

# **Structural Monitoring Systems Plc**

**Annual Financial Report  
30 June 2006**

## Contents

<b>DIRECTORS' REPORT .....</b>	<b>3</b>
<b>INCOME STATEMENT .....</b>	<b>12</b>
<b>BALANCE SHEET .....</b>	<b>13</b>
<b>CASH FLOW STATEMENT .....</b>	<b>14</b>
<b>STATEMENT OF CHANGES IN EQUITY .....</b>	<b>15</b>
<b>NOTES TO THE FINANCIAL STATEMENTS.....</b>	<b>16</b>
<b>AUDIT REPORT .....</b>	<b>45</b>

## DIRECTORS' REPORT

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

### DIRECTORS

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

**Sir John Walker (Non-Executive Chairman)** Sir John is a former Air Marshal who retired after a 41 year distinguished career with the Royal Air Force in the UK. He held a number of commands both in the UK and abroad and prior to retirement he was Chief of Defence Intelligence and Deputy Chairman of the national Joint Intelligence Committee. He was appointed Knight Commander of the Bath early in 1992 and was selected a fellow of the Royal Aeronautical Society later that year. More recently he was Special Advisor to the House of Commons Defence Committee. He is author of three books and has written for the technical press specialising in Air Power, Command and Leadership. He provides Structural Monitoring Systems with important expertise in relation to the development of the military applications of the Company's technology.

**David Forsyth (Non-Executive Director)** Mr Forsyth has extensive experience in the maintenance of aircraft over many years. He holds a Bachelor of Aeronautical Engineering from the University of New South Wales, a Graduate Diploma of Industrial Engineering from the University of New South Wales and is a fellow of the Royal Aeronautical Society. Mr Forsyth had over a 30 year career with Qantas Airways Limited with many responsibilities, and his final position before retirement was Executive General Manager Aircraft Operations where he was responsible for all flight operations, engineering and maintenance and operations co-ordination covering 8,000 staff.

**Robin John Dean (Non-Executive Director)** Mr Dean has extensive experience in management, corporate and investment banking, having held the position as the Head of Project Finance at Bankwest (1989 – 1995). Mr Dean was also Chief Executive of St Barbara Mines Ltd from 1995 – 1997. At that time, the company was a successful Australian gold miner with market capitalisation in excess of \$250 million and with 300 employees. Mr Dean has also held prior corporate finance positions with Westchester Corporate Finance and Westpac Banking Corporation. Mr Dean holds a Bachelor of Economics from the University of Western Australia.

**Mark William George Vellacott (Managing Director)** Mr Vellacott has an impressive record in the aerospace industry with BAE Systems where he was Head of Engineering Technology, Corporate Development based in Adelaide from 1998 to 2001. His last position before joining the Company was Technical Director, Asia Pacific Space Centre, based in Sydney. In 1998 Mr Vellacott worked for British Aerospace PLC Head Office Engineering in the UK on strategic investment and planning issues. Mr Vellacott originally joined British Aerospace Military Aircraft in 1980, and completed a B.Sc in Aeronautical Engineering in 1986; an M.Sc in Systems Engineering in 1988 and his MBA in 1998. He was elected a Fellow of the Royal Aeronautical Society in 2000.

Mr Vellacott is primarily responsible for the day to day management of the Company and the commercialisation of the CVM™ technology and overall strategic development of the company. He brings a depth of experience in management, dealing with the largest Companies in the aerospace industry as well as with Governments around the world.

### **Anthony Thomas Brennan**

Mr Brennan was a non-executive director during the year ended 30 June 2006. He resigned on 7 July 2006.

## DIRECTORS' REPORT (continued)

### REVIEW AND RESULTS OF OPERATIONS

#### 1. PRINCIPAL ACTIVITIES

The principal activities of the Group during the year were the development and commercialisation of its intellectual property for products used in testing and monitoring the structural integrity of materials that are subject to operational stress and fatigue in structures such as aircraft, ships, rolling stock and power plants.

#### 2. REVIEW OF BUSINESS AND FUTURE EVENTS

The following recent activities occurred and will continue into the near future:

- Planning activities with the South African airline SAFAIR has advanced for the installation of CVM™ sensor application on two of their ten Hercules aircraft. In association with this program US aircraft manufacturer Lockheed Martin has invited SMS to present a paper at its Hercules operator conference in October. The Company is now working to market CVM™ to other operators of the popular Hercules to address fleet wide inspection requirements, discussions have commenced with a number of other operators.
- Following the successful test results on CVM™ generated by the United States Government's Sandia National Laboratories and the FAA, a draft procedure has been prepared for inclusion of CVM™ in the Boeing NDT Standard Practices Manual. Following this result discussions are now in progress with Boeing for the development of CVM™ based alternative means of compliance for a number of existing aircraft inspections that have been identified by two US airlines that the Company is working with.
- The Joint Development Agreement ("JDA") program with Airbus is now well advanced. In the next stage of the JDA Airbus has scheduled the installation of CVM™ sensor systems on an Airbus aircraft being operated in their own flight test fleet and also on the aircraft of a major European airline.
- In addition to the JDA activities Airbus is now evaluating CVM™ for use on components manufactured in composite materials. The Company has demonstrated that CVM™ can monitor for structural damage in composite materials where current inspection techniques are difficult and costly. CVM™ can be incorporated into the composite materials at the manufacturing stage, this evaluation on representative aircraft components will be conducted on behalf of Airbus by the Cooperative Research Centre for Advanced Composite Structures in Melbourne.
- At the request of Embraer of Brazil, the world's 4th largest commercial aircraft manufacturer, a costed proposal has been provided for the installation of CVM™ system to monitor a major full scale fatigue test program. In addition Embraer is looking to qualify an in-flight structural monitoring system around the CVM™ system for their aircraft. Embraer manufacture regional and business aircraft in the 50 to 120 seat range.
- The Company has provided a proposal for a qualification program for a large European helicopter manufacturer. A costed proposal has been prepared for a program of work to qualify CVM™ sensor applications for a fleet installation commencing in 2007. An initial assessment of the program has commenced.
- The next generation of CVM™ equipment, the PM-200 periodic monitoring system, has been designed to meet the exacting requirements of the aerospace industry. An initial production batch of PM200 has commenced.

## DIRECTORS' REPORT (continued)

### 2. REVIEW OF BUSINESS AND FUTURE EVENTS (continued)

- The Company has supplied the first modified and simplified CVM™ systems designed for large scale product quality controlled testing to PBR, the Melbourne based automotive brake manufacturer. PBR will use CVM™ for batch testing brake calipers for quality control. Quality control testing in manufacturing is a large business and the Company is now looking to expand in this market and will launch this product in conjunction with the presentation of a paper at an Automotive Industry Conference in Detroit in October.
- The Company has already received an expression of interest from General Motors in Brazil to use CVM™ in automotive tests using the CVM™ testing system that has been developed for PBR.
- The Company is receiving enquiries for use of the CVM™ system in an increasing number of different market sectors, for example mining and ground transportation. There has also been an increase in the interest shown in SMS's CVM™ laboratory equipment by new customers in defence and corporate research centres, and in relation to aircraft structural health monitoring and full scale fatigue test applications. These industry inquiries are placing challenging demands on the Company's staff to develop new CVM™ solutions for the expanding customer base.
- The Company continues the aggressive protection of its intellectual property with lodgement of a series of a new patent applications for different variants of CVM™ and production processes.
- Discussions have been held with a Canadian company concerning potential teaming to present an integrated SHM proposal to the US Coast Guard.
- A number of other potential clients for the CVM™ system have been identified in China.

Commercial interest in CVM™ is on the increase and firm progress is being made towards finalising the initial product qualification activities by the end of 2006. Important developments have also been made in the use of CVM™ in industries other than aviation.

Achievement of commercialisation success will be dependant on:

- Significant penetration into the military aircraft markets;
- Significant penetration into the existing retrofit commercial aircraft markets;
- Penetration of in-flight SHM application into new aircraft, eg Airbus and Embraer;
- Commercialisation into non-aircraft markets, for example, oil & gas, automotive, rail and maritime and industrial processing.

There are several risks that could affect successful commercialisation.

Technical risks are high, as the CVM™ technology involves high levels of innovation and must be proved to be capable of performing in harsh environmental conditions. The manufacturing processes are also critical and must be adapted to take into account varying conditions and materials used in aircraft construction. The Board is confident at this stage of the Company's development that these technological risks have been considered and mitigated, and that the highly qualified technical team that has been assembled at the Company is capable of dealing with technological risks and problems as they arise.

## **DIRECTORS' REPORT (continued)**

### **2. REVIEW OF BUSINESS AND FUTURE EVENTS (continued)**

Another risk that could affect the commercialisation outcomes is the threat of competitive technologies. At this time the Company believes that it has a significant lead time over any competing technologies, and that once it has been accepted by the leading aircraft manufacturers and airlines, it will be difficult for other technologies to be a major threat. However the Company continues to monitor this risk and develop and continually improve its core technologies.

Financial risks include foreign exchange exposures. These are not significant to the Company at this stage in its cycle but the situation will be re-evaluated once international expansion has been achieved.

The Company has in place appropriate technical and financial management teams and committees that constantly monitor progress of the Company's technological development and commercialisation programmes. Given the nature of the Company's business and stage of development the Company does not yet have in place formalised Key Performance Indicators (KPIs) against which it measures performance. However there are several management tools in place that track the development and commercialisation process against timelines and budgets. One of these is the reporting of the progress of research development programmes that are subject to Federal Government grant funding on a quarterly basis to AusIndustry in order for funding to be received.

This business review contains certain forward looking statements that have been made by the directors in good faith based on the information available at the time of the approval of the annual report. By their nature, such forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that will or may occur in the future. Actual results may differ from those expressed in such statements, depending on a variety of factors, including:

- exposure to international and national economic factors;
- the quality and perceived quality of the Company's products and the success of marketing efforts and general business practices;
- the success of competitors in developing alternative SHM technologies;
- reliance on key personnel;
- the risk that technologies cannot be further developed or significant delays and increases in costs arising;
- the risk that the assumptions that have been made in determining future profitability are inaccurate or prove to be invalid;
- the risk of product failure, and
- the risk that the FAA does not certify the technology.

### **3. SIGNIFICANT EVENTS**

On 10 August 2005, the Company announced a commercial licence agreement with The Boeing Company. This agreement places the Company in a strong position for the commercialisation of CVM™ technology on both existing and future large commercial aircraft.

On 2 September 2005, the Company issued 19,800,000 Ordinary shares at 12 cents each to Orbis Capital Limited to raise \$2,376,000. On the same day a further 1,033,333 Ordinary shares were issued at 12 cents each to another sophisticated investor to raise a further \$124,000.

On 8 September 2005, the Company issued 5,833,335 Ordinary shares at 12 cents each to institutional investors through KTM Capital raising \$700,000.

## **DIRECTORS' REPORT (continued)**

### **3. SIGNIFICANT EVENTS (continued)**

On 13 September 2005, the Company issued 1 million options exercisable at 20 cents each on or before 30 April 2007 to Western Aero Services Pty Ltd, a party related to a consultant, Mr Peter Schoonens. These options are provided as part payment of consultancy services and as an incentive to Mr Schoonens. The options are unlisted and will only be listed and tradable upon the signing of a license agreement with Airbus.

On 15 September 2005 the Company initiated a Share Purchase Plan whereby existing shareholders were given the opportunity to subscribe for up to \$5,000 worth of shares at 12 cents each. An amount of \$314,564 was raised on the issue of 2,712,465 shares.

The company implemented an Employee Share Option Scheme, and during the financial year issued a total of 4,139,000 options to employees of the Group. Full details of these issues are contained in Note 14 to the Financial Statements.

On 20 December 2005 the Company announced that it had been awarded a grant for a total of \$2,983,537 under the Australian Government's Commercial Ready program, covering the period to December 2007. The grant has been provided to further develop and commercialise the Company's CVM™ technology, for an in-flight structural health monitoring system. The Company has received \$968,358 to 30 June 2006.

### **4. STATEMENT OF DIRECTORS RESPONSIBILITIES**

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards as adopted by the European Union. They are also responsible for ensuring that the annual report includes information required by the Listing Rules of the Australian Stock Exchange.

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that period. In preparing these financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

### **5. EVENTS OCCURRING AFTER BALANCE SHEET DATE**

No significant events have occurred between the end of the financial year and the date of this report.

## DIRECTORS' REPORT (continued)

### 6. RESULTS AND DIVIDEND

The operating loss, after income tax, for the year was \$3,770,114 (2005: \$23,783,475). No dividends were proposed or paid during the financial year.

### 7. SHARE CAPITAL

The impact on share capital and share premium account of the major share issues in the year was as follows:

	Number of Shares	Share Price \$	Share Capital \$	Share Premium \$	Total \$
Placements to Private Investors	26,666,668	0.12	3,200,000	-	3,200,000
Issue pursuant to Share Purchase Plan	2,712,465	0.12	314,564	10,936	325,500
Costs of Issues				(79,307)	(79,307)
			<b>3,514,564</b>	<b>(68,371)</b>	<b>3,446,193</b>

### 8. DIRECTORS MEETINGS

The number of directors' meetings (including meetings of committees of directors) and number of meetings attended by each of the directors of the Company during the financial year are:

Director	Board Meetings		Audit Committee		Remuneration Committee	
	A	B	A	B	A	B
Sir J Walker	11	11				
M Vellacott	11	11				
R Dean	11	11	2	2	1	1
D Forsyth	10	11				
A Brennan	6	11	2	2	1	1

A – Number of meetings attended

B – Number of meetings held during the time which the director held office during the year

## DIRECTORS' REPORT (continued)

### 9. REMUNERATION OF DIRECTORS AND EXECUTIVE OFFICERS

Details of the nature and amount of each major element of remuneration of each director of the Company and each of the Company executives who receive the highest remuneration are:

Specific Directors	Primary		Post Employment	Other	Equity	Total
	Salary & Fees \$	Cash Bonus \$	Super-annuation \$	Social Security Costs \$	Options \$	\$
<b>30 June 2006</b>						
Sir. John Walker	133,815	-	-	14,661	-	148,476
Mr. Robin Dean	35,000	-	-	-	-	35,000
Mr. Mark Vellacott	253,899	46,506	20,241	-	6,711	327,357
Mr. David Forsyth	30,000	-	-	-	-	30,000
Mr. Anthony Brennan	30,000	-	2,700	-	-	32,700
<b>Total Remuneration: Specified Directors</b>	<b>482,714</b>	<b>46,506</b>	<b>22,941</b>	<b>14,661</b>	<b>6,711</b>	<b>573,533</b>
<b>30 June 2006</b>						
Mr. Andrew Chilcott (commenced 2/1/2006)	76,000	-	6,840	-	-	82,840
Mr. Michael Southern	146,258	3,750	13,163	-	3,133	166,304
Mr. Colin McDonald	146,258	3,750	12,983	-	4,027	167,018
Mr. Alistair Lang	171,317	4,211	-	25,144	3,534	204,206
<b>Total Remuneration: Specified Executives</b>	<b>539,833</b>	<b>11,711</b>	<b>32,986</b>	<b>25,144</b>	<b>10,694</b>	<b>620,368</b>

The remuneration policy of the Company is outlined in Note 25 (b) in the Notes to the Financial Statements.

### 10. OPTIONS GRANTED AS COMPENSATION

Details on options over ordinary shares in the Company that were granted as incentives to each key management person during the reporting period are as follows.

	Grant Date	Tranche A Granted No.	Value per option at grant date (\$)	Tranche B Granted No.	Value per option at grant date (\$)	Tranche C Granted No.	Value per option at grant date (\$)
<b>Specified Directors</b>							
Mr. Mark Vellacott	22 Dec 05	250,000	0.013	250,000	0.013	250,000	0.014
<b>Specified Executives</b>							
Mr. Andrew Chilcott	-	-	-	-	-	-	-
Mr. Michael Southern	8 Feb 06	150,000	0.010	150,000	0.012	150,000	0.012
Mr. Colin McDonald	22 Dec 05	150,000	0.013	150,000	0.013	150,000	0.014
Mr. Alistair Lang	22 Dec 05	131,667	0.013	131,667	0.013	131,666	0.014
<b>Total</b>		<b>681,667</b>		<b>681,667</b>		<b>681,666</b>	

## DIRECTORS' REPORT (continued)

### 10. OPTIONS GRANTED AS COMPENSATION (continued)

These options were issued pursuant to the Employee Share Option Scheme Refer to Note 15 (a) of the Notes to the Financial Statements for details of the exercise prices and periods for each tranche of options. Of the above options, Tranche A options have vested.

No shares were issued on exercise of remuneration options

### 11. SHAREHOLDINGS OF DIRECTORS AND EXECUTIVE OFFICERS

Director	Date Appointed	Ordinary Shares	Percentage of total issued shares of SMS	Options remaining in issue at 30 June 2006
<b>Specified Directors</b>				
J R Walker	17 September 2003	100,000	0.048	100,000
R J Dean	21 July 2003	4,765,600	2.30	-
D A Forsyth	29 April 2004	400,000	0.19	400,000
M W G Vellacott	15 June 2005	-	-	750,000
<b>Specified Executives</b>				
M P Southern		60,000	0.029	510,000
C R McDonald		52,000	0.025	450,000
A R Chilcott		-	-	-
A C Lang		100,000	0.048	495,000
<b>Total</b>		<b>5,477,600</b>	<b>2.64</b>	<b>2,705,000</b>

### 12. AUDITORS

Details of the amounts paid to the auditor of the Company, PKF (UK) LLP, and other auditors for audit and non-audit services provided during the year are set out below.

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Amounts received or due and receivable by PKF (UK) LLP for:				
• an audit or review of the financial report of the entity and the Group	37,308	45,165	37,308	45,165
Amounts received or due and receivable by PKF Perth for:				
• an audit or review of the financial report of the principal trading subsidiary	40,503	55,600	34,033	35,368
• other services in relation to the entity and any other entity in the consolidated entity				
(a) tax compliance	12,403	44,566	3,000	12,425
(b) corporate advice	-	11,988	-	11,988
(c) government grant R&D	7,400	3,788	-	-
	97,614	161,107	74,341	104,946

## **DIRECTORS' REPORT (continued)**

### **13. INFORMATION GIVEN TO AUDITORS**

Each of the directors has confirmed that so far as he is aware, there is no relevant audit information of which the company's auditors are unaware, and that he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

### **14. CREDITOR PAYMENT POLICY**

The Group's policy during the year was to pay suppliers in accordance with agreed terms and this policy will continue for the year ended 30 June 2007. The Group does not follow a specific code or standard in respect of such creditors. As at 30 June 2006, the Group's trade creditors represented 32 days' purchases.

### **15. FINANCIAL INSTRUMENTS**

The company does not actively use financial instruments as part of its financial risk management. It is exposed to the usual credit risk and cash flow risk associated with selling on credit and manages this through credit control procedures. The nature of its financial instruments means that they are not subject to price risk or liquidity risk.

As a result of operations in both the United Kingdom and Australia, the Group's balance sheet can be affected by movements in the UK£/A\$ exchange rates.

The Group also has transactional currency exposures. Such exposure arises from sales or purchases by an operating unit in currencies other than the unit's measurement currency.

The foreign currency risk exposure is not deemed to be significant at this time although the risk could increase in the future as international commercialisation of the Group's technologies increase. There is currently no form of currency hedging or risk strategy in place, but this policy will be reviewed and strategies implemented when deemed prudent.

### **16. INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

Prior to 2005, the Group prepared its audited financial statements and half-year financial statements under UK Generally Accepted Accounting Practice (UK GAAP) principles. From 1 July 2005, the Group has prepared annual consolidated financial statements in accordance with IFRSs as adopted by the European Union. As the 2006 annual financial statements include comparatives with 2005, the Group's date of transition to IFRSs was 1 July 2004 and the 2005 comparatives are restated according to IFRSs.

Reconciliations of IFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report are detailed in Note 2 (s) of the Notes to the Financial Statements.

By Order of the Board

Mark Vellacott  
Executive Director

## Income Statement

FOR THE YEAR ENDED 30 JUNE 2006

	Notes	CONSOLIDATED		PARENT	
		2006	2005	2006	2005
		\$	\$	\$	\$
<b>Continuing Operations</b>					
<b>Revenue</b>					
Sale of goods		1,128,650	543,543	126,769	76,175
Cost of Sales		(470,948)	(67,486)	-	(5,659)
<b>Gross profit</b>					
Other Income	4(a)	997,430	52,078	-	-
Impairment charges	9	-	(19,671,437)	-	(24,485,234)
Depreciation charges		(142,737)	(136,600)	(4,446)	(4,755)
Occupancy expenses		(91,230)	(88,982)	(619)	(1,461)
Marketing expenses		(618,644)	(804,742)	(17,118)	(11,325)
Research and development expenses		(2,875,511)	(2,297,091)	(388,228)	(468,474)
Selling expenses		(15,058)	(10,106)	-	-
Administrative expenses		(1,829,369)	(1,462,236)	(308,073)	(349,181)
<b>Loss from continuing operations before income tax and finance costs</b>					
Finance income	4(c)	158,859	163,894	777	791
Finance costs	4(b)	(11,556)	(4,310)	-	(54)
Income tax expense	5	-	-	-	-
<b>Loss after finance costs and tax from continuing operations</b>					
		(3,770,114)	(23,783,475)	(590,938)	(25,249,177)
<b>Loss attributable to members of the parent</b>					
		(3,770,114)	(23,783,475)	(590,938)	(25,249,177)
Earnings per share (\$ per share)	6				
- basic for loss from continuing operations		(0.0186)	(0.1347)	-	-

## Statement of Total Recognised Income and Expenditure

FOR THE YEAR ENDED 30 JUNE 2006

Loss after finance costs and tax from continuing operations	(3,770,114)	(23,783,475)	(590,938)	(25,249,177)
Currency translation differences	418,609	(487,480)	418,609	(487,480)
<b>Total recognised losses since the last annual report</b>	<b>(3,351,505)</b>	<b>(24,270,955)</b>	<b>(172,329)</b>	<b>(25,736,657)</b>

## Balance Sheet

AS AT 30 JUNE 2006

	Note s	CONSOLIDATED		PARENT	
		2006 \$	2005 \$	2006 \$	2005 \$
<b>ASSETS</b>					
<b>Non-Current Assets</b>					
Property, plant and equipment	7	319,637	358,709	16,370	20,816
Other financial assets	8	-	-	8,291,680	4,920,040
<b>Total Non-current assets</b>		<b>319,637</b>	<b>358,709</b>	<b>8,308,050</b>	<b>4,940,856</b>
<b>Current Assets</b>					
Inventories	12	58,409	23,682	-	-
Prepayments		145,533	161,464	-	-
Trade and other receivables	13	390,236	102,308	968	1,342
Cash and cash equivalents		2,762,052	2,592,737	6,014	47,704
<b>Total Current Assets</b>		<b>3,356,230</b>	<b>2,880,191</b>	<b>6,982</b>	<b>49,046</b>
<b>TOTAL ASSETS</b>		<b>3,675,867</b>	<b>3,238,900</b>	<b>8,315,032</b>	<b>4,989,902</b>
<b>LIABILITIES</b>					
<b>Current Liabilities</b>					
Trade and other payables	17	843,397	586,841	20,920	27,411
Provisions	18	150,615	108,144	55,116	40,611
<b>Total Current Liabilities</b>		<b>994,012</b>	<b>694,985</b>	<b>76,036</b>	<b>68,022</b>
<b>TOTAL LIABILITIES</b>		<b>994,012</b>	<b>694,985</b>	<b>76,036</b>	<b>68,022</b>
<b>NET ASSETS</b>		<b>2,681,855</b>	<b>2,543,915</b>	<b>8,238,996</b>	<b>4,921,880</b>
<b>EQUITY</b>					
<b>Equity attributable to equity holders of the parent</b>					
Issued capital	19	24,841,678	21,327,114	24,841,678	21,327,114
Share premium account	19	9,691,094	9,759,465	9,691,094	9,759,465
Accumulated losses		(31,987,410)	(28,217,296)	(26,430,269)	(25,839,331)
Other reserves	19	136,493	(325,368)	136,493	(325,368)
<b>TOTAL EQUITY</b>		<b>2,681,855</b>	<b>2,543,915</b>	<b>8,238,996</b>	<b>4,921,880</b>

Approved by the Board and authorised for issue on 28 September 2006

.....  
Director

## Cash Flow Statement

FOR THE YEAR ENDED 30 JUNE 2006

	Notes	CONSOLIDATED		PARENT	
		2006	2005	2006	2005
		\$	\$	\$	\$
<b>Cash flows from operating activities</b>					
Receipts from customers		827,093	521,593	127,143	76,174
Payments to suppliers and employees		(5,175,370)	(5,298,420)	(662,660)	(1,345,596)
Receipt of government grants		968,358	-	-	-
Other income		29,072	-	-	-
<b>Net cash flows from/(used in) operating activities</b>	14	<b>(3,350,847)</b>	<b>(4,776,827)</b>	<b>(535,517)</b>	<b>(1,269,422)</b>
<b>Cash flows from investing activities</b>					
Interest received		158,859	163,894	777	791
Finance costs		(11,556)	(4,310)	-	(54)
Proceeds from sale of property, plant and equipment		3,182	1,391	-	-
Purchase of property, plant and equipment		(102,305)	(114,968)	-	(2,949)
<b>Net cash flows from/(used in) investing activities</b>		<b>48,180</b>	<b>46,007</b>	<b>777</b>	<b>(2,212)</b>
<b>Cash flows from financing activities</b>					
Proceeds from issue of shares	19	3,446,193	4,551,997	3,446,193	4,551,997
Loan to subsidiary		-	-	(3,371,640)	(3,224,890)
<b>Net cash flows from/(used in) financing activities</b>		<b>3,446,193</b>	<b>4,551,997</b>	<b>74,553</b>	<b>1,327,107</b>
Net increase/(decrease) in cash and cash equivalents		143,526	(178,823)	(460,187)	55,473
Net foreign exchange differences		25,789	49,838	418,497	-
Cash and cash equivalents at beginning of year		2,592,737	2,721,722	47,704	(7,769)
<b>Cash and cash equivalents at end of year</b>	14	<b>2,762,052</b>	<b>2,592,737</b>	<b>6,014</b>	<b>47,704</b>

## Statement Of Changes In Equity

FOR THE YEAR ENDED 30 JUNE 2006

### CONSOLIDATED

#### At 1 July 2004

Currency translation differences

Profit/(loss) for the year

Issue of shares

#### At 30 June 2005

Currency translation differences

Profit/(loss) for the year

Issue of share capital

Cost of share issues

Cost of share based payments

#### At 30 June 2006

	Issued capital	Accumulated losses	Share Premium Reserve Note 19	Other Reserves Note 19	Total
<b>At 1 July 2004</b>	18,735,051	(4,433,821)	7,799,531	162,112	22,262,873
Currency translation differences	-	-	-	(487,480)	(487,480)
Profit/(loss) for the year	-	(23,783,475)	-	-	(23,783,475)
Issue of shares	2,592,063	-	1,959,934	-	4,551,997
<b>At 30 June 2005</b>	21,327,114	(28,217,296)	9,759,465	(325,368)	2,543,915
Currency translation differences	-	-	-	418,609	418,609
Profit/(loss) for the year	-	(3,770,114)	-	-	(3,770,114)
Issue of share capital	3,514,564	-	10,936	-	3,525,500
Cost of share issues	-	-	(79,307)	-	(79,307)
Cost of share based payments	-	-	-	43,252	43,252
<b>At 30 June 2006</b>	24,841,678	(31,987,410)	9,691,094	136,493	2,681,855

### PARENT

#### At 1 July 2004

Profit/(loss) for the year

Currency translation differences

Issue of shares

#### At 30 June 2005

Currency translation differences

Profit/(loss) for the year

Issue of share capital

Cost of share issues

Cost of share based payments

#### At 30 June 2006

	Issued capital	Accumulated losses	Share Premium Reserve Note 19	Other Reserves Note 19	Total
<b>At 1 July 2004</b>	18,735,051	(590,154)	7,799,531	162,112	26,106,540
Profit/(loss) for the year	-	(25,249,177)	-	-	(25,249,177)
Currency translation differences	-	-	-	(487,480)	(487,480)
Issue of shares	2,592,063	-	1,959,934	-	4,551,997
<b>At 30 June 2005</b>	21,327,114	(25,839,331)	9,759,465	(325,368)	4,921,880
Currency translation differences	-	-	-	418,609	418,609
Profit/(loss) for the year	-	(590,938)	-	-	(590,938)
Issue of share capital	3,514,564	-	10,936	-	3,525,500
Cost of share issues	-	-	(79,307)	-	(79,307)
Cost of share based payments	-	-	-	43,252	43,252
<b>At 30 June 2006</b>	24,841,678	(26,430,269)	9,691,094	136,493	8,238,996

# Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2006

---

## CORPORATE INFORMATION

The financial report of Structural Monitoring Systems Plc for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors on 28 September 2006.

Structural Monitoring Systems Plc is a company limited by shares incorporated in the United Kingdom whose shares are publicly traded on the Australian Stock Exchange.

## 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of Preparation

The consolidated financial statements and those of the parent entity are presented in Australian dollars and have been prepared on the historical cost basis or the fair value basis where the fair valuing of relevant assets and liabilities has been applied. The exchange rate at the balance sheet date was £1:\$2.49, and the average for the year was £1:\$2.38.

Prior to 2005, the Group prepared its audited financial statements and half-year financial statements under UK Generally Accepted Accounting Practice (UK GAAP) principles. From 1 July 2005, the Group has prepared annual consolidated financial statements in accordance with IFRSs as adopted by the European Union. As the 2006 annual financial statements include comparatives with 2005, the Group's date of transition to IFRSs was 1 July 2004 and the 2005 comparatives are restated according to IFRSs.

The financial statements have been prepared on the basis that the Group and the parent company are a going concern. In considering the appropriateness of this basis for preparing the financial statements, the Board has carefully considered the current standing of its existing products and those that are currently being developed, the Group's sales pipeline, its expected working capital requirements and when needed, the Group's access to appropriate sources of funding. The Group's technologies and practices are now established and are endorsed by a number of credible contracts. Our CVM™ Periodic Monitoring system is currently being qualified by Boeing and the FAA with durability and performance trials completing in 2006. Once qualification is achieved the Group should be able to significantly increase the revenues it is able to earn from major aircraft manufacturers and airlines, together with revenues that will be earned from the military aircraft sector and other potential customers outside the aviation industry. Interest in the Group's products and services thus remains strong.

The Board believe that it is essential that the Group continues to invest in its current and developing product range and, as a Company that is listed on the Australian Stock Exchange, your Board is able to access funding to provide additional working capital, should this be needed, to cover the period until the Group is cash flow neutral or positive. Cash flow is monitored closely and the Directors have identified a number of potential funding alternatives to ensure that the Company is financed using the most appropriate source of funds. The Board also recognise that the cost base of the Group is sufficiently scalable that it can be actively managed during the period when the group is commercialising its technology.

Taking all of these factors together, your Board remain satisfied that it is appropriate to prepare the accounts on the basis that the group is a going concern.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

---

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (b) Statement of compliance

The consolidated financial statements and the financial statements of the parent company have been prepared in accordance with International Financial Reporting Standards ('IFRS') and its interpretations adopted by the International Accounting Standards Board (IASB), which are the same as those adopted by the European Union.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated and parent entity financial statements and in preparing an opening IFRS balance sheet at 1 July 2004 for the purposes of the transition to IFRSs.

A detailed explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the Group are provided in Note 2 (t).

#### (c) Basis of consolidation

The consolidated financial statements comprise the financial statements of Structural Monitoring Systems Plc and its subsidiaries as at 30 June each year ('the Group').

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

Adjustments are made to bring into line any dissimilar accounting policies that may exist.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

#### (d) Foreign currency translation

The presentation currency of the group is Australian dollars (\$AUD). The functional currency of Structural Monitoring Systems Plc is pounds sterling and the functional currency of its Australian subsidiary is Australian dollars.

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

As at the reporting date the assets and liabilities of the group are translated into the presentation currency of Structural Monitoring Systems Plc at the rate of exchange ruling at the balance sheet date and the income statements are translated at the weighted average exchange rates for the year. The exchange difference arising on translation is taken directly to a separate component of equity.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (e) Property, plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

Depreciation is calculated on a straight-line basis to write off the cost less estimated residual value over the estimated useful life of the asset as follows:

The principal annual rates used for this purpose are 6.66% - 40% for plant, equipment and other assets.

Leasehold buildings and improvements are written off over the period of the lease.

#### *Impairment*

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

#### (f) Goodwill

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortised.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

#### (g) Intangible Assets

- (i) Research and patent costs are expensed as incurred.
- (ii) Development expenditure incurred is carried forward when its future recoverability can reasonably be regarded as assured.

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 carried forward is amortised over the period of expected future sales from the related project.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use or more frequently when an indicator of impairment arises during the reporting year indicating that the carrying value may not be recoverable.

A summary of the policies applied to the Group's intangible assets is as follows:

	<b><i>Technology Licence</i></b>	<b><i>Patents and Licences</i></b>
<i>Useful lives</i>	<i>Indefinite</i>	<i>Finite</i>
<i>Method used</i>	<i>5 years – Straight line</i>	<i>5 years- Straight line</i>
<i>Internally generated/ Acquired</i>	<i>Acquired</i>	<i>Acquired</i>
<i>Impairment test / Recoverable amount testing</i>	<i>The balance has been fully amortised</i>	<i>The balance has been fully amortised</i>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

---

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (h) Other financial assets

At each reporting date, the Group assesses the value of other financial assets for any indication that the asset may be impaired. Refer to note 2 (i) for the policy on recoverable amounts of assets.

The terms, conditions and circumstances of loans between entities in the Group are assessed at each reporting date to determine whether the loan is more likely to be in the nature of an investment, and if so, the loans are reclassified accordingly.

#### (i) Recoverable amount of assets

At each reporting date, the group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

Recoverable amount is the greater of fair value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

#### (j) 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.

#### (k) Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

#### (l) Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity 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.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

---

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (m) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, 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.

Where 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.

#### (n) Share-based payment transactions

The Group provides benefits to employees (including executive directors) of the Group in the form of share-based payment transactions, whereby employees render services in exchange for rights over shares ('equity-settled transactions').

There is currently one plan in place to provide these benefits, the Employee Share Option Plan (ESOP), which provides benefits to directors and employees.

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. Refer to note 15 for details of the determination of the fair value.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Structural Monitoring Systems Plc ('market conditions').

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 the extent to which the vesting period has expired. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

#### (o) Revenue

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:

##### *Sale of goods*

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

#### (p) Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

The gross amount of grants received are recognised as Other Income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

---

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (q) Income tax

The charge for taxation is based on the profit or loss for the year and takes into account deferred tax. Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit or loss, and is accounted for using the balance sheet method. Deferred tax assets are only recognised to the extent that it is probable that future taxable profit will be available in the foreseeable future against which the temporary differences can be utilised.

#### (r) Other taxes

Revenues, expenses and assets are recognised net of the amount of VAT/GST except:

- where the VAT/GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the VAT/GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables are stated with the amount of VAT/GST included.

The net amount of VAT/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 VAT/GST component of cash flows arising from investing and financing 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 VAT/GST recoverable from, or payable to, the taxation authority

#### (s) Employee Entitlements

- (i) Provision is made for long service and annual leave payable to employees on the basis of relevant statutory requirements or contractual entitlements applicable in Australia.
- (ii) The Group has applied the requirements of IFRS 2 (share based payments) to all equity instruments granted after 7 November 2002.

Group employees are rewarded with share based options. These are stated at fair value at the date of grant and this is expensed on a straight line basis over the estimated vesting period, which is based on the exercise period of the options.

Fair value is estimated using the Black-Scholes valuation model. The assumptions made in determining the fair value of the options granted in the year to 30 June 2006 are set out in Note 15.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (t) Impact of adoption of IFRS

The impacts of adopting IFRS on the total equity and profit after tax as reported under previous United Kingdom Generally Accepted Accounting Practice (“UK GAAP”) are illustrated below.

There are no material differences between the cash flow statement presented under IFRS and the cash flow statement presented under previous UK GAAP.

#### Reconciliation of total equity as presented under previous UK GAAP to that under IFRS

	CONSOLIDATED		PARENT	
	30-Jun-05 \$'000	1-Jul-04 \$'000	30-Jun-05 \$'000	1-Jul-04 \$'000
Total equity under UK GAAP	2,543,915	22,262,873	4,921,880	26,106,540
<i>Adjustments to retained earnings (net of tax):</i>				
Derecognition of amortisation charge	1,043,436	-	1,043,436	-
Recognition of impairment charge	(1,043,436)	-	(1,043,436)	-
Total equity under IFRS	<u>2,543,915</u>	<u>22,262,873</u>	<u>4,921,880</u>	<u>26,106,540</u>

#### Reconciliation of profit before tax under previous UK GAAP to that under IFRS

	CONSOLIDATED	PARENT
	30-Jun-05 \$'000	30-Jun-05 \$'000
Prior year loss before tax as previously reported	(23,783,475)	(25,249,177)
Derecognition of amortisation charge	1,043,436	1,043,436
Recognition of impairment charge	(1,043,436)	(1,043,436)
Prior year profit before tax under IFRS	<u>(23,783,475)</u>	<u>(25,249,177)</u>

Prior to the adoption of IFRS, the carrying value of goodwill was amortised over the useful life of the asset. At 30 June 2005 an impairment charge was applied to bring the carrying value of goodwill down to nil, therefore the amortisation charge that had been applied in that year was reclassified as an impairment charge.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 3 SEGMENT INFORMATION

The Group's primary reporting format is geographical segments. The Group does not report by business segment as it is involved in one segment only, the development and commercialisation of its structural health monitoring technology.

#### Geographical segments

The Group's geographical segments are determined by the location of the Group's assets and operations.

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

	<i>Australia</i>	<i>UK/Europe</i>	<i>Total</i>
<b>Year ended 30 June 2006</b>			
<b>Revenue</b>			
Sales to external customers	1,001,881	126,769	1,128,650
Finance income	158,082	777	158,859
Other revenues from external parties	997,430	-	997,430
Revenue from continuing operations	2,157,393	127,546	2,284,939
Inter-segment sales	-	-	-
Segment revenue	2,157,393	127,546	2,284,939
<b>Sales revenue by customer location</b>			
Australia	31,300	-	31,300
Asia	515,347	-	515,347
Europe	455,234	126,769	582,003
Total revenue	1,001,881	126,769	1,128,650
<b>Result</b>			
Segment result	(3,179,353)	(590,761)	(3,770,114)
Unallocated expenses	-	-	-
Loss before tax	(3,179,353)	(590,761)	(3,770,114)
Income tax expense	-	-	-
Loss for the year	(3,179,353)	(590,761)	(3,770,114)
<b>Assets and liabilities</b>			
Segment assets	3,652,515	23,352	3,675,867
Unallocated assets	-	-	-
Total assets	3,652,515	23,352	3,675,867
Segment liabilities	917,976	76,036	994,012
Unallocated liabilities	-	-	-
Total liabilities	917,976	76,036	994,012
<b>Other segment information</b>			
Capital expenditure	96,199	-	96,199
Depreciation	138,291	4,446	142,737

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 3 SEGMENT INFORMATION (continued)

Year ended 30 June 2005	Australia	UK/Europe	Total
<b>Revenue</b>			
Sales to external customers	467,368	76,175	543,543
Finance income	163,103	791	163,894
Other revenues from external parties	52,078	-	52,078
Revenue from continuing operations	682,549	76,966	759,515
Inter-segment sales	-	-	-
Segment revenue	682,549	76,966	759,515
<b>Sales revenue by customer location</b>			
Australia	241,283	-	241,283
Asia	-	-	-
Europe	226,085	76,175	302,260
Total sales revenue	467,368	76,175	543,543
<b>Assets and liabilities</b>			
Segment assets	3,169,038	69,862	3,238,900
Unallocated assets	-	-	-
Total assets	3,169,038	69,862	3,238,900
Segment liabilities	626,963	68,022	694,985
Unallocated liabilities	-	-	-
Total liabilities	626,963	68,022	694,985
<b>Other segment information</b>			
Capital expenditure	121,507	2,949	124,456
Depreciation	131,845	4,755	136,600
Impairment charge	-	19,671,438	19,671,438
Amortisation	-	151,894	151,894

### 4 INCOME AND EXPENSES

#### (a) Other income

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
AusIndustry Commercial Ready grant	968,358	-	-	-
Export Market Development grant	-	52,078	-	-
Insurance refund	29,072	-	-	-
	997,430	52,078	-	-

An AusIndustry Commercial Ready grant has been received to assist with commercialisation and marketing of the CVM™ technology.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 4 REVENUES AND EXPENSES (continued)

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
<b>(b) Finance costs</b>				
Interest expense	11,556	4,310	-	54
<b>(c) Finance income</b>				
Bank interest receivable	158,859	163,894	777	791
<b>(d) Depreciation, amortisation and foreign exchange differences included in income statement</b>				
Included in cost of sales:				
Depreciation	142,737	136,600	4,446	4,755
Impairment of goodwill	-	19,671,437	-	-
Impairment of investments	-	-	-	24,485,234
Amortisation of intangible assets	-	151,894	-	151,894
Net foreign exchange differences	(25,789)	147,100	(418,609)	487,480
<b>(e) Lease payments and other expenses included in income statement</b>				
Included in administrative expenses:				
Charges in respect of operating leases	4,614	-	-	-
<b>(f) Employee benefits expense</b>				
Wages and salaries	2,328,647	2,182,607	427,730	471,808
Workers' compensation costs	22,193	21,910	-	-
Superannuation costs	148,846	140,903	-	-
Social security costs	50,198	95,758	50,198	95,758
Expense of share-based payments (Note 15)	31,186	-	31,186	-
	<u>2,581,070</u>	<u>2,441,178</u>	<u>509,114</u>	<u>567,566</u>
<b>Average monthly number of employees</b>	No	No	No	No
Administration	4	4	-	-
Business development	3	2	2	2
Operations and technical	18	15	-	-
Total average employees	<u>25</u>	<u>21</u>	<u>2</u>	<u>2</u>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
<b>4 REVENUES AND EXPENSES (continued)</b>				
<b>g) Research and development costs</b>				
Research and development costs charged	2,599,751	2,297,019	392,674	468,474

### 5 INCOME TAX

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 2005 is as follows:

Accounting loss before tax from continuing operations	(3,770,114)	(23,783,475)	(590,938)	(25,249,177)
Accounting loss before income tax	<u>(3,770,114)</u>	<u>(23,783,475)</u>	<u>(590,938)</u>	<u>(25,249,177)</u>
At the statutory income tax rate of 30% (2005: 30%)	(1,131,034)	(7,135,043)	(177,281)	(7,574,753)
Expenditure not allowable for income tax purposes	45,415	5,768,845	14,918	7,346,320
Tax losses not brought to account as a deferred tax asset	1,165,277	1,433,652	326,852	255,593
Temporary differences not brought to account as a deferred tax asset	(79,658)	(67,454)	(164,489)	(27,160)
Income tax expense reported in income statement	-	-	-	-
(At effective income tax rate of 0% (2005: 0%))	-	-	-	-

#### Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Provisions	65,027	50,011	21,424	17,732
Business expenditure (sec 40-880)	183,890	280,052	127,579	170,105
Other temporary differences	56,233	51,358	(128,741)	32,431
Tax losses	<u>7,268,149</u>	<u>6,102,871</u>	<u>770,366</u>	<u>443,514</u>

The tax losses and deductible temporary differences do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available in the foreseeable future against which the Group can utilise the benefits therefrom.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

---

### 6 EARNINGS PER SHARE

Basic earnings per share amounts are calculated by dividing net profit 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 shareholders by the weighted average number of ordinary shares outstanding during the year (adjusted for the effects of dilutive options).

The following reflects the income and share data used in the total operations basic earnings per share computations:

	<i>CONSOLIDATED</i>	
	<i>2006</i>	<i>2005</i>
	\$	\$
Net loss attributable to equity holders from continuing operations	(3,770,114)	(23,783,475)
	<i>Number of</i>	<i>Number of</i>
	<i>shares</i>	<i>Shares</i>
Weighted average number of ordinary shares for basic earnings per share	202,161,487	176,519,262

There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of these financial statements.

The options in issue are anti-dilutive and therefore diluted and undiluted EPS are the same.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 7 PROPERTY, PLANT AND EQUIPMENT

	CONSOLIDATED			PARENT		
	Leasehold Improvements \$	Plant and equipment \$	Total \$	Leasehold Improvements \$	Plant and equipment \$	Total \$
<b>Year ended 30 June 2006</b>						
<b>Cost</b>						
At 1 July 2005	107,627	620,031	727,658	-	27,619	27,619
Additions	2,984	93,215	96,199	-	-	-
Disposals	-	(7,389)	(7,389)	-	-	-
Writeoff obsolete equipment	-	(3,017)	(3,017)	-	-	-
Reclassify inventory to plant and equipment	-	13,745	13,745	-	-	-
<b>At 30 June 2006</b>	<b>110,611</b>	<b>716,585</b>	<b>827,196</b>	<b>-</b>	<b>27,619</b>	<b>27,619</b>
<b>Depreciation</b>						
At 1 July 2005	80,593	288,356	368,949	-	6,803	6,803
Charge for the year	16,514	126,223	142,737	-	4,446	4,446
Eliminated on disposal	-	(4,127)	(4,127)	-	-	-
<b>At 30 June 2006</b>	<b>97,107</b>	<b>410,452</b>	<b>507,559</b>	<b>-</b>	<b>11,249</b>	<b>11,249</b>
<b>Net book value at 30 June 2006</b>	<b>13,504</b>	<b>306,133</b>	<b>319,637</b>	<b>-</b>	<b>16,370</b>	<b>16,370</b>
<b>Year ended 30 June 2005</b>						
<b>Cost</b>						
At 1 July 2004	98,259	532,615	630,874	-	24,670	24,670
Additions	9,368	115,088	124,456	-	2,949	2,949
Disposals	-	(27,672)	(27,672)	-	-	-
<b>At 30 June 2005</b>	<b>107,627</b>	<b>620,031</b>	<b>727,658</b>	<b>-</b>	<b>27,619</b>	<b>27,619</b>
<b>Depreciation</b>						
At 1 July 2004	50,244	196,091	246,335	-	2,048	2,048
Charge for the year	30,349	106,251	136,600	-	4,755	4,755
Eliminated on disposal	-	(13,986)	(13,986)	-	-	-
<b>At 30 June 2005</b>	<b>80,593</b>	<b>288,356</b>	<b>368,949</b>	<b>-</b>	<b>6,803</b>	<b>6,803</b>
<b>Net book value at 30 June 2005</b>	<b>27,034</b>	<b>331,675</b>	<b>358,709</b>	<b>-</b>	<b>20,816</b>	<b>20,816</b>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 8 OTHER FINANCIAL ASSETS (NON-CURRENT)

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Loan to subsidiary undertaking	-	-	-	4,920,040
Investment in subsidiary undertaking	-	-	8,219,680	-
	-	-	8,291,680	4,920,040

Included in the consolidation are the following wholly-owned subsidiaries:  
Structural Monitoring Systems Ltd (registered in Australia)  
Structural Health Monitoring Ltd (registered in United Kingdom)  
Structural Monitoring Systems Inc (registered in USA)

	CONSOLIDATED		PARENT	
	Total	Loan to Subsidiary Undertaking	Investment in Subsidiary Undertaking	Total
	\$	\$	\$	\$
<b>Year ended 30 June 2006</b>				
<b>Cost</b>				
At 1 July 2005	-	4,920,040	24,485,234	29,405,274
Additions during the year	-	3,371,640	-	3,371,640
Reclassification of loan as investment	-	(8,291,680)	8,291,680	-
<b>At 30 June 2006</b>	-	-	32,776,914	32,776,914
<b>Impairment</b>				
At 1 July 2005	-	-	24,485,234	24,485,234
Impairment charge	-	-	-	-
<b>Net carrying amount at 30 June 2006</b>	-	-	8,291,680	8,291,680
<b>Year Ended 30 June 2005</b>				
<b>Cost</b>				
At 1 July 2004	-	1,590,921	24,485,234	26,076,155
Additions during the year	-	3,329,119	-	3,329,119
<b>At 30 June 2005</b>	-	4,920,040	24,485,234	29,405,174
<b>Impairment</b>				
At 1 July 2004	-	-	-	-
Impairment charge	-	-	24,485,234	24,485,234
<b>Net carrying amount at 30 June 2005</b>	-	4,920,040	-	4,920,040

The intercompany loan has been reclassified as an investment as at 30 June 2006 based on the assessment of the terms, conditions and circumstances of the loan. There are no set repayment dates and estimated future cashflows can not be determined for the loan. The intention is to make the loan available indefinitely. Therefore the loan is likely to be the nature of an investment.

In 2005 the directors resolved to state the investment at Nil, resulting in an impairment charge to the operating results of the Company of \$24,485,234.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 9 GOODWILL ARISING ON CONSOLIDATION

	GOODWILL ARISING ON CONSOLIDATION	
	\$	\$
<b>Year ended 30 June 2006</b>		
<b>Cost</b>		
At 1 July 2005	-	20,868,694
Additions	-	-
<b>At 30 June 2006</b>	-	20,868,694
<b>Impairment</b>		
At 1 July 2005	-	20,868,694
Impairment charge	-	-
<b>At 30 June 2006</b>	-	20,868,694
<b>Net book value at 30 June 2006</b>	-	-
<b>Year ended 30 June 2005</b>		
<b>Cost</b>		
At 1 July 2004	-	20,868,694
Additions	-	-
<b>At 30 June 2005</b>	-	20,868,694
<b>Impairment</b>		
At 1 July 2004	-	1,197,256
Impairment charge	-	19,671,438
<b>At 30 June 2005</b>	-	20,868,694
<b>Net book value at 30 June 2005</b>	-	-

### 10 IMPAIRMENT TESTING OF GOODWILL AND INVESTMENTS

The directors reviewed the carrying values of goodwill on consolidation and the investment in the wholly owned subsidiary Structural Monitoring Systems Limited at 30 June 2005. It was decided that the values would be treated as fully impaired, as discounted net cash flow calculations that would support a higher valuation are not able to be reliably estimated due to a lack of historical cashflows and difficulties in determining the size of future revenues. This resulted in a charge to the consolidated operating loss of \$19,671,437 for the impairment in value of goodwill on consolidation, and a charge to the Company's operating loss of \$24,485,234 for the impairment of the value of the investment.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 11 INTANGIBLE ASSETS

	CONSOLIDATED		PARENT	
	<i>Technology Licence</i> \$	<i>Patents and licenses</i> \$	<i>Total</i> \$	<i>Total</i> \$
<b>Year ended 30 June 2006</b>				
<b>Cost</b>				
At 1 July 2005 and 30 June 2006	125,000	1,760,616	1,885,616	-
<b>Amortisation</b>				
At 1 July 2005 and 30 June 2006	125,000	1,760,616	1,885,616	-
<b>Net book value at 30 June 2006</b>	-	-	-	-
<b>Year ended 30 June 2005</b>				
At 1 July 2004 and 30 June 2005	125,000	1,760,616	1,885,616	-
<b>Amortisation</b>				
At 1 July 2004	112,500	1,621,222	1,733,722	-
Charge for the year	12,500	139,394	151,894	-
<b>At 30 June 2005</b>	125,000	1,760,616	1,885,616	-
<b>Net book value at 30 June 2005</b>	-	-	-	-

### 12 INVENTORIES

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Work-in-progress (at cost)	45,986	19,500	-	-
Finished goods (at net realisable value)	12,423	4,182	-	-
<b>Total inventories at lower of cost and net realisable value</b>	<b>58,409</b>	<b>23,682</b>	-	-

### 13 TRADE AND OTHER RECEIVABLES (CURRENT)

Trade receivables	390,236	102,308	968	1,342
Provision for doubtful debts	-	-	-	-
	<b>390,236</b>	<b>102,308</b>	<b>968</b>	<b>1,342</b>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 14 RECONCILIATION FROM THE NET LOSS AFTER TAX TO THE NET CASH FLOWS FROM OPERATIONS

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Net Loss	(3,770,114)	(23,783,475)	(590,938)	(25,249,177)
<i>Adjustments for:</i>				
Finance income	(158,859)	(163,894)	(777)	(791)
Finance costs	11,556	4,310	-	54
Depreciation and amortisation	142,737	288,495	4,446	4,755
Impairment losses	-	19,671,437	-	24,485,234
Net (profit)/loss on disposal of plant and equipment	-	2,807	-	-
Writeoffs and adjustments in carrying value of plant and equipment	(7,468)	-	-	-
Currency translation	392,775	(537,318)	113	(486,690)
Share options expensed	43,252	-	43,252	-
<i>Changes in assets and liabilities</i>				
(increase)/decrease in inventories	(31,744)	41,537	-	-
(increase)/decrease in trade and other receivables	(251,866)	26,409	4,179	3,215
(increase)/decrease in prepayments	15,957	-	-	(1,342)
(decrease)/increase in trade and other payables	262,927	(327,135)	4,208	(24,680)
Net cash from operating activities	<u>(3,350,847)</u>	<u>(4,776,827)</u>	<u>(535,517)</u>	<u>(1,269,422)</u>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 15 EMPLOYEE BENEFITS

#### (a) Employees share option plan

The Group has an employee share options plan (ESOP) for the granting of non-transferable options to executive directors and employees with more than six months' service at the grant date.

Options are issued under the ESOP in three tranches.

1. Tranche A options are exercisable at any time between 1 September 2005 and 31 August 2007 at 20 cents each.
2. Tranche B options are exercisable at any time between 1 September 2006 and 31 August 2008 at 25 cents each.
3. Tranche C options are exercisable at any time between 1 September 2007 and 31 August 2009 at 30 cents each.

The options are cancelled upon the director or employee leaving the service of the Group..

The following options were granted during the year ended 30 June 2006.

Date of allotment	Tranche A		Tranche B		Tranche C		Total	
	Number of options	Fair Value \$	Number of options	Fair Value \$	Number of options	Fair Value \$	Number of options	Fair Value \$
22 Dec 2005	872,000	10,935	872,000	8,705	871,999	3,768	2,615,999	23,408
8 Feb 2006	275,000	2,344	275,000	1,809	275,000	707	825,000	4,860
25 March 2006	232,667	1,458	232,667	1,083	232,667	377	698,001	2,918
<b>Total</b>	<b>1,379,667</b>	<b>14,737</b>	<b>1,379,667</b>	<b>11,597</b>	<b>1,379,666</b>	<b>4,852</b>	<b>4,139,000</b>	<b>31,186</b>

The fair value of the options are estimated at the date of grant using the Black Scholes option value method. The following table gives the assumptions made in determining the fair value of the options granted in the year to 30 June 2006.

	<u>2006</u>
Interest rate (%)	5.25
Expected volatility (%)	50
Expected life of option (years)	Over vesting period of each tranche
Option exercise price (\$)	20c/25c/30c
Share price at grant date (\$)	
22 December 2005	12.5 c
8 February 2006	12 c
25 March 2006	11 c

During the year ended 30 June 2006, no options were exercised over ordinary shares.

#### b) Pensions and other post-employment benefit plans

The Company is below the threshold requiring it to maintain a Stakeholder Pension for its UK employees and there is no equivalent legislation in Australia. Accordingly, the Group does not maintain a pension fund for its employees or directors.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 16 SHARE BASED PAYMENTS

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Employee benefits (note 15)	31,186	-	31,186	-
Expense recognised in income statement from other share based payments (i)	12,066	-	12,066	-
	<u>43,252</u>	<u>-</u>	<u>43,252</u>	<u>-</u>

(i) On 13 September 2005, the Company issued 1 million options exercisable at 20 cents each on or before 30 April 2007 to Western Aero Services Pty Ltd, a party related to a consultant, Mr Peter Schoonens. These options are provided as part of remuneration for consultancy services and as an incentive to Mr Schoonens. The options are unlisted and will only be listed and tradable upon the signing of a license agreement with Airbus.

The fair value of the options are estimated at the date of grant using the Black Scholes option value method. The following table gives the assumptions made in determining the fair value of the options granted to Western Aero Services Pty Ltd.

	2006
Interest rate (%)	5.25
Expected volatility (%)	50
Expected life of option (years)	To expiry date of 30 April 2007
Option exercise price (\$)	20c
Share price at grant date (\$) 13 September 2005	12.5 c

### 17 TRADE AND OTHER PAYABLES (CURRENT)

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Trade payables	359,442	199,781	-	-
Other payables	4,622	8,917	4,622	8,917
Accruals and deferred income	357,886	272,656	-	-
Payroll liabilities	121,447	105,487	16,298	18,494
	<u>843,397</u>	<u>586,841</u>	<u>20,920</u>	<u>27,411</u>

Trade payables are non-interest bearing and are normally settled on 60-day terms. Other payables are non-interest bearing and have an average term of 6 months.

### 18 PROVISIONS

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Provision for annual leave entitlements	125,787	95,799	43,743	32,477
Provision for on-costs on employee entitlements	24,828	12,345	11,373	8,134
	<u>150,615</u>	<u>108,144</u>	<u>55,116</u>	<u>40,611</u>

On-costs on employee entitlements include provision for workers compensation insurance, payroll tax and superannuation costs.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 19 ISSUED CAPITAL AND RESERVES

	2006 Number	2005 Number	2006 GBP	2005 GBP
<i>Authorised Capital</i>				
Ordinary shares of 5p each	500,000,000	500,000,000	25,000,000	25,000,000
	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	2006	2005	2006	2005
	\$	\$	\$	\$
<i>Ordinary Shares</i>				
Issued and fully paid	24,841,678	21,327,114	24,841,678	21,327,114
	<i>Shares in Issue</i>		\$	
<i>Movement in ordinary shares in issue</i>				
At 1 July 2004	158,142,679	18,735,051		
Issued on 31 July 2004 for cash	20,000,000	2,574,000		
Issued on 16 December 2004 as consideration for pre-IPO costs	138,889	18,063		
At 1 July 2005	178,281,568	21,327,114		
Issued on 2 September 2005 for cash	20,833,333	2,500,000		
Issued on 8 September 2005 for cash	5,833,335	700,000		
Issued on 15 September 2005 for cash pursuant to Share Purchase Plan	2,712,465	314,564		
At 30 June 2006	207,660,701	24,841,678		
<i>Share Premium Reserve</i>				
Share Premium Reserve	9,691,094	9,759,465	9,691,094	9,759,465
	<i>Shares in Issue</i>		\$	
<i>Movement in Share Premium Reserve</i>				
At 1 July 2004	158,142,679	7,799,531		
Issue for IPO 31 July 2004	20,000,000	2,426,000		
Issue as consideration IPO costs 16 December 2004	138,889	7,062		
Cost of issues		(473,128)		
At 1 July 2005	178,281,568	9,759,465		
Placement 2 September 2005	20,833,333	-		
Placement 8 September 2005	5,833,335	-		
Share Purchase Plan 15 September 2005	2,712,465	10,936		
Cost of issues		(79,307)		
At 30 June 2006	207,660,701	9,691,094		



## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 19 ISSUED CAPITAL AND RESERVES (continued)

The Company has a share option scheme under which options to subscribe for the company's shares have been granted to executive directors and employees (refer note 15).

<i>Other Reserves</i>	CONSOLIDATED				PARENT			
	<i>Share Premium Reserve</i>	<i>Option Reserve</i>	<i>Currency translation reserve</i>	<i>Total</i>	<i>Share Premium Reserve</i>	<i>Option Reserve</i>	<i>Currency translation reserve</i>	<i>Total</i>
	\$	\$	\$	\$	\$	\$	\$	\$
At 1 July 2004	7,799,531	-	162,112	7,961,643	7,799,531	-	162,112	7,961,643
Issue of shares	2,433,062	-	-	2,433,062	2,433,062	-	-	2,433,062
Currency translation differences	-	-	(487,480)	(487,480)	-	-	(487,480)	(487,480)
Cost of share issues	(473,128)	-	-	(473,128)	(473,128)	-	-	(473,128)
At 30 June 2005	9,759,465	-	(325,368)	9,434,097	9,759,465	-	(325,368)	9,434,097
Share issues	10,936	-	-	10,936	10,936	-	-	10,936
Cost of share issues	(79,307)	-	-	(79,307)	(79,307)	-	-	(79,307)
Currency translation differences	-	-	418,609	418,609	-	-	418,609	418,609
Issues of options pursuant to								
Employee Option Scheme	-	31,186	-	31,186	-	31,186	-	31,186
Issue of option to consultants as								
performance incentive	-	12,066	-	12,066	-	12,066	-	12,066
As at 30 June 2006	9,691,094	43,252	93,241	9,827,587	9,691,094	43,252	93,241	9,827,587

#### Nature and purpose of reserves

##### Share premium reserve

The share premium reserve is used to record increments in the value of share issues when the issue price per share is greater than the par value. Costs of the issues are written off against the reserve.

##### Option reserve

The option reserve is used to record the value of equity benefits provided to employees and directors as part of their remuneration, or to other parties in lieu of cash compensation. Refer to note 15 for further details of these plans, and note 16 for issues to other parties.

##### Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 20 FINANCIAL INSTRUMENTS

#### Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements at other than fair values.

	<i>Carrying amount</i>	
	<i>2006</i>	<i>2005</i>
	\$	\$
<b>CONSOLIDATED</b>		
<i>Financial assets</i>		
Cash	2,762,052	2,592,737
Trade receivables	390,236	102,308
	=====	
<i>Financial liabilities</i>		
Trade payables	359,442	199,781
	=====	
<b>PARENT</b>		
<i>Financial assets</i>		
Cash	6,014	47,704
Trade receivables	968	1,342
	=====	

#### Interest rate risk

The Group's financial instruments comprise bank and cash balances, and various items such as trade debtors and trade creditors which arise directly from its operations.

At 30 June 2006, the Group had net funds of \$2,762,052 all of which was held in current accounts. An amount of \$1,766,096 was held in a current account bearing interest at a rate of 4.8% and \$535,174 was held in a Great British Pounds Currency Account bearing interest at a rate of 2.25%. The remaining net funds were held in current accounts that do not bear interest.

At 30 June 2006 the Group had no overdraft facilities.

The Group's principal exposure to exchange rate fluctuations arises in the translation of cash held in Great British pounds. The Group has some transaction risk as some transactions are in currencies other than Australian dollars. The Group does not make use of foreign currency hedges to manage currency transaction risk. The directors do not consider any other risks attaching to the use of financial instruments to be material to an assessment of the Group's financial position or profit/loss.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 21 COMMITMENTS AND CONTINGENCIES

#### Operating lease commitments - Group as lessee

The Group has entered into an operating lease on office equipment where it is not in the best interest of the Group to purchase these assets.

These leases have an average life of 5 years with renewal terms included in the contracts. Renewals are at the option of the specific entity that holds the lease.

There are no restrictions placed upon the lessee by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at 30 June are as follows:

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Within one year	7,910	-	-	-
After one year but not more than five years	31,632	-	-	-
More than five years	-	-	-	-
	<u>39,542</u>	-	-	-

### 22 RELATED PARTY DISCLOSURE

The consolidated financial statements include the financial statements of Structural Monitoring Systems Plc and the subsidiaries listed in the following table.

	Country of incorporation	% Equity interest		Investment (\$)	
		2006	2005	2006	2005
Structural Monitoring Systems Ltd	Australia United	100	100	-	-
Structural Health Monitoring Ltd	Kingdom	100	100	-	-
Structural Monitoring Systems Inc	United States	100	100	-	-
				<u>-</u>	<u>-</u>

Structural Monitoring Systems Plc is the ultimate parent entity and is incorporated in the United Kingdom.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 22 RELATED PARTY DISCLOSURE (continued)

Structural Monitoring Systems Ltd (SMS) has at various times paid various expenses of Structural Monitoring Systems Plc (SMS plc) for which SMS plc accepts liability. These expenses were paid from Australia with SMS funds, some payments were made in Great British pounds and others were in Australian dollars.

During the 2004 financial year SMS plc raised capital in the UK and after paying certain fees and expenses, transferred net proceeds in the amount of £952,416.19 to a Great British pounds bank account in the name of SMS ("GBP Account"). This bank account is maintained by SMS for the purpose of paying SMS plc expenses and was established so that control of the funds would be in Australia. The account is in Great British pounds so as to avoid exposure to movements in exchange rates as the funds were raised in the UK and are intended for use in the UK.

Since then SMS plc has raised capital of AUD\$8,525,500 in Australia. The net proceeds of the capital raisings were deposited to a SMS Cash Management Account held by SMS. This bank account is maintained by SMS for the purpose of paying SMS and SMS plc expenses; control of the funds remains in Australia.

As a consequence of the above, there is an amount owing by SMS to SMS plc.

- There is no written or formal loan agreement in place;
- The loan is interest free and repayable on demand;
- The denomination of loan account is Great British pounds and is repayable in Great British pounds;
- Transactions on the GBP Account retain their Great British pounds value when calculating the balance of the loan account;
- As the loan is interest free and to minimise compliance costs associated with withholding taxes, any interest earned on the GBP account is to be retained by SMS and is not repayable to SMS plc;
- At 30 June 2006 the net balance owed to SMS plc by SMS was £3,333,669.83. When converted at an exchange rate of 0.40205 the balance expressed in Australian dollars is \$8,291,679.72.

### 23 EVENTS AFTER THE BALANCE SHEET DATE

No significant events have occurred between the end of the financial year and the date of this report.

### 24 AUDITORS' REMUNERATION

Details of the amounts paid to the auditor of the Company, PKF (UK) LLP, and other auditors for audit and non-audit services provided during the year are set out below.

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Amounts received or due and receivable by PKF (UK) LLP for:				
• an audit or review of the financial report of the entity and the group entity	37,308	45,165	37,308	45,165
Amounts received or due and receivable by PKF Perth for:				
• an audit or review of the financial report of the principal trading entity	40,503	55,600	34,033	35,368
• other services in relation to the entity and any other entity in the consolidated entity				
- tax compliance	12,403	44,566	3,000	12,425
- corporate advice	-	11,988	-	11,988
- government grant R&D	7,400	3,788	-	-
	<u>97,614</u>	<u>161,107</u>	<u>74,341</u>	<u>104,946</u>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 25 DIRECTOR AND EXECUTIVE DISCLOSURES

#### (a) Details of Specified Directors and Specified Executives

##### (i) Specified directors

Sir John Walker	Chairman (non-executive)
Mr Mark Vellacott	Managing Director
Mr Robin Dean	Director (non-executive)
Mr David Forsyth	Director (non-executive)
Mr Anthony Brennan	Director (non-executive) resigned 7 July 2006

##### (ii) Specified executives

Mr Colin McDonald	Chief Financial Officer and Company Secretary
Mr Mike Southern	Chief Operating Officer
Mr Andrew Chilcott	Vice President, Sales and Marketing
Mr Alistair Lang	Head of Engineering UK

#### (b) Remuneration of Specified Directors and Specified Executives

##### (i) Remuneration Policy

The Remuneration Committee of the Board of Directors of Structural Monitoring Systems Plc 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. Such officers are given the opportunity to receive their base emolument in a variety of forms including cash and fringe benefits such as motor vehicles and expense payment plans. It is intended that the manner of payment chosen will be optimal for the recipient without creating undue cost for the company.

To assist in achieving these objectives, the Remuneration Committee links the nature and amount of executive directors' and senior executives' emoluments to the company's financial and operational performance. Executive directors and employees have the opportunity to qualify for participation in the Employee Share Option Plan.

It is the Remuneration Committee's policy that employment agreements shall be entered into with the Managing Director and all other executives. The current employment agreement is consistent for all executives. The agreement has a 3 month notice period and provides for payment of an amount of three months salary at the end of the three month notice period. Any options held lapse when the service period is completed.

##### (ii) Remuneration of Specified Directors and Specified Executives

Specific Directors	Primary		Post Employ- ment	Other Social Security Costs	Equity Options	Total
	Salary & Fees \$	Cash Bonus \$	Super- annuation \$	\$	\$	\$
<b>30 June 2006</b>						
Sir John Walker	133,815	-	-	14,661	-	148,476
Mr Robin Dean	35,000	-	-	-	-	35,000
Mr Mark Vellacott	253,899	46,506	20,241	-	6,711	327,357
Mr David Forsyth	30,000	-	-	-	-	30,000
Mr Anthony Brennan	30,000	-	2,700	-	-	32,700
<b>Total Remuneration: Specified Directors</b>	<b>482,714</b>	<b>46,506</b>	<b>22,941</b>	<b>14,661</b>	<b>6,711</b>	<b>573,533</b>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 25 DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

(ii) Remuneration of Specified Directors and Specified Executives (continued)

Specific Directors	Primary		Post Employment	Social Security Costs	Equity	Total
	Salary & Fees	Cash Bonus	Super-annuation		Options	
	\$	\$	\$	\$	\$	\$
<b>30 June 2005</b>						
Sir John Walker	133,615	-	-	14,608	-	148,223
Mr Robin Dean	231,250	-	12,863	-	-	244,113
Mr Mark Vellacott	18,758	-	1,688	-	-	20,446
Mr David Forsyth	35,158	-	-	-	-	35,158
Mr Anthony Brennan	65,000	-	8,775	-	-	73,775
	-	-	-	-	-	-
<b>Total Remuneration: Specified Directors</b>	<b>483,781</b>	<b>-</b>	<b>23,326</b>	<b>14,608</b>	<b>-</b>	<b>521,715</b>
<b>Specific Executives</b>						
<b>30 June 2006</b>						
Mr Andrew Chilcott (start date 2/1/2006)	76,000	-	6,840	-	-	82,840
Mr Michael Southern	146,258	3,750	13,163	-	3,133	166,304
Mr Colin McDonald	146,258	3,750	12,983	-	4,027	167,018
Mr Alistair Lang	171,317	4,211	-	25,144	3,534	204,206
<b>Total Remuneration: Specified Executives</b>	<b>539,833</b>	<b>11,711</b>	<b>32,986</b>	<b>25,144</b>	<b>10,694</b>	<b>620,368</b>
<b>30 June 2005</b>						
Mr Mark Vellacott (start date 1/11/2004)	154,218	-	13,880	-	-	168,098
Mr Michael Southern	141,252	-	12,713	-	-	153,965
Mr Stephen Randell	124,124	-	11,171	-	-	135,295
Mr Colin McDonald (start date 2/5/2005)	22,500	-	2,025	-	-	24,525
Mr. Alistair Lang	123,564	-	11,120	17,670	-	152,354
<b>Total Remuneration: Specified Executives</b>	<b>565,658</b>	<b>-</b>	<b>50,909</b>	<b>17,670</b>	<b>-</b>	<b>634,237</b>

#### (iii) Bonus payments

The Board authorised an amount of \$40,000 to be paid to Mr Vellacott as a bonus for his efforts in the management of the Company and achieving a successful placement by the Company of shares in September 2005

Mr Vellacott, the specified executives and all other employees of the Company were paid a bonus of 2.5% of their salaries in December 2005 by way of a Christmas bonus and as a reward for their efforts during the year.

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 25 DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

#### (c) Remuneration options: Granted and vested during the year

During the financial year options were granted as equity compensation benefits under the employee share option plan (ESOP) to certain specified directors and specified executives as disclosed below. The options were issued free of charge. For further details of the terms and conditions refer to note 15.

	<i>Grant Date</i>	<i>Tranche A Granted No.</i>	<i>Value per option at grant date (\$)</i>	<i>Tranche B Granted No</i>	<i>Value per option at grant date (\$)</i>	<i>Tranche C Granted No</i>	<i>Value per option at grant date (\$)</i>
<b>Specified Directors</b>							
Mr Mark Vellacott	22 Dec 05	250,000	0.013	250,000	0.013	250,000	0.014
<b>Specified Executives</b>							
Mr Andrew Chilcott	-	-	-	-	-	-	-
Mr Michael Southern	8 Feb 06	150,000	0.010	150,000	0.012	150,000	0.012
Mr Colin McDonald	22 Dec 05	150,000	0.013	150,000	0.013	150,000	0.014
Mr Alistair Lang	22 Dec 05	131,667	0.013	131,667	0.013	131,666	0.014
<b>Total</b>		<b>681,667</b>		<b>681,667</b>		<b>681,666</b>	

Refer to Note 15 (a) for details of the exercise prices and periods for each tranche of options. Of the above options, Tranche A options have vested.

#### (d) No shares were issued on exercise of remuneration options

#### (e) Option holdings of specified directors and specified executives

	<i>Balance at beg of period 01-Jul-05</i>	<i>Granted as Remuneration</i>	<i>Options Exercised</i>	<i>Net Change Other</i>	<i>Balance at end of period 30-Jun-06</i>	<i>Not Vested &amp; Not Exercisable</i>	<i>Vested &amp; Exercisable</i>
<b>Specified Directors</b>							
Sir John Walker	100,000	-	-	-	100,000	-	100,000
Mr Robin Dean	-	-	-	-	-	-	-
Mr Mark Vellacott	-	750,000	-	750,000	750,000	500,000	250,000
Mr David Forsyth	400,000	-	-	-	400,000	-	400,000
<b>Specified Executives</b>							
Mr Andrew Chilcott	-	-	-	-	-	-	-
Mr Michael Southern	60,000	450,000	-	450,000	510,000	300,000	210,000
Mr Colin McDonald	-	450,000	-	450,000	450,000	300,000	150,000
Mr Alistair Lang	100,000	395,000	-	395,000	495,000	263,333	231,667
<b>Total</b>	<b>660,000</b>	<b>2,045,000</b>	<b>-</b>	<b>2,045,000</b>	<b>2,705,000</b>	<b>1,363,333</b>	<b>1,341,667</b>

## Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2006

### 25 DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

#### (f) Shareholdings of Specified Directors and Specified Executives

*Shares held in Structural Monitoring Systems Plc*

	<i>Balance at beg of period 01- Jul-05</i>	<i>Granted as Remuneration</i>	<i>Options Exercised</i>	<i>Net Change Other</i>	<i>Balance at end of period 30- Jun-06</i>
<b>Specified Directors</b>					
Sir John Walker	100,000	-	-	-	100,000
Mr Robin Dean	4,765,000	-	-	-	4,765,000
Mr Mark Vellacott	-	-	-	-	-
Mr David Forsyth	400,000	-	-	-	400,000
<b>Specified Executives</b>					
Mr Andrew Chilcott	-	-	-	-	-
Mr Michael Southern	60,000	-	-	-	60,000
Mr Colin McDonald	-	-	-	52,000	52,000
Mr Alistair Lang	100,000	-	-	-	100,000
<b>Total</b>	<b>5,425,000</b>	<b>-</b>	<b>-</b>	<b>52,000</b>	<b>5,477,000</b>

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF STRUCTURAL MONITORING SYSTEMS PLC**

We have audited the group and parent company financial statements ('the financial statements') of Structural Monitoring Systems plc for the year ended 30 June 2006 which comprise the consolidated and company income statements, balance sheets, cash flow statements and statements of change in shareholders' equity and the related notes. The financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

We report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's and the parent company's affairs as at 30 June 2006 and of the group's and the parent company's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

29 September 2006



**PKF(UK) LLP**  
**Registered Auditors**