

QrxPharma Pty Limited

ACN 102 254 151

Annual report for the year ended 30 June 2006

QrxPharma Pty Limited ACN 102 254 151
Annual report - 30 June 2006

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Directors' report

Your directors present their report on the consolidated entity (referred to hereafter as the Group) consisting of QrxPharma Pty Limited (referred to hereafter as the company) and the entities it controlled at the end of, or during, the year ended 30 June 2006.

Directors

The following persons were directors of QrxPharma Pty Limited during the whole of the financial year and up to the date of this report:

M A Quinn
G W Pace
M S Hirshorn
G Savage
D A Henderson
D Stack
D Creswell (Resigned 10 February 2006)

Principal activities

During the year the principal continuing activities of the Group consisted of the development and commercialisation of biopharmaceutical products based on Australian research and targeting the US market.

Dividends - QrxPharma Pty Limited

No dividends were paid or declared since the start of the financial year. Dividends on preference shares accrued in 2005 of \$1,045,344 were reclassified to financial liabilities as adjustment on adoption of AASB 132 and AASB 139 at 1 July 2005.

Review of operations

The consolidated entity has made a loss from ordinary activities after income tax for the year of \$3,510,503 (2005: loss of \$4,797,049).

Significant changes in the state of affairs

There were no significant changes in the state of affairs of the consolidated entity that occurred during the financial year under the review.

Matters subsequent to the end of the financial year

Management are preparing to list on the Australian Stock Exchange in April 2007. The accounts for the 6 months ended 31 December 2006 will be used as historical information in proforma accounts.

No other matter or circumstance has arisen since 30 June 2006 that has significantly affected, or may significantly affect:

- (a) the Group's operations in future financial years, or
- (b) the results of those operations in future financial years, or
- (c) the Group's state of affairs in future financial years.

Likely developments and expected results of operations

Information on likely developments in the operations of the Group and the expected results of operations have not been included in this annual report because the directors believe it would be likely to result in unreasonable prejudice to the Group.

Environmental regulation

There are no particular and significant environmental regulations under a law of the Commonwealth or of a State or Territory affecting the Group.

Share options granted to directors

No options over unissued ordinary shares of QrxPharma Pty Limited were granted during or since the end of the financial year to any of the directors of the Company and consolidated entity.

Shares under option

Unissued ordinary shares of QrxPharma Pty Limited under option at the date of this report are as follows:

| Date options granted | Expiry date | Issue price of shares | Number under option |
|----------------------|-------------------|-----------------------|---------------------|
| 19 December 2002 | 19 December 2012 | \$0.30 | 40,000 |
| 24 February 2004 | 24 February 2013 | \$0.15 | 3,920 |
| 24 February 2004 | 24 February 2014 | \$0.30 | 10,000 |
| 24 February 2004 | 24 February 2014 | \$0.15 | 6,875 |
| 25 February 2004 | 24 February 2014 | \$0.15 | 1,960 |
| 16 March 2004 | 16 March 2014 | \$0.15 | 10,000 |
| 19 May 2004 | 19 May 2014 | \$0.15 | 25,000 |
| 24 June 2004 | 24 June 2014 | \$0.15 | 20,000 |
| 13 July 2004 | 13 July 2014 | \$0.15 | 50,000 |
| 14 July 2004 | 14 July 2014 | \$0.15 | 40,000 |
| 17 August 2004 | 17 August 2014 | \$0.15 | 20,000 |
| 19 October 2004 | 19 October 2014 | \$0.15 | 784,248 |
| 19 February 2005 | 19 February 2015 | \$0.15 | 150,000 |
| 18 May 2005 | 18 May 2015 | \$0.15 | 240,000 |
| 21 September 2005 | 21 September 2015 | \$0.15 | 110,000 |
| | | | 1,512,003 |

Shares issued on the exercise of options

The following ordinary shares of QrxPharma Pty Limited were issued during the year ended 30 June 2006 on the exercise of options granted under the QrxPharma Employee Option Plan. No further shares have been issued since that date. No amounts are unpaid on any of the shares.

| Date options granted | Issue price of shares | Number of shares issued |
|----------------------|-----------------------|-------------------------|
| 21 November 2003 | \$0.15 | 5,000 |
| 15 December 2003 | \$0.15 | 50,000 |
| 24 February 2004 | \$0.15 | 8,125 |
| 19 October 2004 | \$0.15 | 207,096 |
| | | 270,221 |

Insurance of officers

During the financial year, the company made, in respect of the directors and officers of the company an agreement for indemnifying against a liability incurred as an officer, including costs and expenses in successfully defending legal proceedings. Insurance premiums have been paid in respect of Directors' and Officers Liability insuring against a liability arising in the United States, incurred as an officer for the costs or expenses to defend legal proceedings. The terms of that policy prohibits disclosure of the premiums paid and the extent of risks insured.

Proceedings on behalf of the company

No person has applied to the Court under section 237 of the *Corporations Act 2001* for leave to bring proceedings on behalf of the company, or to intervene in any proceedings to which the company is a party, for the purpose of taking responsibility on behalf of the company for all or part of those proceedings.

No proceedings have been brought or intervened in on behalf of the company with leave of the Court under section 237 of the *Corporations Act 2001*.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 4.

Auditor

PricewaterhouseCoopers continues in office in accordance with section 327 of the *Corporations Act 2001*.

This report is made in accordance with a resolution of directors.



M A Quinn
Director

4/04/07
Sydney
Date:

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Auditor's Independence Declaration

As lead auditor for the audit of QrxPharma Pty Limited for the year ended 30 June 2006, I declare that, to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of QrxPharma Pty Limited and the entities it controlled during the period.



Andrew Sneddon
Partner
PricewaterhouseCoopers

Sydney
Date:

5/4/07

QrxPharma Pty Limited ACN 102 254 151

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This financial report covers both QrxPharma Pty Limited as an individual entity and the consolidated entity consisting of QrxPharma Pty Limited and its subsidiaries. The financial report is presented in the Australian currency.

QrxPharma Pty Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

QrxPharma Pty Limited
Suite 401, 35 Lime St
Sydney NSW 2000.

A description of the nature of the Group's operations and its principal activities is included in the directors' report on pages 1-3, which is not part of this financial report.

QrxPharma Pty Limited
Income statements
For the year ended 30 June 2006

| | | Consolidated | | Parent | |
|---|-------|---------------------|-------------|--------------------|-------------|
| | Notes | 2006 | 2005 | 2006 | 2005 |
| | | \$ | \$ | \$ | \$ |
| Revenue from continuing operations | 5 | 18,362 | 72,287 | 18,362 | 72,287 |
| Research and development | 6 | (1,060,320) | (3,422,847) | (1,060,320) | (3,422,847) |
| Marketing | | (178,837) | (617,841) | (178,837) | (617,841) |
| General and administration | | (595,059) | (745,781) | (595,059) | (745,781) |
| Finance costs | 6 | (1,694,649) | (82,867) | (1,694,649) | (82,867) |
| Loss before income tax | | (3,510,503) | (4,797,049) | (3,510,503) | (4,797,049) |
| Income tax expense | 7 | - | - | - | - |
| Loss for the year | | (3,510,503) | (4,797,049) | (3,510,503) | (4,797,049) |

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

QrxPharma Pty Limited
Balance sheets
As at 30 June 2006

| | Notes | Consolidated | | Parent | |
|------------------------------------|-------|---------------------|---------------------|---------------------|---------------------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$ | \$ | \$ | \$ |
| ASSETS | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 8 | <u>248,711</u> | <u>1,412,133</u> | <u>248,711</u> | <u>1,412,133</u> |
| Total current assets | | <u>248,711</u> | <u>1,412,133</u> | <u>248,711</u> | <u>1,412,133</u> |
| Non-current assets | | | | | |
| Other financial assets | 9 | - | - | - | - |
| Property, plant and equipment | 10 | <u>18,342</u> | <u>48,330</u> | <u>18,342</u> | <u>48,330</u> |
| Total non-current assets | | <u>18,342</u> | <u>48,330</u> | <u>18,342</u> | <u>48,330</u> |
| Total assets | | <u>267,053</u> | <u>1,460,463</u> | <u>267,053</u> | <u>1,460,463</u> |
| LIABILITIES | | | | | |
| Current liabilities | | | | | |
| Trade and other payables | 11 | <u>599,488</u> | <u>765,346</u> | <u>627,188</u> | <u>793,046</u> |
| Borrowings | 12 | <u>3,195,563</u> | <u>2,222,192</u> | <u>3,195,563</u> | <u>2,222,192</u> |
| Total current liabilities | | <u>3,795,051</u> | <u>2,987,538</u> | <u>3,822,751</u> | <u>3,015,238</u> |
| Non-current liabilities | | | | | |
| Borrowings | 13 | <u>13,574,115</u> | - | <u>13,574,115</u> | - |
| Provisions | 14 | <u>-</u> | <u>2,244,891</u> | <u>-</u> | <u>2,244,891</u> |
| Total non-current liabilities | | <u>13,574,115</u> | <u>2,244,891</u> | <u>13,574,115</u> | <u>2,244,891</u> |
| Total liabilities | | <u>17,369,166</u> | <u>5,232,429</u> | <u>17,396,866</u> | <u>5,260,129</u> |
| Net liabilities | | <u>(17,102,113)</u> | <u>(3,771,966)</u> | <u>(17,129,813)</u> | <u>(3,799,666)</u> |
| EQUITY | | | | | |
| Contributed equity | 15 | <u>669,968</u> | <u>10,527,652</u> | <u>669,968</u> | <u>10,527,652</u> |
| Reserves | 16(a) | <u>161,881</u> | <u>123,841</u> | <u>161,881</u> | <u>123,841</u> |
| Accumulated losses | 16(b) | <u>(17,933,962)</u> | <u>(14,423,459)</u> | <u>(17,961,662)</u> | <u>(14,451,159)</u> |
| | | <u>(17,102,113)</u> | <u>(3,771,966)</u> | <u>(17,129,813)</u> | <u>(3,799,666)</u> |
| Total deficiency in capital | | <u>(17,102,113)</u> | <u>(3,771,966)</u> | <u>(17,129,813)</u> | <u>(3,799,666)</u> |

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

QrxPharma Pty Limited
Statements of changes in equity
For the year ended 30 June 2006

| | Notes | Consolidated | | Parent | |
|---|-------|---------------------|--------------------|---------------------|--------------------|
| | | 2006 \$ | 2005 \$ | 2006 \$ | 2005 \$ |
| Total equity / (deficiency in capital) at the beginning of the financial year | | <u>(3,771,966)</u> | <u>1,988,205</u> | <u>(3,799,666)</u> | <u>1,960,505</u> |
| Adjustment on adoption of AASB 132 and AASB 139 to: | | | | | |
| Preference shares | 13 | <u>(9,898,217)</u> | <u>-</u> | <u>(9,898,217)</u> | <u>-</u> |
| Restated equity / (deficiency in capital) at the beginning of the financial year | | <u>(13,670,183)</u> | <u>1,988,205</u> | <u>(13,697,883)</u> | <u>1,960,505</u> |
| Loss for the year | | <u>(3,510,503)</u> | <u>(4,797,049)</u> | <u>(3,510,503)</u> | <u>(4,797,049)</u> |
| Transactions with equity holders in their capacity as equity holders: | | | | | |
| Contributions of equity, net of transaction costs | 15 | <u>40,533</u> | <u>(41,619)</u> | <u>40,533</u> | <u>(41,619)</u> |
| Employee share options | 16 | <u>38,040</u> | <u>123,841</u> | <u>38,040</u> | <u>123,841</u> |
| Dividends | | <u>-</u> | <u>(1,045,344)</u> | <u>-</u> | <u>(1,045,344)</u> |
| | | <u>78,573</u> | <u>(963,122)</u> | <u>78,573</u> | <u>(963,122)</u> |
| Total deficiency in capital at the end of the financial year | | <u>(17,102,113)</u> | <u>(3,771,966)</u> | <u>(17,129,813)</u> | <u>(3,799,666)</u> |

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

QrxPharma Pty Limited
Cash flow statements
For the year ended 30 June 2006

| | Notes | Consolidated | | Parent | |
|--|-------|--------------------|--------------------|--------------------|--------------------|
| | | 2006 | 2005 | 2006 | 2005 |
| | | \$ | \$ | \$ | \$ |
| Cash flows from operating activities | | | | | |
| Payments to suppliers and employees (inclusive of goods and services tax) | | <u>(1,901,124)</u> | <u>(4,637,169)</u> | <u>(1,901,124)</u> | <u>(4,637,169)</u> |
| Interest received | | 18,362 | 72,287 | 18,362 | 72,287 |
| R&D grant received | | 43,060 | 227,326 | 43,060 | 227,326 |
| GST tax refund | | - | 9,752 | - | 9,752 |
| Net cash outflow from operating activities | 21 | <u>(1,839,702)</u> | <u>(4,327,804)</u> | <u>(1,839,702)</u> | <u>(4,327,804)</u> |
| Cash flows from investing activities | | | | | |
| Payments for property, plant and equipment | | - | (12,025) | - | (12,025) |
| Net cash outflow from investing activities | | - | (12,025) | - | (12,025) |
| Cash flows from financing activities | | | | | |
| Proceeds from borrowings | | 635,747 | 2,139,325 | 635,747 | 2,139,325 |
| Proceeds from issues of shares | | 40,533 | 11,250 | 40,533 | 11,250 |
| Share issue transaction costs | | - | (52,869) | - | (52,869) |
| Net cash inflow from financing activities | | <u>676,280</u> | <u>2,097,706</u> | <u>676,280</u> | <u>2,097,706</u> |
| Net increase (decrease) in cash and cash equivalents | | (1,163,422) | (2,242,123) | (1,163,422) | (2,242,123) |
| Cash and cash equivalents at the beginning of the financial year | | <u>1,412,133</u> | <u>3,654,256</u> | <u>1,412,133</u> | <u>3,654,256</u> |
| Cash and cash equivalents at end of year | 8 | <u>248,711</u> | <u>1,412,133</u> | <u>248,711</u> | <u>1,412,133</u> |

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

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1 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial report includes separate financial statements for QrxPharma Pty Limited as an individual entity and the consolidated entity consisting of QrxPharma Pty Limited and its subsidiaries.

(a) Going concern

The Group has continued to experience operating losses of \$3,510,503 and operating cash outflows of \$1,839,702 during the year ended 30 June 2006 as the Group continues to focus on the achievement of key milestones set out in the funding of its R&D program and operating plan. As of the balance date, the Group had a deficiency in capital of \$17,102,113 and cash balances of \$248,711. The continuing viability of the company and its controlled entities and their ability to continue as a going concern and meet their debts and commitments as they fall due is dependent upon:

(i) the Group being successful in negotiating and obtaining additional funding, including securing equity financing and government research and development grants based on continued achievement of key milestones in the R&D program; and

(ii) the Group successfully implementing its business strategy and operating plan.

The Group's short operating history and reliance on future funding and successfully executing its business strategy result in there being significant uncertainty whether the Group will continue as a going concern and, therefore, whether it will realise its assets and settle its liabilities and commitments in the normal course of business and at the amounts stated in the financial report.

As at the date of this report, however, the Group has received a draft underwriting agreement and is proceeding towards a listing on the Australian Stock Exchange. Up to \$50 million plus oversubscription is sought through this round of funding. Hence the directors believe that the Group will be successful in the above matters, and accordingly, have prepared the financial report on a going concern basis. The directors regularly monitor the Group's cash position and on an on-going basis consider a number of strategic and operational plans and initiatives to ensure that adequate funding continues to be available for the Group to meet its business objectives.

At this time, the directors are of the opinion that no asset is likely to be realised for an amount less than the amount at which it is recorded in the financial report at 30 June 2006. No adjustments have been made to the financial report relating to recoverability and classification of the asset carrying amounts or the amounts and classification of liabilities that might be necessary should the company not continue as a going concern.

(b) Basis of preparation

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

Compliance with IFRSs

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

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

These financial statements are the first QrxPharma Pty Limited financial statements prepared in accordance with AIFRSs. AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards has been applied in preparing these financial statements

Financial statements of QrxPharma Pty Limited until 30 June 2005 had been prepared in accordance with previous Australian Generally Accepted Accounting Principles (AGAAP). AGAAP differs in certain respects from AIFRS. When preparing QrxPharma Pty Limited 2006 financial statements, management has amended certain accounting, valuation and consolidation methods applied in the AGAAP financial statements to comply with AIFRS. With the exception of financial instruments, the comparative figures in respect of 2005 were restated to reflect these adjustments. The Group has taken the exemption available under AASB 1 to only apply AASB 132 and AASB 139 from 1 July 2005.

Reconciliations and descriptions of the effect of transition from previous AGAAP to AIFRSs on the Group's capital deficiency and its net loss are given in note 24.

1 Summary of significant accounting policies (continued)

Historical cost convention

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

Critical accounting estimates

The preparation of financial statements in conformity with AIFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 3.

(c) Principles of consolidation

(i) Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of QrxPharma Pty Limited ("company" or "parent entity") as at 30 June 2006 and the results of all subsidiaries for the year then ended. QrxPharma Pty Limited and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

Subsidiaries are all those entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) Foreign currency translation

(i) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. At balance date amounts payable and receivable in foreign currencies are translated to Australian currency at rates of exchange current at that date. Resulting exchange differences are recognised in determining the profit and loss for the year.

(e) Income tax

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

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or a liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

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

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

Tax consolidation legislation

1 Summary of significant accounting policies (continued)

QrxPharma Pty Limited and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation as of 1 July 2003.

The head entity, QrxPharma Pty Limited, and the controlled entities in the tax consolidated group continue to account for their own current and deferred tax amounts. These tax amounts are measured as if each entity in the tax consolidated group continues to be a stand alone taxpayer in its own right.

(f) Business combinations

The purchase method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. Cost is measured as the fair value of the assets given, shares issued or liabilities incurred or assumed at the date of exchange plus costs directly attributable to the acquisition. Where equity instruments are issued in an acquisition, the fair value of the instruments is their published market price as at the date of exchange unless, in rare circumstances, it can be demonstrated that the published price at the date of exchange is an unreliable indicator of fair value and that other evidence and valuation methods provide a more reliable measure of fair value. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

(g) Impairment of assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(h) Grant income

Grant income is recognised during the year in which the income is received and is disclosed in the results for the period against related R&D expenditure incurred last year.

(i) Cash and cash equivalents

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

(j) Property, plant and equipment

Depreciation on plant and equipment is calculated using the straight line method to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives, as follows:

| | |
|-----------------------|---------|
| - Plant and equipment | 4 years |
|-----------------------|---------|

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 1(g)).

(k) Trade and other payables

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

(l) Borrowings

Non-redeemable preference shares are classified as liabilities. The accrued liabilities on preference shares are recognised in the income statement as interest expense.

1 Summary of significant accounting policies (continued)

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Convertible notes and accrued interest are recognised as a liability. The liability is included in borrowings until the conversion or maturity of the notes.

(m) Borrowing costs

Borrowing costs are recognised as expenses in the period in which they are incurred. Borrowing costs include interest paid or payable on convertible notes.

(n) Employee benefits

(i) Wages and salaries, annual leave and sick leave

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

(ii) Long service leave

The liability for long service leave expected to be settled within 12 months of the reporting date is recognised in the provision for employee benefits and is measured in accordance with (i) above.

(iii) Share-based payments

Share-based compensation benefits are provided to employees via the QrxPharma Employee Share Option Plan and an employee share scheme. Information relating to these schemes is set out in note 22.

Shares and options granted after 7 November 2002 and vested after 1 January 2005

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

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

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

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

Under the employee share scheme, shares issued to employees for no cash consideration vest immediately on grant date. On this date, the market value of the shares issued is recognised as an employee benefits expense with a corresponding increase in equity.

(o) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2006 reporting periods. The Group's assessment of the impact of these new standards and interpretations is set out below.

1 Summary of significant accounting policies (continued)

(i) *AASB 7 Financial Instruments: Disclosures and AASB 2005-10 Amendments to Australian Accounting Standards [AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 & AASB 1038]*
AASB 7 and AASB 2005-10 are applicable to annual reporting periods beginning on or after 1 January 2007. AASB 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces AASB 130 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and the disclosure requirements in IAS 32 Financial Instruments: Disclosure and Presentation. It is applicable to all reporting entities. The amendment to AASB 101 introduces disclosures about the level of an entity's capital and how it manages capital. The Group assessed the impact of AASB 7 and the amendment to AASB 101 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of AASB 101. The Group will apply the standards from annual reporting periods beginning 1 June 2007.

(ii) *UIG 9 Reassessment of Embedded Derivatives*
UIG 9 is effective for annual reporting periods beginning on or after 1 June 2006. It requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. As none of the group entities have changed the terms of their contracts, UIG 9 is not relevant to the Group's operations.

(iii) *Revised AASB 101 Presentation of Financial Statements*
A revised AASB 101 was issued in October 2006 and is applicable to annual reporting periods beginning on or after 1 January 2007. The Group has not adopted the standard early. Application of the revised standard will not have any impact on the Group's financial statements.

2 Financial risk management

(a) Credit risk exposures

The credit risk on financial assets of the Group which have been recognised on the balance sheet, other than investment in shares, is generally the carrying amount, net of any provisions for doubtful debts.

(b) Interest rate risk exposures

The Group's exposure to interest rate risk predominately arises from assets and liabilities bearing variable interest rates as the company intends to hold fixed rate assets and liabilities to maturity or to a time when the assets and liabilities are converted at the option of the holder.

3 Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

Research and development expenditure

The Group has expensed all research and development expenditure incurred during the year as the costs relate to the initial expenditure for research and development of biopharmaceutical products and the generation of future economic benefits are not considered probable. It was considered appropriate to expense the research and development costs as they did not meet the criteria to be capitalised under AASB 138.

4 Segment information

The Group's operations during the year were predominantly in Australia. The Group operates in only one market segment, that of the research and development of biopharmaceutical products for commercial sale.

5 Revenue

| | Consolidated | | Parent | |
|-----------------------------------|---------------|---------------|---------------|---------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| From continuing operations | | | | |
| Interest | <u>18,362</u> | <u>72,287</u> | <u>18,362</u> | <u>72,287</u> |
| Revenue from ordinary activities | <u>18,362</u> | <u>72,287</u> | <u>18,362</u> | <u>72,287</u> |

6 Expenses

| | Consolidated | | Parent | |
|---|------------------|---------------|------------------|---------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Loss before income tax includes the following specific expenses: | | | | |
| <i>Depreciation</i> | | | | |
| Plant and equipment | 29,988 | 26,955 | 29,988 | 26,955 |
| Net foreign exchange loss | 7,289 | 33,814 | 7,289 | 33,814 |
| <i>Finance costs</i> | | | | |
| Interest payable on convertible notes | 262,113 | 82,867 | 262,113 | 82,867 |
| Interest payable on preference shares | 1,431,007 | - | 1,431,007 | - |
| Other finance expense | <u>1,529</u> | <u>-</u> | <u>1,529</u> | <u>-</u> |
| | <u>1,694,649</u> | <u>82,867</u> | <u>1,694,649</u> | <u>82,867</u> |

6 Expenses (continued)

| | Consolidated | | Parent | |
|-----------------------------------|------------------|------------------|------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| <i>Employee benefit expense</i> | 351,312 | 1,109,832 | 351,312 | 1,109,832 |
| <i>Research and development</i> | | | | |
| Research and development expensed | 1,103,380 | 3,547,722 | 1,103,380 | 3,547,722 |
| Research and development grant | <u>(43,060)</u> | <u>(124,875)</u> | <u>(43,060)</u> | <u>(124,875)</u> |
| | <u>1,060,320</u> | <u>3,422,847</u> | <u>1,060,320</u> | <u>3,422,847</u> |

7 Income tax expense

| | Consolidated | | Parent | |
|--|--------------------|--------------------|--------------------|--------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| (a) Numerical reconciliation of income tax expense to prima facie tax payable | | | | |
| Loss from continuing operations before income tax expense | <u>(3,510,503)</u> | <u>(4,797,049)</u> | <u>(3,510,503)</u> | <u>(4,797,049)</u> |
| Tax at the Australian tax rate of 30% (2005 - 30%) | <u>(1,053,151)</u> | <u>(1,439,115)</u> | <u>(1,053,151)</u> | <u>(1,439,115)</u> |
| Tax effect of amounts which are not deductible in calculating taxable income: | | | | |
| Share-based payments | 11,412 | 37,152 | 11,412 | 37,152 |
| Interest payable on preference shares | <u>429,302</u> | <u>-</u> | <u>429,302</u> | <u>-</u> |
| | <u>(612,437)</u> | <u>(1,401,963)</u> | <u>(612,437)</u> | <u>(1,401,963)</u> |
| Benefit of tax losses not recognised | <u>612,437</u> | <u>1,401,963</u> | <u>612,437</u> | <u>1,401,963</u> |
| Total income tax expense | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| (b) Tax losses | | | | |
| Unused tax losses for which no deferred tax asset has been recognised | <u>15,478,364</u> | <u>13,436,907</u> | <u>15,478,364</u> | <u>13,436,907</u> |
| Potential tax benefit @ 30% | <u>4,643,509</u> | <u>4,031,072</u> | <u>4,643,509</u> | <u>4,031,072</u> |

The benefit for tax losses will only be obtained if:

- (i) the Group derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the losses to be realised, or
- (ii) the Group continues to comply with the conditions for deductibility imposed by tax legislation, and
- (iii) no changes in tax legislation adversely affect the Group in realising the benefit from the deduction for the losses.

(c) Tax consolidation legislation

QrxPharma Pty Limited and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation as of 7 December 2002. The accounting policy in relation to this legislation is set out in note 1(e).

8 Current assets - Cash and cash equivalents

| | Consolidated | | Parent | |
|--------------------------|----------------|------------------|----------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Cash at bank and in hand | <u>248,711</u> | <u>1,412,133</u> | <u>248,711</u> | <u>1,412,133</u> |

The weighted average interest rate was 4.25% (2005: 5.10%)

9 Non-current assets - Other financial assets

| | Consolidated | | Parent | |
|---|--------------|----------|------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Shares in subsidiaries (note 20) | - | - | 500,750 | 500,750 |
| Less provision for write down to recoverable amount | <u>-</u> | <u>-</u> | <u>(500,750)</u> | <u>(500,750)</u> |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

10 Non-current assets - Property, plant and equipment

| Consolidated | Plant and equipment \$ |
|--------------------------------|---------------------------------------|
| | |
| At 1 July 2004 | |
| Cost | 97,252 |
| Accumulated depreciation | <u>(31,831)</u> |
| Net book amount | <u>65,421</u> |
| | |
| Year ended 30 June 2005 | |
| Opening net book amount | 65,421 |
| Additions | 12,025 |
| Depreciation charge | <u>(29,116)</u> |
| Closing net book amount | <u>48,330</u> |
| | |
| At 30 June 2005 | |
| Cost | 109,277 |
| Accumulated depreciation | <u>(60,947)</u> |
| Net book amount | <u>48,330</u> |
| | |
| Year ended 30 June 2006 | |
| Opening net book amount | 48,330 |
| Depreciation charge | <u>(29,988)</u> |
| Closing net book amount | <u>18,342</u> |
| | |
| At 30 June 2006 | |
| Cost | 109,277 |
| Accumulated depreciation | <u>(90,935)</u> |
| Net book amount | <u>18,342</u> |

10 Non-current assets - Property, plant and equipment (continued)

| Parent | Plant and equipment \$ |
|--------------------------------|------------------------------|
| At 1 July 2004 | |
| Cost | 97,252 |
| Accumulated depreciation | <u>(31,831)</u> |
| Net book amount | <u>65,421</u> |
| Year ended 30 June 2005 | |
| Opening net book amount | 65,421 |
| Additions | 12,025 |
| Depreciation charge | <u>(29,116)</u> |
| Closing net book amount | <u>48,330</u> |
| At 30 June 2005 | |
| Cost | 109,277 |
| Accumulated depreciation | <u>(60,947)</u> |
| Net book amount | <u>48,330</u> |
| Year ended 30 June 2006 | |
| Opening net book amount | 48,330 |
| Depreciation charge | <u>(29,988)</u> |
| Closing net book amount | <u>18,342</u> |
| At 30 June 2006 | |
| Cost | 109,277 |
| Accumulated depreciation | <u>(90,935)</u> |
| Net book amount | <u>18,342</u> |

11 Current liabilities - Trade and other payables

| | Consolidated | | Parent | |
|---------------------------|----------------|----------------|----------------|----------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Trade payables | 398,727 | 587,366 | 398,727 | 587,366 |
| Amounts due to associates | - | - | 27,700 | 27,700 |
| Accrued expenses | 193,887 | 140,808 | 193,887 | 140,808 |
| Other payables | <u>6,874</u> | <u>37,172</u> | <u>6,874</u> | <u>37,172</u> |
| | <u>599,488</u> | <u>765,346</u> | <u>627,188</u> | <u>793,046</u> |

12 Current liabilities - Borrowings

| | Consolidated | | Parent | |
|---------------------------------------|------------------|------------------|------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Secured | | | | |
| Convertible notes Series A | 2,750,333 | 2,139,325 | 2,750,333 | 2,139,325 |
| Convertible notes Series B | 275,072 | - | 275,072 | - |
| Accrued interest on convertible notes | 94,647 | 82,867 | 94,647 | 82,867 |
| Warrant liability | 75,511 | - | 75,511 | - |
| Total secured current borrowings | <u>3,195,563</u> | <u>2,222,192</u> | <u>3,195,563</u> | <u>2,222,192</u> |

Convertible notes - Series A

The parent entity issued \$2,500,000 by way of convertible notes in three tranches. The notes are convertible into Series B preference shares at the option of the holder, or mandatorily on occurrence of qualified financing, being the raising of greater than \$15 million of funds. The conversion price of each convertible note is to be determined by the issue price of the Series B preference shares.

The notes mature on 31 December 2006 and have been rolled-over to be payable by 30 April 2007. The roll-over has been approved by the note holders.

Interest accrues daily at a rate of 10% per annum on the Principal Amount. Any unpaid interest will be capitalised annually into the underlying note balance. The unpaid interest will be convertible into Series B preference shares.

Convertible notes - Series B

The parent entity issued \$1,745,000 by way of convertible notes in four tranches, the first being called on 30 June 2006. The notes are convertible into Series A preference shares at the option of the holder at a conversion price of \$0.50. In the event a Qualified Financing, being the raising of greater than \$5,000,000 funds occurs the notes are convertible into Qualified Financing shares, the conversion price at 80% of the Qualified Financing Issue price and in the event a Qualified Merger occurs, involving at least \$20,000,000 of funding by way of equity or securities in the Company, the notes are converted into ordinary shares at \$0.50.

The notes were repayable on 15 December 2006 but have been rolled over to 30 April 2007, consistent with the convertible note series A.

Interest accrues daily at a rate of 20% per annum on the Principal Amount (or that proportion of the Principal Amount that has been advanced). Any unpaid interest is capitalised monthly into the underlying note balance.

The warrants attached to the convertible notes has been recognised at fair value through profit or loss.

13 Non-current liabilities - Borrowings

| | Consolidated | | Parent | |
|--|-------------------|------|-------------------|------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Unsecured | | | | |
| Preference shares Series A | 12,782,281 | - | 12,782,281 | - |
| Interest payable on preference shares | <u>791,834</u> | - | <u>791,834</u> | - |
| Total unsecured non-current borrowings | <u>13,574,115</u> | - | <u>13,574,115</u> | - |

The balance represents 10,249,142 fully paid cumulative convertible preference shares less transaction costs. The shares are convertible at \$1 per share or a price in accordance with the terms included in the Shareholders Deed dated 6 December 2002.

Convertible preference shares entitle the holder to have priority over ordinary shareholders upon liquidation of the company or in the event of an initial public offering, and each preferred shareholder maintains the right to receive cumulative dividends if the company declares and pays discretionary dividends in respect of ordinary shares. Each Series A Preferred Share carries a right to receive, out of funds legally available for the payment of dividends, cumulative dividends at an annual rate equal to 10% of the Issue Price, which will accrue on a daily basis from the date of issuance of such share, whether or not declared. Accrued and unpaid dividends will compound on an annual basis calculated on each anniversary of the date of issue. Upon liquidation of the company, preferred shareholders are entitled to a liquidation preference equal to 10% of the issue price per annum plus all accrued but unpaid dividends (refer to note 14).

Each Series A Preferred Share carries the right to receive any document or information an Ordinary Share carries the right to receive, and has the same right to attend and speak at the general meeting of the company and the same number of votes as if each preferred share were converted into Ordinary Shares, as per terms included in the shareholder deed dated 6 December 2002.

There were no movements in preference shares during years ended 30 June 2006 and 30 June 2005.

14 Non-current liabilities - Provisions

| | Consolidated | | Parent | |
|---|--------------|------------------|--------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Dividend accrued on series A preferred shares | - | <u>2,244,891</u> | - | <u>2,244,891</u> |

Dividends accrued on preference shares were reclassified to interest non-current borrowings as adjustment on adoption of AASB 132 and AASB 139 at 1 July 2005 (refer to note 13 and note 24).

15 Contributed equity

| | Parent | | Parent | |
|---|------------------|-------------------|----------------|-------------------|
| | 2006 Shares | 2005 Shares | 2006 \$ | 2005 \$ |
| (a) Share capital | | | | |
| Ordinary shares - fully paid | 7,588,721 | 7,318,500 | 669,968 | 629,435 |
| Preference shares Series A - fully paid | - | 10,249,142 | - | 9,898,217 |
| | <u>7,588,721</u> | <u>17,567,642</u> | <u>669,968</u> | <u>10,527,652</u> |

(b) Movements in ordinary share capital:

| Date | Details | Number of shares | Issue price | \$ |
|-------------------|--|---------------------|----------------|-----------------|
| 1 July 2004 | Opening balance | 7,253,500 | | 672,554 |
| 12 September 2004 | Exercise of 2003 options | 20,000 | \$0.15 | 3,000 |
| 22 September 2004 | Exercise of 2003 options | 10,000 | \$0.15 | 1,500 |
| 29 September 2004 | Exercise of 2003 options | 5,000 | \$0.15 | 750 |
| 30 March 2005 | Exercise of 2004 options | 30,000 | \$0.15 | 4,500 |
| | Less: Transaction costs arising on share issue | | | <u>(52,869)</u> |
| 30 June 2005 | Balance | <u>7,318,500</u> | | <u>629,435</u> |
| 1 July 2005 | Opening balance | 7,318,500 | | 629,435 |
| 6 September 2005 | Exercise of 2003 options | 5,000 | \$0.15 | 750 |
| 10 May 2006 | Exercise of 2004 options | 8,125 | \$0.15 | 1,219 |
| 18 June 2006 | Exercise of 2003 options | 50,000 | \$0.15 | 7,500 |
| 18 June 2006 | Exercise of 2004 options | <u>207,096</u> | \$0.15 | <u>31,064</u> |
| 30 June 2006 | Balance | <u>7,588,721</u> | | <u>669,968</u> |

(c) Ordinary shares

Each ordinary shareholder maintains, when present in person or by proxy or by attorney at any general meeting of the company, the right to cast one vote for each ordinary share held (subject to any agreement between the company and a member affecting the voting rights attaching to any share).

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of and amounts paid on the shares held, subsequent to the satisfaction of preferred shareholder rights as included in the shareholder deed dated 6 December 2002. (refer to note 13).

(d) Preference shares Series A

Preference shares Series A were reclassified to non-current borrowings as adjustment on adoption of AASB 132 and AASB 139 at 1 July 2005 (refer to note 13 and note 24).

15 Contributed equity (continued)

(e) Options

Each option granted to founding shareholders on 19 September 2002 was exercisable immediately on issue. Upon exercising, each option is convertible into one ordinary share and entitles the holder to the same ordinary share rights as noted above.

Information relating to the QrxPharma Employee Option Plan, including details of options issued, exercised and lapsed during the financial year and options outstanding at the end of the financial year are set out in note 22.

16 Reserves and accumulated losses

| | Consolidated | | Parent | |
|--|-----------------|----------------|-----------------|----------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| (a) Reserves | | | | |
| Exercised share options reserve | 27,426 | 4,131 | 27,426 | 4,131 |
| Share-based payments reserve | <u>134,455</u> | <u>119,710</u> | <u>134,455</u> | <u>119,710</u> |
| | <u>161,881</u> | <u>123,841</u> | <u>161,881</u> | <u>123,841</u> |
| | | | | |
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Movements: | | | | |
| <i>Exercised share options reserve</i> | | | | |
| Balance 1 July | 4,131 | - | 4,131 | - |
| Transfer from share-based payments reserve (options exercised) | <u>23,295</u> | <u>4,131</u> | <u>23,295</u> | <u>4,131</u> |
| Balance 30 June | <u>27,426</u> | <u>4,131</u> | <u>27,426</u> | <u>4,131</u> |
| <i>Share-based payments reserve</i> | | | | |
| Balance 1 July | 119,710 | - | 119,710 | - |
| Option expense | 38,040 | 123,841 | 38,040 | 123,841 |
| Transfer to exercised share options reserve | <u>(23,295)</u> | <u>(4,131)</u> | <u>(23,295)</u> | <u>(4,131)</u> |
| Balance 30 June | <u>134,455</u> | <u>119,710</u> | <u>134,455</u> | <u>119,710</u> |

These reserves are not distributable.

(b) Accumulated losses

Movements in accumulated losses were as follows:

| | Consolidated | | Parent | |
|----------------------------|---------------------|---------------------|---------------------|---------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Opening accumulated losses | (14,423,459) | (8,581,066) | (14,451,159) | (8,608,766) |
| Loss for the year | (3,510,503) | (4,797,049) | (3,510,503) | (4,797,049) |
| Dividends | - | (1,045,344) | - | (1,045,344) |
| Balance 30 June | <u>(17,933,962)</u> | <u>(14,423,459)</u> | <u>(17,961,662)</u> | <u>(14,451,159)</u> |

17 Key management personnel disclosures

(a) Directors

The following persons were directors of QrxPharma Pty Limited during the financial year:

M A Quinn
G W Pace
M S Hirshorn
G Savage
D A Henderson
D Stack
R Creswell (resigned 10 February 2006)

(b) Other key management personnel

The following persons also had authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, during the financial year:

| <i>Name</i> | <i>Position</i> |
|---------------------|-------------------------|
| Nicholas Harvey | Chief Financial Officer |
| Felix de la Iglesia | Chief Technical Officer |

(c) Key management personnel compensation

| | Consolidated | | Parent | |
|------------------------------|----------------|----------------|----------------|----------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Short-term employee benefits | 329,110 | 376,547 | 329,110 | 376,547 |
| Post-employment benefits | - | - | - | - |
| Share-based payments | <u>20,117</u> | <u>80,919</u> | <u>20,117</u> | <u>80,919</u> |
| | <u>349,227</u> | <u>457,466</u> | <u>349,227</u> | <u>457,466</u> |

18 Remuneration of auditors

| | Consolidated | | Parent | |
|---|---------------|---------------|---------------|---------------|
| | 2006 \$ | 2005 \$ | 2006 \$ | 2005 \$ |
| (a) Assurance services | | | | |
| <i>Audit services</i> | | | | |
| PricewaterhouseCoopers Australian firm | | | | |
| Audit and review of financial reports and other audit work under the <i>Corporations Act 2001</i> | <u>15,000</u> | <u>16,000</u> | <u>15,000</u> | <u>16,000</u> |
| Total remuneration for audit services | <u>15,000</u> | <u>16,000</u> | <u>15,000</u> | <u>16,000</u> |
| <i>Other assurance services</i> | | | | |
| PricewaterhouseCoopers Australian firm | | | | |
| Preparation of financial statements | - | 6,000 | - | 6,000 |
| IFRS accounting services | <u>-</u> | <u>2,000</u> | <u>-</u> | <u>2,000</u> |
| Total remuneration for other assurance services | <u>-</u> | <u>8,000</u> | <u>-</u> | <u>8,000</u> |
| Total remuneration for assurance services | <u>15,000</u> | <u>24,000</u> | <u>15,000</u> | <u>24,000</u> |
| (b) Taxation services | | | | |
| PricewaterhouseCoopers Australian firm | | | | |
| Tax compliance and consulting services, including preparation of company income tax returns | <u>-</u> | <u>43,400</u> | <u>-</u> | <u>43,400</u> |
| Total remuneration for taxation services | <u>-</u> | <u>43,400</u> | <u>-</u> | <u>43,400</u> |
| | <u>15,000</u> | <u>67,400</u> | <u>15,000</u> | <u>67,400</u> |

19 Related party transactions

(a) Directors

The names of persons who were directors of the company at any time during the financial year are set out in note 17.

(b) Subsidiaries

Interests in subsidiaries are set out in note 20.

(c) Key management personnel

Disclosures relating to key management personnel are set out in note 17.

(d) Transactions with related parties

The following transactions occurred with related parties:

| | Consolidated | | Parent | |
|----------|--------------|---------|---------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Expenses | 362,539 | 421,182 | 362,539 | 421,182 |

During the year, the company directly engaged and contracted the services of certain shareholders in relation to the ongoing normal course of business operations. The total amount paid to shareholders for contracted services rendered during the year amounted to \$362,532 (2005: \$421,182).

(e) Outstanding balances

The following balances are outstanding at the reporting date in relation to transactions with related parties:

| | Consolidated | | Parent | |
|---|--------------|---------|---------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| <i>Current payable</i> | | | | |
| Subsidiaries | - | - | 27,700 | 27,700 |
| Balances in relation to related parties | 135,960 | 142,144 | 135,960 | 142,144 |

20 Subsidiaries

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

| Name of entity | Country of incorporation | Class of shares | Equity holding | |
|------------------|--------------------------|-----------------------|----------------|------|
| | | | 2006 | 2005 |
| | | | % | % |
| Lynx Pty Limited | Australia | Ordinary | 100 | 100 |
| Haempatch | Australia | Ordinary / Preference | 100 | 100 |

21 Reconciliation of profit after income tax to net cash inflow from operating activities

| | Consolidated | | Parent | |
|---|--------------------|--------------------|--------------------|--------------------|
| | 2006 | 2005 | 2006 | 2005 |
| | \$ | \$ | \$ | \$ |
| Loss for the year | (3,510,503) | (4,797,049) | (3,510,503) | (4,797,049) |
| Depreciation and amortisation | 29,988 | 29,116 | 29,988 | 29,116 |
| Non-cash employee benefits expense - share-based payments | 38,040 | 123,841 | 38,040 | 123,841 |
| Change in operating assets and liabilities | | | | |
| Decrease in other operating assets | - | 12,752 | - | 12,752 |
| (Decrease) / increase in trade creditors and accruals | (188,639) | 304,507 | (188,639) | 304,507 |
| Increase / (decrease) in other operating liabilities | <u>1,791,412</u> | <u>(971)</u> | <u>1,791,412</u> | <u>(971)</u> |
| Net cash outflow from operating activities | <u>(1,839,702)</u> | <u>(4,327,804)</u> | <u>(1,839,702)</u> | <u>(4,327,804)</u> |

22 Share-based payments

(a) QrxPharma Pty Limited Employee Share Option Plan (ESOP)

The ESOP was established to enable QrxPharma to grant options over shares to employees and consultants of the economic entity, subject to local regulations. Under the ESOP, the Board may invite applications for options from directors, full time or part time employees and consultants of QrxPharma having regard to the employee's position, services provided by the employees, recorded employment or service, potential contributions and any other matters which indicate the employee's merit. The exercise price in respect of an option granted shall be the market price for a share prevailing at the time of grant unless the Board decides otherwise. Options will lapse if they are not exercised before the expiration date or if the option holder leaves the employment of QrxPharma. The Board reserves discretion to waive the latter provisions.

Options granted under the plan carry no dividend or voting rights. The vesting period for each option is 4 years, or as varied by the Board, 25% vesting after 12 months from the date of grant and the balance vesting monthly over the remaining 36 month period. When exercisable, each option is convertible into one ordinary share and entitles the holder to the same ordinary share rights as set out in note 15.

Set out below are summaries of options granted under the plan:

| Grant Date | Expiry date | Exercise price | Balance at start of the year Number | Granted during the year Number | Exercised during the year Number | Cancelled during the year Number | Balance at end of the year Number |
|---------------------------------------|-------------------|----------------|--|-----------------------------------|-------------------------------------|-------------------------------------|--------------------------------------|
| Consolidated and parent - 2006 | | | | | | | |
| 19 December 2002 | 19 December 2012 | \$0.30 | 40,000 | - | - | - | 40,000 |
| 19 February 2003 | 19 February 2006 | \$0.15 | 40,000 | - | - | - | 40,000 |
| 21 November 2003 | 21 November 2005 | \$0.15 | 5,000 | - | (5,000) | - | - |
| 1 December 2003 | 1 December 2006 | \$0.15 | 20,000 | - | - | - | 20,000 |
| 15 December 2003 | 15 December 2013 | \$0.15 | 50,000 | - | (50,000) | - | - |
| 24 February 2004 | 24 February 2013 | \$0.15 | 10,000 | - | - | - | 10,000 |
| 24 February 2004 | 24 February 2014 | \$0.30 | 10,000 | - | - | - | 10,000 |
| 24 February 2004 | 24 February 2014 | \$0.15 | 15,000 | - | (8,125) | - | 6,875 |
| 25 February 2004 | 24 February 2014 | \$0.15 | 5,000 | - | - | - | 5,000 |
| 16 March 2004 | 16 March 2014 | \$0.15 | 10,000 | - | - | - | 10,000 |
| 19 May 2004 | 19 May 2014 | \$0.15 | 25,000 | - | - | - | 25,000 |
| 24 June 2004 | 24 June 2014 | \$0.15 | 20,000 | - | - | - | 20,000 |
| 13 July 2004 | 13 July 2014 | \$0.15 | 50,000 | - | - | - | 50,000 |
| 14 July 2004 | 14 July 2014 | \$0.15 | 40,000 | - | - | - | 40,000 |
| 17 August 2004 | 17 August 2014 | \$0.15 | 20,000 | - | - | - | 20,000 |
| 19 October 2004 | 19 October 2014 | \$0.15 | 1,041,344 | - | (207,096) | (50,000) | 784,248 |
| 19 February 2005 | 19 February 2015 | \$0.15 | 150,000 | - | - | - | 150,000 |
| 18 May 2005 | 18 May 2015 | \$0.15 | 240,000 | - | - | - | 240,000 |
| 21 September 2005 | 21 September 2015 | \$0.15 | 110,000 | - | - | - | 110,000 |
| Total | | | <u>1,901,344</u> | <u>-</u> | <u>(270,221)</u> | <u>(50,000)</u> | <u>1,581,123</u> |

