison Limited.

(ii) During the year Probiomics Limited was provided services, on normal terms and conditions, by Good Health Solutions Pty Ltd totalling $19,459. Prof Ron Penny is a director of Good Health Solutions Pty Ltd.

26. TRANSITION TO AIFRS

For all periods up to and including the year ended 30 June 2005, the Company prepared its financial statements in accordance with Australian generally accepted accounting practice (AGAAP). These annual financial statements for the year ended 30 June 2006 are the first the Company is required to prepare in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS).

Accordingly, the Company has prepared financial statements that comply with AIFRS applicable for periods beginning on or after 1 January 2005 and the significant accounting policies meeting those requirements are described in Note 2. In preparing these financial statements, the Company has started from an opening balance sheet as at 1 July 2004, the Company's date of transition to AIFRS, and made those changes in accounting policies and other restatements required by AASB 1 First-time adoption of AIFRS.

This note explains the principal adjustments made by the Company in restating its AGAAP balance sheet as at 1 July 2004 and its previously published AGAAP financial statements for the year ended 30 June 2005.

There is no AASB 132: Financial Instruments: Disclosure and Presentation and AASB 139 Financial Instruments: Recognition and Measurement impact at 1 July 2005.

Exemptions applied:
AASB 1 allows first-time adopters certain exemptions from the general requirement to apply AIFRS retrospectively. The Company has taken the following exemptions:

- Comparative information for financial instruments is prepared in accordance with AGAAP and the Company has adopted AASB 132: Financial Instruments: Disclosure and Presentation and AASB 139 Financial Instruments: Recognition and Measurement from 1 July 2005.

- AASB 2 Share-based Payment has not been applied to any equity instruments that were granted on or before 7 November 2002, nor has it been applied to equity instruments granted after 7 November 2002 that vested before 1 January 2005.

Explanation of material adjustments to the cash flow statement
There are no material differences between the cash flow statement presented under AIFRS and the cash flow statement presented under previous AGAAP.

26. TRANSITION TO AIFRS (CONT.)

Balance sheet reflecting reconciliation of adjustments to AIFRS as at 30 June 2004.

	Notes	CONSOLIDATED			PROBIOMICS LIMITED		
		AGAAP	AIFRS Impact	AIFRS	AGAAP	AIFRS Impact	AIFRS
		$	$	$	$	$	$
CURRENT ASSETS							
Cash and cash equivalents		268,629		268,629	268,629		268,629
Trade and other receivables		1,423,030		1,423,030	1,423,030		1,423,030
Inventories		439,936		439,936	439,936		439,936
Other		88,121		88,121	88,121		88,121
TOTAL CURRENT ASSETS		2,219,716		2,219,716	2,219,716		2,219,716
NON-CURRENT ASSETS							
Property, plant and equipment		159,033		159,033	159,033		159,033
TOTAL NON-CURRENT ASSETS		159,033		159,033	159,033		159,033
TOTAL ASSETS		2,378,749		2,378,749	2,378,749		2,378,749
CURRENT LIABILITIES							
Trade and other payables	B	1,111,854	10,141	1,121,995	1,111,854	10,141	1,121,995
Provisions		80,200		80,200	80,200		80,200
TOTAL CURRENT LIABILITIES		1,192,054		1,202,195	1,192,054		1,202,195
NON-CURRENT LIABILITIES							
Provisions		11,422		11,422	11,422		11,422
TOTAL NON-CURRENT LIABILITIES		11,422		11,422	11,422		11,422
TOTAL LIABILITIES		1,203,476		1,213,617	1,203,476		1,213,617
NET ASSETS		1,175,273	(10,141)	1,165,132	1,175,273	(10,141)	1,165,132

26. TRANSITION TO AIFRS (continued)

	Notes	CONSOLIDATED			PROBIOMICS LIMITED		
		AGAAP	AIFRS Impact	AIFRS	AGAAP	AIFRS Impact	AIFRS
		$	$	$	$	$	$
EQUITY							
Contributed equity		19,955,725	-	19,955,725	19,955,725	-	19,955,725
Reserves	A	-	32,137	32,137	-	32,137	32,137
Retained profits	A, B	(18,780,452)	(42,278)	(18,822,730)	(18,780,452)	(42,278)	(18,822,730)
TOTAL EQUITY		1,175,273	(10,141)	1,165,132	1,175,273	(10,141)	1,165,132

Balance sheet reflecting reconciliation of adjustments to AIFRS as at 30 June 2005.

	Notes	CONSOLIDATED			PROBIOMICS LIMITED		
		AGAAP	AIFRS Impact	AIFRS	AGAAP	AIFRS Impact	AIFRS
		$	$	$	$	$	$
CURRENT ASSETS							
Cash and cash equivalents		403,486	-	403,486	403,486	-	403,486
Trade and other receivables		381,044	-	381,044	381,044	-	381,044
Inventories		364,160	-	364,160	364,160	-	364,160
Prepayments		23,491	-	23,491	23,491	-	23,491
Government grants		-	-	-	-	-	-
TOTAL CURRENT ASSETS		1,172,181		1,172,181	1,172,181		1,172,181
NON-CURRENT ASSETS							
Property, plant and equipment		129,001	-	129,001	129,001	-	129,001
TOTAL NON-CURRENT ASSETS		129,001	-	129,001	129,001	-	129,001
TOTAL ASSETS		1,301,182		1,301,182	1,301,182		1,301,182
CURRENT LIABILITIES							
Trade and other payables		1,039,922	-	1,039,922	1,039,922	-	1,039,922
Provisions		66,653		66,653	66,653		66,653
Government grants	B	-	9,012	9,012	-	9,012	9,012
TOTAL CURRENT LIABILITIES		1,106,575	9,012	1,115,587	1,106,575	9,012	1,115,587
NON-CURRENT LIABILITIES							
Provisions		7,631	-	7,631	7,631	-	7,631
TOTAL NON-CURRENT LIABILITIES		7,631	-	7,631	7,631	-	7,631
TOTAL LIABILITIES		1,114,206	9,012	1,123,218	1,114,206	9,012	1,123,218
NET ASSETS		186,976	(9,012)	177,964	186,976	(9,012)	177,964
EQUITY							
Contributed equity		22,900,486	-	22,900,486	22,900,486	-	22,900,486
Reserves	A	-	101,754	101,754	-	101,754	101,754
Retained profits	A,B	(22,713,510)	(110,766)	(22,824,276)	(22,713,510)	(110,766)	(22,824,276)
TOTAL EQUITY		186,976	(9,012)	177,964	186,976	(9,012)	177,964

26. TRANSITION TO AIFRS (continued)

Income statement for the year ended 30 June 2005.

YEAR ENDED 30 June 2005	Notes	CONSOLIDATED			PROBIOMICS LIMITED		
		AGAAP	AIFRS Impact	AIFRS	AGAAP	AIFRS Impact	AIFRS
		$	$	$	$	$	$
Sales revenue		1,388,812	-	1,388,812	1,388,812	-	1,388,812
Finance revenue		57,366	-	57,366	57,366	-	57,366
		1,446,178	-	1,446,178	1,446,178	-	1,446,178
Cost of sales		(1,048,802)	-	(1,048,802)	(1,048,802)	-	(1,048,802)
Gross Profit		397,376	-	397,376	397,376	-	397,376
Other income	B	37,859	1,129	38,988	37,859	1,129	38,988
Research and development costs		(697,962)	-	(697,962)	(697,962)	-	(697,962)
Intellectual property expenses		(307,650)	-	(307,650)	(307,650)	-	(307,650)
Marketing expenses		(947,985)	-	(947,982)	(947,985)	-	(947,982)
Administrative and corporate expenses	A	(2,414,696)	(69,617)	(2,484,313)	(2,414,696)	(69,617)	(2,484,313)
Finance costs		-	-	-	-	-	-
Profit before income tax expense		(3,933,058)	(68,488)	(4,001,546)	(3,933,058)	(68,488)	(4,001,546)
Income tax expense		-	-	-	-	-	-
Profit after income tax expense		(3,933,058)	(68,488)	(4,001,546)	(3,933,058)	(68,488)	(4,001,546)

Impact of adopting AIFRS

Outlined below are the areas impacted by adoption of AIFRS, including the financial impact on equity and profit.

Reference	Item	AGAAP	AIFRS	Impact	
A	Share based payments	Share-based payments were not required to be expensed	AASB 2 *Share-based payments* requires entities to recognise an expense in relation to shares, options and other equity instruments provided to employees (including directors). These share-based payment transactions must be fair valued at grant date and recognised as an expense in profit or loss evenly over the vesting period. An adjustment was required to recognise share-based payments granted after 7 November 2002 and vesting after 1 January 2005.	CONSOLIDATED *Equity at transition:* Increase to accumulated losses and increase to employee equity benefits reserve of $32,137. Net effect zero. *Equity at 30 June 2005:* Increase to accumulated losses and increase to employee equity benefits reserve of $101,754. *Profit for 30 June 2005:* Increase in losses of $69,617.	PARENT *Equity at transition:* Increase to accumulated losses and increase to employee equity benefits reserve of $32,137. Net effect zero. *Equity at 30 June 2005:* Increase to accumulated losses and increase to employee equity benefits reserve of $101,754. *Profit for 30 June 2005:* Increase in losses of $69,617.

Reference	Item	AGAAP	AIFRS	Impact	
B	Government grants	Fair value of the government grant was recognised as revenue when the entity gained control over the grant.	Under AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance,* grant income should be matched to the expenditure to which it relates in the period when the expenditure is incurred.	CONSOLIDATED *Equity on transition:* Increase to accumulated losses and recognition of government grants (deferred income) of $10,141. *Equity at 30 June 2005:* Increase to accumulated losses and recognition of government grants (deferred income) of $9,012. *Loss for 30 June 2005:* Decrease to loss of $1,129.	PARENT *Equity on transition:* Increase to accumulated losses and recognition of government grants (deferred income) of $10,141. *Equity at 30 June 2005:* Increase to accumulated losses and recognition of government grants (deferred income) of $9,012. *Loss for 30 June 2005:* Decrease to loss of $1,129

DIRECTORS' DECLARATION

In accordance with a resolution of the Directors of Probiomics Limited, I state that:

1. In the opinion of the directors:

a) the financial statements and the notes of the company and of the consolidated entity are in accordance with the Corporations Act 2001, including:

   (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2006 and of their performance for the year ended on that date; and

   (ii) comply with Accounting Standards and Corporations Regulations 2001; and

b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

2. This declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial year ended 30 June 2006.

On behalf of the Board

Bryan Gardiner
Chairman

Sydney 28th September 2006

ERNST & YOUNG

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Auditor's Independence Declaration to the Directors of Probiomics Limited

In relation to our audit of the financial report of Probiomics Limited for the year ended 30 June 2006, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

Gamini Martinus

Gamini Martinus
Partner
Sydney
28 September 2006

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Independent audit report to members of Probiomics Limited

Scope

The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, statement of changes in equity, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for Probiomics Limited (the company) and the consolidated entity, for the year ended 30 June 2006. The consolidated entity comprises both the company and the entities it controlled during that year.

The directors of the company are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the company and the consolidated entity, and that complies with Accounting Standards in Australia, 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.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report.. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the company.

ERNST & YOUNG

Independence

We are independent of the company and the consolidated entity 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 Auditor's Independence Declaration, a copy of which is included in the annual report. In addition to our audit of the financial report, 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.

Audit opinion

In our opinion, the financial report of Probiomics Limited is in accordance with:

(a) the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the financial position of Probiomics Limited and the consolidated entity at 30 June 2006 and of their performance for the year ended on that date; and

  (ii) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*; and

(b) other mandatory financial reporting requirements in Australia.

Inherent Uncertainty Regarding Continuation of Going Concern

Without qualification to the opinion expressed above, attention is drawn to the following matter. As a result of the matters described in Note 2 (a) 'Basis of Accounting – Going Concern' to the financial statements, there is significant uncertainty whether the company and/or the consolidated entity will be able to continue as going concerns and therefore whether they will be able to pay their debts as and when they fall due and realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report. The financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the company and/or the consolidated entity not continue as going concerns.

Ernst & Young

Ernst & Young

Gamini Martinus

Gamini Martinus
Partner
Sydney
28 September 2006

ASX ADDITIONAL INFORMATION

Additional information required by the Australian Stock Exchange Ltd and not shown elsewhere in this report is as follows. The information is current as at 28th September 2006.

(a) Distribution of equity securities

The number of shareholders, by size of holding, in each class of security are:

			Ordinary shares	
			Number of holders	**Number of shares**
1	-	1,000	229	191,808
1,001	-	5,000	455	1,202,189
5,001	-	10,000	254	2,055,431
10,001	-	100,000	673	26,825,872
100,001	and over		235	131,903,581
			1,846	162,178,881

(b) Twenty largest shareholders

The names of the twenty largest holders of ordinary shares are:

		Ordinary shares	**% of shares**
1	Link Traders (Aust) Pty Ltd	7,520,952	4.64
2	Hurst Pollock Noms Pty Ltd	5,186,584	3.20
3	I E Properties Pty Ltd	5,047,332	3.11
4	Mr A & Mrs S W Grant-Smith, A & S Grant-Smith SF A/c	4,169,819	2.57
5	Acres Holdings Pty Ltd	3,691,666	2.28
6	Redbook Nominees Pty Ltd	3,428,142	2.11
7	Diskdew Pty Ltd P Ford Super Fund a/c	3,269,333	2.02
8	McKell Place Nominees Pty Ltd	3,100,000	1.91
9	Symington Pty Ltd	3,100,000	1.91
10	Biogaia AB	3,000,000	1.85
11	D H Slatyer Pty Ltd	2,900,000	1.79
12	Jamel Investments Pty Ltd	2,766,666	1.71
13	Whitehall Nominees Pty Ltd G C Super a/c	2,744,800	1.69
14	Trivenia Pty Ltd	2,543,667	1.57
15	Frere & Associates Pty Limited, Derek Frere Super Fund a/c	1,959,491	1.21
16	Swell Nominees Pty Ltd	1,722,900	1.06
17	Octifil Pty Ltd	1,600,000	0.99
18	D M D Holdings Pty Ltd	1,450,000	0.89
19	Mr J C Whiting, K W Share a/c	1,285,000	0.79
20	D H Slatyer Pty Ltd The Slatyer Super Account	1,200,000	0.74
		61,686,352	38.04

(c) Substantial shareholders

The company had no substantial shareholders, as defined by the Corporations Act 2001, as at the date of this report.

(d) Voting rights

ASX ADDITIONAL INFORMATION (cont.)

All ordinary shares (whether fully paid or not) carry one vote per share without restriction.

(e) Unquoted equity on issue

Class of security	Number of securities	Number of holders
Employee Options over ordinary shares	4,360,000	3