PORTLAND ORTHOPAEDICS

Portland Orthopaedics Limited and controlled entities

ABN 92 086 839 992

Annual Report – 30 June 2005

Note	Contents	Page

This financial report covers both Portland Orthopaedics Limited as an individual entity and the consolidated entity consisting of Portland Orthopaedics Limited and its controlled entities.

Portland Orthopaedics Limited is a Company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Portland Orthopaedics Limited
Unit 3
44 McCauley Street
Matraville NSW 2036

A description of the nature of the consolidated entity's operations and its principal activities is included in the Directors' Report on page 1.

Directors' Report

The directors present their report on the consolidated entity, consisting of Portland Orthopaedics Limited and the entities it controlled for the year ended 30 June 2005.

Directors
The following persons were directors of Portland Orthopaedics Limited ('the Company') during the whole of the financial year and up to the date of this report:

Professor Ron Sekel	
Mr. David Sekel	
Dr. Geoff Brooke	(resigned 27/10/2005)
Dr. Richard Gregson	
Dr. Chris Roberts	(appointed 01/07/2004, resigned 31/07/2004)
Mr. John Quin	(appointed 11/10/2004, resigned 30/04/2005)
Mr. Ronald Rowland	(appointed 01/11/2005)
Mr. John Lee	(appointed 01/11/2005)

Company Secretary
Mr. David Edwards – Bachelor of Economics, Chartered Accountant. Mr. Edwards has worked for Portland Orthopaedics Limited since May 2003 performing the role of Chief Financial Officer. Mr. Edwards was appointed company secretary on 17 July 2003.

Principal activities
The consolidated entity's principal continuing activities during the year consisted of the manufacture and distribution of orthopaedic implants.

Significant changes in the state of affairs
There have been no significant changes in the nature of the consolidated entity's activities during the year.

Environmental regulation
No environmental regulation applies.

Review of operations
The consolidated net loss of the consolidated entity for the year was $2,993,686 (2004: $4,051,117).

Likely developments and expected results of operations
Further information on likely developments in the operations of the consolidated entity and the expected results of operations have not been included in this report because the directors believe it would be likely to result in unreasonable prejudice to the consolidated entity.

Information on directors

Director	**Experience**	**Special responsibilities**
Executive directors		
Professor Ronald Sekel MBBS, FRACS (orth), FRCSE	Practicing as an orthopaedic surgeon for more than 25 years, specialising in joint replacements. A Fellow of the Royal Colleges of Australasia and Edinburgh. He is an Affiliate of engineering at the University of New South Wales and has extensive experience in managing private companies.	Chief Technology Officer
David Sekel	A qualified lawyer and accountant with extensive experience in corporate advisory and corporate governance. He is Deputy Chairman of the National Steering Committee of the Medical Device Network and an adviser to Ausbiotech.	Chief Executive Officer Member of remuneration committee

Directors' Report (continued)

Director	Experience	Special responsibilities
Non-Executive directors		
Dr. Richard Gregson PhD, MBA	Has served as non-executive director on many boards of private companies. Currently managing director of Equity Partners, a private equity fund management group that manages funds on behalf of 14 institutions. Dr Gregson has extensive experience in product and business development in the healthcare industry.	Member of remuneration committee Member of audit committee
Dr. Geoff Brooke MBA	Managing director of GBS Venture Partners Limited with more than 15 years of venture capital experience. Dr. Brooke has been the founder, lead investor and director of healthcare and bioscience based companies both in the United States and Australia.	
Ronald Rowland AM	Group Managing director and CEO of Australian Pharmaceuticals industries for over 22 years. In 1999 was honoured as a member of the Order of Australia by Her Majesty the Queen. A fellow of the Australian Institute of Company Directors.	
John Lee BCom; BEdu; MBA; FAICD	Extensive background as a company director and chairman with various listed companies. Experienced in areas such as capital raisings, corporate governance, strategic reviews, industrial relations strategies and senior management succession.	

Particular of directors' interests in shares and options
Ron Sekel is the holder of 2,142,000 ordinary shares in Portland Orthopaedics Limited

Meetings of directors
The numbers of meetings of the Company's board of directors held during the year ended 30 June 2005, and the number of meetings attended by each director were:

			Meetings of Committees			
	Full meetings of directors		Audit		Remuneration	
	A	B	A	B	A	B
Ronald Sekel	4	5	*	*	*	*
David Sekel	5	5	-	-	-	
Richard Gregson	5	5	-	-	-	-
Geoff Brooke	5	5	*	*	*	*
Chris Roberts	1	1	-	-	-	-
John Quin	2	2	-	-	-	-

A = Number of meetings attended.
B = Number of meetings held during the time the director held office or was a member of the committee during the year
* = Not a member of the relevant committee

Directors' Report (continued)

Shares under option
Unissued ordinary shares of Portland Orthopaedics Limited under option at the date of this report are as follows:

Date Options Granted	Exercise Price of Shares	Number Under Option
1 January 2001	$0.70	197,595
1 February 2001	$0.70	55,000
1 October 2001	$0.70	306,000
1 January 2002	$0.70	6,630
1 July 2002	$0.70	45,000
1 February 2003	$0.70	5,000
1 March 2003	$0.70	15,000
1 May 2003	$0.70	180,000
22 September 2003	$0.70	152,865
11 October 2004	$0.70	10,000
10 November 2004	$0.70	35,000
3 March 2005	$0.70	5,000
		1,013,090

Dividends paid of recommended
No dividends were paid or recommended during the financial year.

Insurance of officers
During the financial year, the Company paid a premium of $55,707 (2004: $61,810) to insure the directors and officers of the Company.

Matters subsequent to the end of the financial year

Subsequent to the reporting date the company has issued the following preference shares to existing preference shareholders:

Date	Number of Preference Shares	$
5 August 2005	171,429	150,000
14 September 2005	571,429	500,000
	742,858	**650,000**

Except for the matter discussed above, there is no other matter or circumstance subsequent to the end of the financial year that has significantly affected or may significantly affect:

i. the consolidated entity's operations in future financial years, or
ii. the results of those operations in future financial years, or
iii. the consolidated entity's state of affairs in future financial years.

Directors' Report (continued)

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

The lead auditor's independence declaration for the year ended 30 June 2005 has been received and can be found on page 33 of the Annual Report.

Auditor
PricewaterhouseCoopers resigned as auditors on 8 September 2005. On 23 September the shareholders appointed Grant Thornton NSW as auditors in accordance with section 327 of the Corporations Act 2001.

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

David Sekel
Director
Sydney
1 December 2005

Portland Orthopaedics Limited and controlled entities
Statements of Financial Performance
For the year ended 30 June 2005

	Notes	Consolidated 2005 $	Consolidated 2004 $	Parent Entity 2005 $	Parent Entity 2004 $
Revenue from ordinary activities	3	**3,437,683**	2,764,430	**3,689,605**	2,697,419
Raw materials and consumables used		**(1,456,544)**	(1,049,646)	**(1,495,425)**	(1,461,219)
Changes in inventories of finished goods		**698,874**	107,445	**692,026**	506,939
Employee benefits expense		**(1,951,168)**	(2,167,008)	**(1,191,513)**	(1,233,235)
Depreciation and amortisation	4	**(375,709)**	(338,462)	**(245,072)**	(250,290)
Borrowing costs	4	**(145,588)**	(37,237)	**(116,477)**	(16,359)
Consulting fees		**(501,105)**	(853,757)	**(361,219)**	(780,182)
Facilities		**(377,281)**	(305,323)	**(300,665)**	(285,478)
Travel & entertainment		**(542,114)**	(644,328)	**(310,965)**	(348,907)
Sales distribution and marketing		**(769,458)**	(625,070)	**(146,140)**	(112,076)
Research and development		**(762,563)**	(682,832)	**(793,684)**	(790,281)
Provision against related party loan		**-**	-	**-**	(4,009,537)
Other expenses from ordinary activities		**(248,713)**	(219,329)	**(177,889)**	(192,529)
Loss from ordinary activities before income tax expenses		**(2,993,686)**	(4,051,117)	**(757,418)**	(6,275,735)
Income tax expense relating to ordinary activities	5	**-**	-	**-**	-
Loss from ordinary activities after income tax expenses		**(2,993,686)**	(4,051,117)	**(757,418)**	(6,275,735)
Net loss attributable to outside equity interest		**-**	-	**-**	-
Total changes in equity other than those resulting from transactions with owners as owners	19	**(2,993,686)**	(4,051,117)	**(757,418)**	(6,275,735)

The above statements of financial performance should be read in conjunction with the accompanying notes.

Portland Orthopaedics Limited and controlled entities
Statements of Financial Position
As at 30 June 2005

		Consolidated		Parent Entity	
		2005	**2004**	**2005**	**2004**
	Notes	**$**	**$**	**$**	**$**
Current assets					
Cash assets	6	**559,037**	697,043	**382,295**	620,289
Receivables	7	**355,601**	635,562	**2,925**	416,673
Inventories	8	**2,387,162**	2,312,033	**2,542,318**	2,482,314
Other	9	**65,619**	86,090	**53,006**	80,712
Total current assets		**3,367,419**	3,730,728	**2,980,544**	3,599,988
Non current assets					
Property, plant and equipment	10	**936,353**	914,889	**322,602**	535,027
Intangible assets	11	**2,446,739**	2,395,909	**248,371**	194,541
Investments	12	**-**	-	**2,302,103**	2,302,103
Other	13	**-**	-	**2,482,229**	50,864
Total non-current assets		**3,383,092**	3,310,798	**5,355,305**	3,082,535
Total assets		**6,750,511**	7,041,526	**8,335,849**	6,682,523
Current liabilities					
Payables	14	**908,482**	1,980,975	**240,292**	1,438,187
Provisions	15	**173,491**	184,397	**86,041**	47,814
Interest bearing liabilities	16	**168,192**	101,125	**38,519**	24,517
Total current liabilities		**1,250,165**	2,266,497	**364,852**	1,510,518
Non current liabilities					
Interest bearing liabilities	17	**249,398**	1,133,332	**7,774**	1,046,291
Other	18	**50,000**	50,000	**133,850**	141,860
Total non-current liabilities		**299,398**	1,183,332	**141,624**	1,188,151
Total liabilities		**1,549,563**	3,449,829	**506,476**	2,698,669
Net assets		**5,200,948**	3,591,697	**7,829,373**	3,983,854
Equity					
Contributed equity	20	**16,789,947**	12,187,010	**16,789,947**	12,187,010
Accumulated losses	19	**(11,588,999)**	(8,595,313)	**(8,960,574)**	(8,203,156)
Total equity		**5,200,948**	3,591,697	**7,829,373**	3,983,854

The above statements of financial position should be read in conjunction with the accompanying notes.

Portland Orthopaedics Limited and controlled entities
Statements of cash flows
For the year ended 30 June 2005

	Notes	Consolidated 2005 $	Consolidated 2004 $	Parent Entity 2005 $	Parent Entity 2004 $
Cashflows from operating activities					
Receipts from customers (inclusive of GST)		**2,785,195**	2,364,313	**583,995**	853,263
Payments to suppliers and employees (inclusive of GST)		**(7,268,687)**	(6,417,138)	**(2,751,419)**	(2,079,492)
Borrowing costs		**(16,587)**	(37,237)	**(10,031)**	(16,359)
Interest received		**18,547**	58,028	**17,491**	58,028
Interest paid		**(34,121)**	-	**(11,566)**	-
Other revenue		**841,951**	790,300	**820,472**	786,281
Net cash outflow from operating activities	**26**	**(3,673,702)**	(3,241,734)	**(1,351,058)**	(398,279)
Cash flows from investing activities					
Payments for property, plant and equipment		**(18,310)**	(176,098)	**-**	(32,048)
Payments for patents and trademarks		**(100,387)**	(81,378)	**(100,387)**	(81,378)
Net cash outflow from investing activities		**(118,697)**	(257,476)	**(100,387)**	(113,426)
Cash flows from financing activities					
Loans to related parties		**-**	(4,286)	**(3,697,647)**	(3,204,853)
Loans from related parties		**-**	-	**1,144,411**	-
Proceeds from issue of shares		**3,850,000**	2,500,000	**3,850,000**	2,500,000
Proceed from issue of convertible notes		**-**	750,000	**-**	750,000
Share transaction costs		**(58,796)**	(40,000)	**(58,796)**	(40,000)
Repayment of borrowings		**(121,509)**	(118,684)	**(24,517)**	(69,042)
Net cash inflow/(outflow) from financing activities		**3,669,695**	3,087,030	**1,213,451**	(63,895)
Net (decrease)/increase in cash held		**(122,704)**	**(412,180)**	**(237,994)**	**(575,600)**
Cash at the beginning of the financial year		**681,741**	1,093,921	**620,289**	1,195,889
Cash at the end of the financial year	**6**	**559,037**	681,741	**382,295**	620,289

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

Note 1. Summary of significant accounting policies

This general purpose financial report has been prepared in accordance with Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Consensus Views and the *Corporations Act 2001*.

It is prepared in accordance with the historical cost convention. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

(a) Going concern

The Company and Consolidated entity continued to generate operating losses of $2,993,686 and negative cash flows from operations of $3,673,702 in the year ended 30 June 2005 as the Consolidated entity continues to grow and expand sales within the US market. At the balance sheet date, the Consolidated entity had net assets of $5,200,948 and cash balances of $559,037. The continuing viability of the Company and its Controlled entities and their ability to continue as going concerns and meet their debts as they fall due in future years are dependent upon the Consolidated entity being successful in achieving sales in the US market and in negotiating and obtaining additional funding.

As a result of these matters, there is uncertainty whether the Company and Consolidated entity 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. 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 2005. No adjustments have been made to the financial report relating to the recoverability and classification of the asset carrying amounts or the amounts and classification of liabilities that might be necessary should the Consolidated entity not continue as a going concern.

The Directors believe that the Consolidated entity will be successful in the above matters and, accordingly, have prepared the financial report on a going concern basis.

(b) Principles of Consolidation

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by Portland Orthopaedics Limited (the "Company" or "parent entity") For the year ended 30 June 2005 and the results of all entities for the year then ended. Portland Orthopaedics Limited and its controlled entities are together referred to in this financial report as the Consolidated entity. The effects of all transactions within the consolidated entity have been eliminated in full.

(c) Income Tax

Tax effect accounting procedures are followed whereby the income tax expense in the statement of financial performance is matched with the accounting profit after allowing for permanent differences. The future tax benefit relating to tax losses is not carried forward as an asset unless the benefit is virtually certain of realisation. Income tax on cumulative timing differences is set aside to the deferred income tax or the future income tax benefit accounts at the rates which are expected to apply when those timing differences reverse.

(d) Foreign Currency Translation

i) Transactions

Transactions denominated in a foreign currency are converted into Australian currency at the exchange rate at the date of the transaction. At balance date, foreign currency payables and receivables are translated to Australian currency at exchange rates current at that date. Resultant exchange gains and losses are brought to account in determining the profit or loss for the year.

ii) Foreign Operations

The activities undertaken in United States of America (USA) are integrated with the related Australian activities. The assets, liabilities and equity of the USA operations are translated into Australian currency using the temporal method of translation whereby non-monetary assets and liabilities and equity items, including revenue and expenses are translated using historic rates of exchange, and monetary assets and liabilities are translated using rates of exchange current at the reporting date. Any resultant exchange differences are recorded as revenue or expense.

Note 1. Summary of significant accounting policies (continued)

(e) Acquisition of assets
The purchase method of accounting is used for all acquisitions of assets regardless of whether equity instruments or other assets are acquired. Cost is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus incidental costs directly attributable to the acquisition. Where equity instruments are issued in an acquisition, the value of the instruments is their fair value as at the acquisition date based on the best available evidence of the price at which the instruments could be exchanged between knowledgeable, willing parties in an arm's length transaction. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

(f) Revenue Recognition
Revenue is recognised as follows:
(i) Stocking distributor
A sale is recorded when goods have been passed to the distributor pursuant to a sales order and the associated risks have passed to the carrier or distributor.
(ii) Consignment distributor
Revenue is recognised on completion of the surgical procedure.
(iii) Grant income
Grant income is recognised in accordance with the conditions of the grant.

(g) Receivables
Trade accounts receivable are generally settled within 60 days and are carried at amounts due. Collectibility of trade debtors is reviewed on an ongoing basis. A provision is raised for any doubtful debt based on a review of all outstanding amounts at the balance sheet date. Bad debts are written off in the period in which they are identified.

(h) Inventories
Finished goods, raw materials and work in progress are stated at the lower of cost and net realisable value. Cost comprises the cost of purchases including costs of bringing the inventories to location. In the case of manufactured goods, direct labour costs, variable overhead and a portion of fixed overhead costs allocated on the basis of normal operating capacity are included.

(i) Investments
Investments in associates are accounted for using the equity method. Under this method, the Company's share of the post-acquisition profits or losses of associates is recognised in the statement of financial performance, and its share of post-acquisition movements in reserves is recognised in reserves. Controlled entities are accounted for in the consolidated financial statements as set out in note 1 (b).

(j) Depreciation of property, plant and equipment
Property, plant and equipment, are depreciated over their expected useful lives, using the reducing balance method.

The expected useful lives are as follows:

Manufacturing Equipment	2-6 years
Motor Vehicles	4 years
Office Equipment	2-5 years
Fixtures and Fittings	2-5 years

Instruments sets are depreciated on a straight line basis. The expected useful life of instrument sets is between 2 and 5 years.

Note 1. Summary of significant accounting policies (continued)

(k) Leased non-current assets
A distinction is made between finance leases which effectively transfer from the lessor to the lessee substantially all the risks and benefits incident to ownership of leased non-current assets and operating leases under which the lessor effectively retains substantially all such risks and benefits.

Finance leases are capitalised. A lease asset and liability are established at the present value of minimum lease payments. Lease payments are allocated between the principal component of the lease liability and the interest expense.

Lease assets are amortised in accordance with the expected useful life of the asset in accordance with note (j) above.

Other operating lease payments are charged to the statement of financial performance in the periods in which they are incurred, as this represents the pattern of benefits derived from the leased assets.

(l) Goodwill
Goodwill purchased is shown in the financial statements at cost less amounts written off. Goodwill is amortised on a straight-line basis over the period of expected benefit, which has been assessed as 20 years.

(m) Patents and trademarks
Significant costs associated with patents are deferred and amortised on a straight-line basis over the periods of their expected benefit, which vary from 3 to 5 years.

Trademarks and intellectual property are valued at cost. The directors have considered the legal and commercial factors likely to impact on the useful lives of the trademarks and intellectual property and consider that they have infinite lives. Accordingly, no amortisation has been provided against the carrying amount.

(n) Trade and other creditors
These amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year which remain unpaid. The amounts are unsecured and are usually paid within 60 days of recognition.

(o) Interest bearing liabilities
Loans are carried at their principal amounts, which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other creditors.

On issue of convertible notes, the fair value of the liability component, being the obligation to make future payments of principle and interest to note holders, is calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the fair value of the conversion option, is included in equity as other equity securities with no recognition of any change in the value of the option in subsequent periods.

(p) Maintenance and repairs
The consolidated entity's plant is required to be overhauled on a regular basis. This is managed as part of an ongoing major cyclical maintenance program. The costs of this maintenance are charged as expenses as incurred, except where they relate to the replacement of a component of an asset, in which case the costs are capitalised and depreciated. Other routine operating maintenance, repair and minor renewal costs are also charged as expenses as incurred.

(q) Web site costs
Costs in relation to web sites controlled by the Company are charged, as expenses in the period in which they are incurred unless they relate to the acquisition of an asset, in which case they are capitalised and amortised over their period of expected benefit.

Note 1. Summary of significant accounting policies (continued)

(r) Employee Benefits

i) Wages and salaries and annual leave

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date are recognised in other creditors 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. The liability for long service leave expected to be settled more then 12 months from the reporting date is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

iii) Employee benefit on-costs

Employee benefit on-costs, including payroll tax and superannuation, are recognised and included in employee benefit liabilities and costs when the employee benefits to which they relate are recognised as liabilities.

(s) Borrowings

Borrowings are recorded at their principal amounts and interest is accrued and recorded as part of other creditors over the period it becomes due.

Borrowing costs are recognised as expenses in the period in which they are incurred. Borrowing costs include interest on bank overdrafts and on related party loans.

(t) Cash

For the purpose of the statements of cash flows, cash includes deposits at call, which are readily convertible to cash on hand and are subject to insignificant risk of changes in value, net of bank overdrafts

(u) Recoverable amount of non-current assets

The recoverable amount of an asset is the net amount expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal.

Where the carrying amount of a non-current asset is greater then its recoverable amount, the asset is written down to its recoverable amount. Where net cash inflows are derived from a group of assets working together, recoverable amount is determined on the basis of the relevant group of assets. The decrement in the carrying amount is recognised as an expense in net profit or loss in the reporting period which the recoverable amount write-down occurs.

The expected net cash flows included in determining recoverable amounts of non current assets are discounted to their present values using a risk-adjusted discount rate.

(v) Research and development

Costs incurred on research and development are charged as expenses in the period in which they are incurred.

(w) Non-current assets constructed by the consolidated entity

The cost of non-current assets constructed by the consolidated entity includes the cost of all materials used in construction, direct labour and an appropriate proportion of directly attributable variable and fixed overheads.

Note 1. Summary of significant accounting policies (continued)

(x) Adoption of Australian Equivalents to International Financial Reporting Standards

The company is preparing and managing the transition to Australian Equivalents to International Financial Reporting Standards (A-IFRS) effective for financial years commencing 1 January 2005. The adoption of A-IFRS will be reflected in the economic entity's and the parent entity's financial statements for the year ending 30 June 2006. On first time adoption of A-IFRS, comparatives for the financial year ended 30 June 2005 are required to be restated. The majority of the A-IFRS transitional adjustments will be made retrospectively against retained earnings at 1 July 2004.

The economic entity's management, in consultation with its auditors, has assessed the significance of these changes and are preparing for their implementation. The Audit Committee will oversee and manage the economic entity's transition to A-IFRS. The impact of the alternative treatments and elections under AASB 1: First Time Adoption of Australian Equivalents to International Financial Reporting Standards has been considered where applicable.

The directors are of the opinion that the key differences in the economic entity's accounting policies on conversion to A-IFRS and the financial effect of these differences, where known, are as follows. Users of the financial statements should note, however, that the amounts disclosed could change if there are any amendments by standard-setters to the current A-IFRS or interpretation of the A-IFRS requirements changes from the continuing work of the economic entity's audit committee.

Impairment of Assets
The economic entity currently determines the recoverable amount of an asset on the basis of undiscounted net cash flows that will be received from the assets use and subsequent disposal. In terms of AASB 136: Impairment of Assets, the recoverable amount of an asset will be determined as the higher of fair value less costs to sell and value in use. It is likely that this change in accounting policy will lead to impairments being recognised more often than under the existing policy. However, no impairments have been identified on first time adoption.

Goodwill on Consolidation
Under AASB 3: Business Combinations, goodwill is to be capitalised in the statement of financial position and subjected to an annual impairment test. Amortisation of goodwill is to be prohibited. Current accounting policy of the entity is to amortise goodwill on a straight line basis over the period of 20 years. The Company has elected under AASB 1: Business Combinations, First Time Adoption of Australian Equivalents to International Financial Reporting Standards not to restate any prior business acquisitions, as such on opening balances, the net book value of goodwill will be the company's deemed costs. For a quantification of the financial impact, refer to the reconciliation below.

Income Tax
Currently, the economic entity adopts the liability method of tax-effect accounting whereby the income tax expense is based on the accounting profit adjusted for any permanent differences. Timing differences are currently brought to account as either a provision for deferred income tax or future income tax benefit. Under AASB 1020: Income Taxes, the economic entity will be required to adopt a balance sheet approach under which temporary differences are identified for each asset and liability rather than the effects of the timing and permanent differences between taxable income and accounting profit. The economic entity has not been impacted in respect of income tax on first time adoption of the A-IFRS.

Share Based Remuneration
Currently, options over unissued shares provided to executives as part of their remuneration are not expensed through the statement of financial performance. With the introduction of AASB 2: Share Based Payment, the economic entity will be required to expense the fair value of the options granted as remuneration over the period that the options vest. For a quantification of the financial impact, refer to the reconciliation below.

Foreign Currency Translation (foreign operations)
Under AASB 121: The effects of changes in foreign exchange rates assets and liabilities of overseas controlled entities are translated at year-end rates and operating results are translated at rates ruling at the end of each month. Gains and losses arising on translation are taken directly to the foreign currency translation reserve.

Portland Orthopaedics Limited and controlled entities
Notes to the financial statements
For the year ended 30 June 2005

Note 1. Summary of significant accounting policies (continued)

The estimated cumulative financial impact of A-IFRS, on the financial statements of the company and economic entity for the year ended 30 June 2005 is summarised below. As noted above these amounts represent management's best estimates and could differ from actuals.

Reconciliation of net profit		**Economic Entity Year ended 30 June 2005**	**Parent Entity Year ended 30 June 2005**
Net loss reported under existing Australian Accounting Standards		(2,993,686)	(757,418)
Transitional adjustments:			
Expense employee benefits	i	(14,252)	(14,252)
Reversal of amortisation of goodwill	ii	3,000	-
Total transitional adjustments		(11,252)	(14,252)
Adjusted net loss under A-IFRS		(3,004,938)	(771,670)
Reconciliation of Equity			
Equity reported under existing Australian Accounting Standards		5,200,948	7,829,373
Retrospective adjustments to equity:			
Employee expense benefit	i	(57,974)	(57,974)
Bring share based payments to contributed equity		72,226	72,226
Total transitional adjustments to equity		5,215,200	7,843,625
Increase in current year loss due to transitional adjustments to A-IFRS		(11,252)	(14,252)
Adjusted equity under A-IFRS		5,203,948	7,829,373

A-IFRS adjustment notes:

i The adjustment reflects the expensing of the fair value of options over ordinary shares issued and vest as remuneration with the recognition of an associated equity remuneration reserve. The impact of the expense in the current financial year of $14,252 has been taken to current year losses, with the impact of the previous financial years expenses of $57,974 taken to opening retained earnings. The combined impact of the expensing of current and prior financial years equity remuneration of $72,226 is reflected in an equity remuneration reserve.

The opening retained earnings balance comprises the net equity remuneration expense attributable to the 2004 financial year.

ii The adjustment reflects the goodwill under the impairment standard as at the opening balance sheet date of 1 July 2004. The impact of reversal of current year amortisation of $3,000 has been taken to the current year loss.

Note 2. Segment information

Business Segments

The Company operates in one business segment globally, being orthopaedic implants.

Geographical Segments

Although the consolidated entity's divisions are managed on a global basis they operate in three main geographical areas, Australia, Israel and the United States.

2005	**Australia**	**United States**	**Europe**	**Inter-segment eliminations**	**Consolidated**
	$	**$**	**$**	**$**	**$**
Sales to external customers	1,218,182	1,222,004	132,227	-	2,572,413
Inter-segment sales	3,455,545	-	-	(3,455,545)	-
Total sales revenue	4,673,727	1,222,004	132,227	(3,455,545)	2,572,413
Other revenue	865,270	-	-	-	865,270
Total segment revenue	5,538,997	1,222,004	132,227	(3,455,545)	3,437,683
Segment result	(927,312)	(1,608,830)	(457,499)	-	(2,993,641)
Segment assets	9,339,447	251,255	74,463	(2,914,654)	6,750,511
Segment liabilities	1,719,136	5,830,117	531,962	(6,531,652)	1,549,563
Acquisitions of plant and equipment and intangibles	375,242	-	-	(13,281)	361,961
Depreciation and amortisation expense	361,948	13,761	-	-	375,709

Notes to and forming part of the segment information

Accounting policies

Segment information is prepared in conformity with the accounting policies of the entity as disclosed in note 1 and accounting standard AASB 1005 *Segment Reporting.*

Segment revenues, expenses, assets and liabilities are those directly attributable to a segment and the relevant portion that can be allocated on a reasonable basis. Segment assets include all assets used by a segment and consist primarily of operating cash, receivables, inventories, property, plant and equipment and goodwill and other intangible assets, net of related provisions. Segment liabilities consist primarily of trade and other creditors, and employee benefits.

Portland Orthopaedics Limited and controlled entities
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Note 2. Segment information (continued)

2004	Australia $	United States $	Europe $	Other $	Inter-segment eliminations $	Consolidated $
Sales to external customers	535,128	1,376,888	-	4,071	-	1,916,087
Intersegment sales	2,883,619	-	-	-	(2,883,619)	-
Total sales revenue	3,418,747	1,376,888	-	4,071	(2,883,619)	1,916,087
Other revenue	848,343	-	-	-	-	848,343
Total segment revenue	4,267,090	1,376,888	-	4,071	(2,883,619)	2,764,430
Segment result	(2,686,921)	(1,364,196)	-	-	-	(4,051,117)
Segment assets	11,677,554	315,252	-	-	(4,951,280)	7,041,526
Segment liabilities	3,109,141	5,171,404	-	-	(4,830,716)	3,449,829
Acquisitions of plant and equipment and intangibles	329,674	10,469	-	-	-	340,143
Depreciation and amortisation expense	325,516	12,946	-	-	-	338,462
Other non-cash expenses	7,985	-	-	-	-	7,985

Note 3. Revenue

	Consolidated 2005 $	Consolidated 2004 $	Parent Entity 2005 $	Parent Entity 2004 $
Revenue from operating activities				
Sale of goods	**2,572,413**	1,916,087	**2,319,965**	1,591,292
Revenue from outside the operating activities				
Interest	**18,547**	58,043	**90,692**	319,846
Government grants	**410,772**	772,800	**410,772**	772,800
R&D Tax concession	**409,700**	-	**409,700**	-
Management fees	**-**	-	**452,327**	-
Other	**26,251**	17,500	**6,149**	13,481
	865,270	848,343	**1,369,640**	1,106,127
Revenue from ordinary activities	**3,437,683**	2,764,430	**3,689,605**	2,697,419

Portland Orthopaedics Limited and controlled entities
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For the year ended 30 June 2005

Note 4. Loss from Ordinary Activities

	Consolidated		Parent Entity	
	2005	2004	2005	2004
	$	$	$	$
Expenses				
Cost of sales	**757,670**	942,201	**803,399**	954,280
Depreciation				
Furniture & Fittings	**7,573**	10,595	**7,573**	7,576
Instruments	**167,482**	194,043	**167,482**	191,275
Manufacturing Equipment	**103,401**	61,028	**7,914**	7,915
Motor Vehicles	**31,580**	26,251	**11,520**	8,703
Office Equipment	**30,461**	27,836	**18,371**	19,112
	340,497	319,753	**212,860**	234,581
Amortisation				
Patents	**32,212**	15,709	**32,212**	15,709
Goodwill	**3,000**	3,000	**-**	-
	35,212	18,709	**32,212**	15,709
Borrowing costs				
Interest and finance charges paid	**145,588**	37,237	**116,477**	16,359
	145,588	37,237	**116,477**	16,359
Rental expenses relating to operating leases				
Minimum lease payments	**78,708**	78,663	**19,692**	19,665
Total rental expenses	**78,708**	78,663	**19,692**	19,665
Research and development	**762,563**	682,832	**793,684**	790,281
Foreign currency translation losses	**44,621**	-	**-**	-
Write down of obsolete inventory	**62,978**	-	**62,978**	-
Write back of interest provision	**186,634**	-	**186,634**	-
Write back of provision for stock transaction	**120,250**	-	**120,250**	-
Write down of property, plant and equipment	**-**	7,985	**-**	7,985
Provision against related party loan	**-**	-	**-**	4,009,537

Note 5. Income tax

The income tax expense for the financial year differs from the amount calculated on the profit. The differences are reconciled as follows:

	Consolidated		Parent Entity	
	2005	2004	2005	2004
	$	$	$	$
Loss from ordinary activities before income tax expense	**(2,993,641)**	(4,051,117)	**(757,418)**	(6,275,735)
Income tax calculated at 30% (2004 - 30%)	**(898,092)**	(1,215,335)	**(227,225)**	(1,882,721)
Tax effect of permanent differences:				
Research and development	**293,094**	285,946	**293,094**	285,946
Non-deductible expenses	**8,102**	90,585	**7,925**	90,408
Income tax adjusted for permanent differences	**(596,896)**	(838,804)	**73,794**	(1,506,367)
Tax losses not brought to account as future income tax benefits	**596,896**	838,804	**-**	1,506,367
Recoupment of prior year tax losses not previously brought to account	**-**	-	**-**	-
Utilised in the current financial year	**-**	-	**(73,794)**	-
Income tax expense	**-**	-	**-**	-
a) Future income tax benefits not brought to account, the benefits of which will only be realised if the conditions for deductibility in note 1(c) occur:				
Timing differences	**54,815**	46,477	**38,785**	22,001
Tax losses	**2,143,070**	1,546,173	**739,872**	813,666
	2,197,885	1,592,650	**778,657**	835,667

This benefit for tax losses will only be obtained if:

(i) The consolidation entity derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deduction for the losses to be realised, or

(ii) The losses are transferred to an eligible entity in the consolidated entity, and

(iii) The consolidated entity continues to comply with the conditions for deductibility imposed by tax legislation, and

(iv) No changes in tax legislation adversely affect the consolidated entity in realising the benefit from the deductions for the losses.

Tax consolidation legislation

At the date of this report, the directors have not adopted the tax consolidation legislation.

While the Company has carried forward tax losses, no future income tax benefit has been recognised in relation to those losses. No adjustment is therefore required as a result of the mandatory provisions of the tax consolidation legislation. Should the Company not elect to adopt the legislation, the future income tax benefit in respect of tax losses not brought to account will only be obtained if the Company itself derives future assessable income to recoup these losses, continues to comply with the conditions for deductibility imposed by tax legislation and no changes to tax legislation adversely affect the Company realising the benefit.

Note 6. Current assets - Cash assets

	Consolidated		Parent Entity	
	2005	2004	2005	2004
	$	$	$	$
Cash at bank and on hand	**559,037**	697,043	**382,295**	620,289
	559,037	697,043	**382,295**	620,289

The above figures are reconciled to cash at the end of the financial year as shown in the statement of cash flows as follows:

Balance as above	**559,037**	697,043	**382,295**	620,289
Less: Bank overdrafts (note 16)	-	(15,302)	-	-
Balance per statement of cashflows	**559,037**	681,741	**382,295**	620,289

Note 7. Current assets - Receivables

Trade debtors	**335,195**	371,829	-	155,811
Less: provision for doubtful debts	-	-	-	-
	335,195	371,829	-	155,811
Converting note	-	250,000	-	250,000
Other debtors	**16,284**	6,989	**903**	6,418
Loans to directors	**4,122**	6,744	**2,022**	4,444
	355,601	635,562	**2,925**	416,673

Further information relating to loans to directors is set out in note 24.

Note 8. Current assets - Inventories

Raw materials (at cost)	**93,126**	27,000	-	-
Work in progress (at cost)	**121,660**	190,855	-	-
Goods in transit (at cost)	-	636,795	-	636,795
Finished goods (at cost)	**2,172,376**	1,457,383	**2,542,318**	1,845,519
	2,387,162	2,312,033	**2,542,318**	2,482,314

Note 9. Current assets - Other

	Consolidated		Parent Entity	
	2005	2004	2005	2004
	$	$	$	$
Prepayments	**65,619**	86,090	**53,006**	80,712

Note 10. Non-current assets - Property, Plant and Equipment

	Consolidated		Parent Entity	
	2005	2004	2005	2004
Instruments				
At cost	**638,886**	667,492	**631,373**	683,938
Less: Accumulated depreciation	**(402,237)**	(287,755)	**(402,632)**	(288,150)
	236,649	379,737	**228,741**	395,788
Office Equipment				
At cost	**128,086**	125,586	**77,084**	77,084
Less: Accumulated depreciation	**(91,682)**	(73,141)	**(53,156)**	(41,593)
	36,404	52,445	**23,928**	35,491
Office equipment under finance lease	**40,885**	25,544	**25,544**	25,544
Less: Accumulated depreciation	**(16,835)**	(4,915)	**(11,723)**	(4,915)
	24,050	20,629	**13,821**	20,629
Total office equipment	**60,454**	73,074	**37,749**	56,120
Furniture & Fittings				
At cost	**54,623**	54,623	**54,445**	54,445
Less: Accumulated depreciation	**(31,726)**	(24,153)	**(31,726)**	(24,153)
	22,897	30,470	**22,719**	30,292
Motor Vehicles				
At cost	**55,478**	55,478	**-**	-
Less: Accumulated depreciation	**(33,913)**	(24,550)	**-**	-
	21,565	30,928	**-**	-
Motor vehicles under finance lease	**113,203**	113,203	**46,364**	46,364
Less: Accumulated depreciation	**(73,481)**	(51,264)	**(38,528)**	(27,008)
	39,722	61,939	**7,836**	19,356
Total motor vehicles	**61,287**	92,867	**7,836**	19,356
Manufacturing Equipment				
At cost	**529,137**	512,402	**-**	-
Less: Accumulated depreciation	**(369,548)**	(328,508)	**-**	-
	159,589	183,894	**-**	-
Manufacturing equipment under finance lease	**480,629**	177,638	**46,560**	46,560
Less: Accumulated depreciation	**(85,152)**	(22,791)	**(21,003)**	(13,089)
	395,477	154,847	**25,557**	33,471
Total manufacturing equipment	**555,066**	338,741	**25,557**	33,471
	936,353	914,889	**322,602**	535,027

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

Reconciliations

Reconciliations of the carrying amounts of each class of property, plant and equipment at the beginning and end of the current financial year are set out below:

Consolidated

	Instruments	Office Equipment	Leased Office Equipment	Furniture & Fittings	Motor Vehicles	Leased Motor Vehicles	Manufacturing Equipment	Leased Manufacturing Equipment	Total
	$	$	$	$	$	$	$	$	$
Carrying amount at 1 July 2004	379,737	52,445	20,629	30,470	30,928	61,939	183,894	154,847	914,889
Additions	24,394	2,500	15,341	-	-	-	16,735	302,991	361,961
Depreciation expense (Note 4)	(167,482)	(18,541)	(11,920)	(7,573)	(9,363)	(22,217)	(41,040)	(62,361)	(340,497)
Carrying Amount at 30 June 2005	**236,649**	**36,404**	**24,050**	**22,897**	**21,565**	**39,722**	**159,589**	**395,477**	**936,353**

Parent

	Instruments	Office Equipment	Leased Office Furniture	Furniture & Fittings	Motor Vehicles	Leased Motor Vehicles	Manufacturing Equipment	Leased Manufacturing Equipment	Total
	$	$	$	$	$	$	$	$	$
Carrying amount at 1 July 2004	395,788	35,491	20,629	30,292	-	19,356	-	33,471	535,027
Additions	435	-	-	-	-	-	-	-	435
Depreciation expense (Note 4)	(167,482)	(11,563)	(6,808)	(7,573)	-	(11,520)	-	(7,914)	(212,860)
Carrying Amount at 30 June 2005	**228,741**	**23,928**	**13,821**	**22,719**	**-**	**7,836**	**-**	**25,557**	**322,602**

Note 11. Non-current assets - Intangible assets

	Consolidated 2005	Consolidated 2004	Parent Entity 2005	Parent Entity 2004
	$	$	$	$
Goodwill	**110,368**	110,368	-	-
Less: Accumulated amortisation	**(12,000)**	(9,000)	-	-
	98,368	101,368	-	-
Patents	**193,243**	120,848	**193,243**	120,848
Less: Accumulated amortisation	**(54,547)**	(22,335)	**(54,547)**	(22,335)
	138,696	98,513	**138,696**	98,513
Trademarks/Intellectual Property	**2,209,675**	2,196,028	**109,675**	96,028
	2,446,739	2,395,909	**248,371**	194,541

Note 12. Non-current assets - Investments

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
Investment in subsidiaries (note 25)	**-**	-	**2,302,103**	2,302,103

Note 13. Non-current assets - Other

Loans to related parties (note 24)	**-**	-	**2,482,229**	50,864

Note 14. Current liabilities - Payables

Trade creditors	**451,565**	1,342,140	**157,402**	1,147,000
Other creditors	**456,917**	638,835	**82,890**	291,187
	908,482	1,980,975	**240,292**	1,438,187

Note 15. Liabilities - Provisions

Employee entitlements- current	**147,866**	167,489	**70,855**	40,134
Employee entitlements- non-current	**25,625**	16,908	**15,186**	7,680
Aggregate employee entitlements	**173,491**	184,397	**86,041**	47,814

	2005	**2004**	**2005**	**2004**
	Number		**Number**	
Employee numbers				
Number of employees at year end.	**28**	27	**8**	6

Portland Orthopaedics Limited Employee Share Option Plan
The establishment of the Portland Orthopaedics Employee Share Option Plan was approved by shareholders in October 2001. All staff are eligible to participate in the plan. Options are granted under the plan for no consideration. Options are granted for an indefinite period, and 1/3 of each new tranche vests (i.e. they are not conditional on future employment) after the first anniversary of the date of grant and 1/24 of each new tranche vests monthly thereafter. When exercisable, each option is convertible into one ordinary share.

Note 15. Liabilities – Provisions (continued)

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

Grant date	Exercise Price	Balance at the start of the year Number	Issued during the year Number	Exercised during the year Number	Lapsed during the year Number	Balance at the end of the year Number
Consolidated and parent entity - 2005						
1 January 2001	$0.70	197,595	-	-	-	197,595
1 February 2001	$0.70	55,000	-	-	-	55,000
1 October 2001	$0.70	306,000	-	-	-	306,000
1 January 2002	$0.70	6,630	-	-	-	6,630
1 July 2002	$0.70	45,000	-	-	-	45,000
1 February 2003	$0.70	5,000	-	-	-	5,000
1 March 2003	$0.70	15,000	-	-	-	15,000
1 May 2003	$0.70	180,000	-	-	-	180,000
22 September 2003	$0.70	158,610	-	-	(5,745)	152,865
11 October 2004	$0.70	-	10,000	-	-	10,000
10 November 2004	$0.70	-	35,000	-	-	35,000
3 March 2005	$0.70	-	5,000	-	-	5,000
Total		**968,835**	**50,000**	**-**	**(5,745)**	**1,013,090**

Grant date	Exercise Price	Balance at the start of the year Number	Issued during the year Number	Exercised during the year Number	Lapsed during the year Number	Balance at the end of the year Number
Consolidated and parent entity - 2004						
1 January 2001	$0.70	197,595	-	-	-	197,595
1 February 2001	$0.70	55,000	-	-	-	55,000
1 October 2001	$0.70	306,000	-	-	-	306,000
1 January 2002	$0.70	15,000	-	-	(8,370)	6,630
1 July 2002	$0.70	67,500	-	-	(22,500)	45,000
1 February 2003	$0.70	5,000	-	-	-	5,000
1 March 2003	$0.70	30,000	-	-	(15,000)	15,000
1 May 2003	$0.70	180,000	-	-	-	180,000
22 September 2003	$0.70	-	158,610	-	-	158,610
Total		**856,095**	**158,610**	**-**	**(45,870)**	**968,835**

There were no options exercised during the financial year.

Note 16. Current liabilities – Interest bearing liabilities

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
Lease liabilities	**168,192**	85,823	**38,519**	24,517
Bank overdraft	**-**	15,302	**-**	-
	168,192	101,125	**38,519**	24,517

Note 17. Non-current liabilities – Interest bearing liabilities

Secured				
Convertible notes	**-**	1,000,000	**-**	1,000,000
Lease liabilities	**249,398**	133,332	**7,774**	46,291
	249,398	1,133,332	**7,774**	1,046,291

Lease liabilities
Motor vehicles and manufacturing equipment are under lease (Note 10). The lease liabilities of the parent entity and controlled entities are secured by personal guarantees by the executive directors.

Note 18. Non-current liabilities – Other

Loans from related parties (note 24)	**50,000**	50,000	**133,850**	141,860
	50,000	50,000	**133,850**	141,860

Note 19. Accumulated losses

(Accumulated losses) at the beginning of the financial year	**(8,595,313)**	(4,544,196)	**(8,203,156)**	(1,927,421)
Net loss for the year	**(2,993,686)**	(4,051,117)	**(757,418)**	(6,275,735)
(Accumulated losses) at the end of the financial year	**(11,588,999)**	(8,595,313)	**(8,960,574)**	(8,203,156)

Note 20. Contributed equity

	Consolidated			
	2005 Shares	**2004 Shares**	**2005 $**	**2004 $**
(a) Share capital				
Ordinary Shares - fully paid	**17,000,000**	17,000,000	**2,227,010**	2,227,010
Preference Shares – fully paid	**18,191,016**	12,857,144	**14,562,937**	9,960,000
	35,191,016	29,857,144	**16,789,947**	12,187,010

(b) **Movements in preference share capital of the Company during the past year were as follows. There was no movement in ordinary share capital.**

Dates	**Details**	**No. of Shares**	**Issue Price**	$
30 June 2004	Opening Balance	12,857,144		9,960,000
24 December 2004	Conversion of 2,500,000 $1 convertible notes	2,857,143	0.875	2,500,000
24 December 2004	Shares issued in consideration for convertible note interest	76,730	0.875	67,139
24 December 2004	Share Issue (Note i)	342,857	0.875	300,000
4 January 2005	Share Issue (Note i)	342,857	0.875	300,000
21 January 2005	Share Issue (Note i)	342,857	0.875	300,000
28 January 2005	Share Issue (Note i)	685,714	0.875	600,000
1 June 2005	Share Issue (Note i)	685,714	0.875	600,000
	Less: transaction costs arising on share issue	-		(64,202)
		18,191,016		**14,562,937**

i) The share issues during the year are in accordance with the terms and conditions set out in a shareholders agreement with existing investors.

(c) **Ordinary shares**
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.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

(d) **Options**
Information relating to the Portland Orthopaedics Limited 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 15.

(e) **Preference Shares**
All redeemable preference shares are redeemable at a face value $1 each. These preference shares are converted into ordinary shares at the end of the redemption period, which is also the conversion period. The preference shareholder must at the date of conversion relinquish the preference share certificates to the company after which new ordinary share certificates will be issued. Any market value decrement below $1 per share will be borne by the preference shareholder at the point of conversion. The redeemable preference shares are entitled to the same dividend declared and paid to the ordinary shareholders in respect to the ordinary shares

Note 21. Financial instruments

a) Credit Risk Exposure

The credit risk on financial assets of the consolidated entity that have been recognised on the statement of financial position, is generally the carrying amount, net of any provisions for doubtful debts.

b) Interest Rate Exposure

The consolidated entity's exposure to interest rate risk and the effective weighted average interest rate by maturity periods is set out in the following table. For interest rates applicable to each class of asset or liability refer to the individual note in the financial statements. Exposures arise predominantly from assets and liabilities bearing variable interest rates as the consolidated entity intends to hold fixed rate assets and liabilities to maturity.

c) Net Fair Value of Financial Assets and Liabilities

The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of the consolidated entity approximates their carrying amounts.

2005

	Floating Interest Rate $'000	1 Year or Less $'000	Over 1 Year to 5 Years $'000	More Than 5 Years $'000	Non-Interest Bearing $'000	Total $'000
Financial Assets						
Cash and deposits	559,037	-	-	-	-	559,037
Receivables	-	-	-	-	355,601	355,601
	559,037	-	-	-	355,601	914,638
Weighted Average Interest Rate	2.25%	-	-	-	-	
Financial Liabilities						
Bank overdrafts and loans	-	168,192	249,398	-	-	417,590
Trade and other creditors	-	-	-	-	908,482	908,482
Other loans	-	-	-	-	50,000	50,000
	-	168,192	249,398	-	958,482	1,376,072
Weighted Average Interest Rate	-	7.70%	7.70%	-	-	

2004

	Floating Interest Rate $'000	1 Year or Less $'000	Over 1 Year to 5 Years $'000	More Than 5 Years $'000	Non-Interest Bearing $'000	Total $'000
Financial Assets						
Cash and deposits	697,043	-	-	-	-	697,043
Receivables	-	-	-	-	635,562	635,562
	697,043	-	-	-	635,562	1,332,605
Weighted Average Interest Rate	2.25%	-	-	-	-	
Financial Liabilities						
Bank overdrafts and loans	15,302	85,823	133,332	-	-	234,457
Convertible notes			1,000,000			1,000,000
Trade and other creditors	-	-	-	-	1,980,975	1,980,975
Other loans	-	-	-	-	50,000	50,000
	15,302	85,823	1,133,332	-	2,030,975	3,265,432
Weighted Average Interest Rate	10.10%	7.70%	8.00%	-	-	

Note 22. Remuneration of directors

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
Income paid or payable, or otherwise made available, to directors by the Company and related parties in connection with the management of the affairs of the Company.				
	482,581	473,373	**482,581**	473,373

The number of directors whose total income from the Company or related parties was within the specified bands are as follows:

	2005	2004
$0 - $10,000	**1**	-
$10,000 - $19,999	**-**	2
$20,000 - $29,999	**3**	-
$30,000 - $39,999	**-**	1
$170,000 - $179,999	**1**	1
$240,000 - $249,999	**1**	1

Note 23. Remuneration of auditors

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
During the year the following services were paid to the auditor of the parent entity:				
PricewaterhouseCoopers Australian firm				
Audit of financial reports of the entity	-	19,500	-	19,500
Due diligence services	-	106,697	-	106,697
Taxation services – tax advice	-	40,255	-	40,255
	-	166,452	-	166,452
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Audit of financial reports of the entity	**19,500**	-	**19,500**	-
	19,500	166,452	**19,500**	166,452

Note 24. Related parties

Directors

The names of persons who were directors of the Company during the financial year are as follows:
R Sekel; D F Sekel; G Brooke; R Gregson; C Roberts, John Quin, Ronald Rowland and John Lee.

Chris Roberts resigned from the position of non-executive director on 31 July 2004 and John Quin resigned from the position of executive chairman on 30 April 2005. Geoff Brooke resigned from the position of non-executive director on 27 October 2005. Ronald Rowland and John Lee were appointed on 1 November 2005.

Remuneration

Information on remuneration is disclosed in Note 22

Loans to and from directors and director-related entities

Loans to directors of the Company and their director-related entities disclosed in note 7 comprise:

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
Unsecured Loan to D F Sekel	**4,122**	6,744	**2,022**	4,444
Loans from directors of the Company and their director related entities disclosed in note 19 comprise:				
Unsecured loan from Sekel Superannuation Fund	**50,000**	50,000	**-**	-

Share transactions with director related entities

The beneficial holdings of the directors and their director related entities in the ordinary and preference shares of the parent company as at 30 June 2005 were:

	Parent Entity	
	2005	2004
	$	$
Ordinary Shares – fully paid	**6,599,400**	6,599,400
Preference shares – fully paid	**18,191,016**	12,857,144
	24,790,416	19,456,544

Transactions with director related entities

Dr Richard Gregson is a director of Equity Partners Limited. During the year Equity Partners received $20,000 (2004: $10,000) from Portland Orthopaedics Limited in relation to fees payable for Dr Richard Gregson's services as a non-executive director.

Dr. Geoff Brooke is a director of GBS Venture Partners Limited. During the year GBS Venture Partners received $20,000 (2004: $10,000) from Portland Orthopaedics Limited in relation to fees payable for Dr Geoff Brooke's services as a non-executive director.

Note 24. Related parties (continued)

Wholly owned group

Aggregate amounts included in the determination of loss from ordinary activities before income tax that results from transactions with each class of other related parties:

	Consolidated		Parent Entity	
	2005	**2004**	**2005**	**2004**
	$	**$**	**$**	**$**
Sales				
Controlled entities	-	-	2,319,965	1,153,220
Management Fees				
Controlled entities	-	-	452,327	-
Purchases				
Controlled entities	-	-	992,600	1,482,027

Aggregate amounts receivable from, and payable to, each class of other related parties at balance date:

Non-current assets				
Controlled entities	-	-	2,482,229	50,864
Non-current liabilities				
Controlled entities	-	-	133,850	141,860

All loan balances from controlled entities are non-interest bearing.

Controlling entity
The ultimate parent entity in the wholly owned group is Portland Orthopaedics Limited.

Note 25. Investments in controlled entities

Name of entity	Country of incorporation	Class of shares	Equity holding 2005 %	Equity holding 2004 %
Portland Orthopaedics Inc	United States of America	Ordinary	**100**	100
Portland Square Pty Ltd	Australia	Ordinary	**100**	100
Portland Square Manufacturing Pty Ltd	Australia	Ordinary	**100**	100
Portland Orthopaedics (Aust.) Pty Ltd	Australia	Ordinary	**100**	100
Vimek Pty Ltd	Australia	Ordinary	**46**	46
Portland Orthopaedics Limited	United Kingdom	Ordinary	**100**	100
Entities controlled by Portland Square Manufacturing Pty Ltd				
Vimek Pty Ltd	Australia	Ordinary	**54**	54

Note 28. Commitments for expenditure

	Consolidated 2005 $	Consolidated 2004 $	Parent Entity 2005 $	Parent Entity 2004 $
Lease commitments				
Commitments in relation to leases contracted for at the reporting date but not recognised as liabilities payable:				
Within one year	**113,811**	98,109	**27,510**	28,153
Later than one year but not later than 5 years	**206,019**	180,820	**41,343**	49,164
	319,830	278,929	**68,853**	77,317
Representing:				
Non-cancellable operating leases	**236,124**	236,124	**59,076**	59,076
Future finance charges on finance leases	**(83,706)**	(42,805)	**(9,777)**	(18,241)
	319,830	278,929	**68,853**	77,317
Operating Leases				
Commitments for minimum lease payments in relation to Non-cancellable operating leases are payable as follows:				
Within one year				
Later than one year but not later than 5 years	**78,708**	78,708	**19,692**	19,692
Later than 5 years	**157,416**	157,416	**39,384**	39,384
Commitments not recognised in the financial statements	**236,124**	236,124	**59,076**	59,076
Finance leases				
Commitments in relation to finance leases are payable as follows:				
Within one year				
Later than one year but not later than 5 years	**203,292**	105,224	**46,333**	32,978
Later than 5 years	**298,009**	156,736	**9,737**	56,071
Minimum lease repayments	**501,301**	261,960	**56,070**	89,049
Less: future finance charges	**83,706**	42,805	**9,777**	18,241
Total lease liability	**417,595**	219,155	**46,293**	70,808
Representing lease liabilities:				
Current (note 16)	**168,197**	85,823	**38,519**	24,517
Non-current (note 17)	**249,398**	133,332	**7,774**	46,291
	417,595	219,155	**46,293**	70,808

Finance leases relate to motor vehicles and manufacturing equipment.

Note 29. Contingent liabilities

The consolidated entity had contingent liabilities at 30 June 2005 in respect of:

Government grants
To date, the consolidated entity has received various grants from the Federal and State Government to assist on a dollar for dollar basis with the commercialisation of new products and to also assist with the funding of specific projects. There are certain circumstances in accordance with the grant deed that certain of these grants, together with interest, may be repayable. These circumstances include the project not being commercialised within its prescribed timeframe, the Company breaching the agreement, or an insolvency event occurring. The directors consider these events extremely unlikely.

Total grants received for the year to 30 June 2005 were $410,772 (2004: $772,800).

Note 30. Events Occurring after reporting date

Subsequent to the reporting date the company has issued the following preference shares to existing preference shareholders:

Date	Number of Preference Shares	$
5 August 2005	171,429	150,000
14 September 2005	571,429	500,000
	742,858	**650,000**

Note 31. Company Details

The registered office and principal place of operations of the company is:

Unit 3
44 McCauley Street
MATRAVILLE NSW 2036

Portland Orthopaedics and controlled entities
Directors' declaration
For the year ended 30 June 2005

In the directors' opinion:

(a) the financial statements and notes set out on pages 5 to 31 are in accordance with the *Corporations Act 2001*, including
   (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
   (ii) giving a true and fair view of the Company's and Consolidated entity's financial position as at 30 June 2005 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date.

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

This declaration is made in accordance with a resolution of the directors.

D Sekel
Director

Sydney
1 December 2005

Chartered Accountants
Business Advisers and Consultants

Grant Thornton

AUDITOR'S INDEPENDENCE DECLARATION TO THE DIRECTORS OF PORTLAND ORTHOPAEDICS LIMITED

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of Portland Orthopaedics Limited for the year ended 30 June 2005, 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.

A J ARCHER
Partner
Grant Thornton NSW

Sydney

1 December 2005

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INDEPENDENT AUDIT REPORT
TO THE MEMBERS OF PORTLAND ORTHOPAEDICS LIMITED

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for Portland Orthopaedics Limited and Controlled entities for the year ended 30 June 2005. The consolidated entity comprises both the company and the entities it controlled during that year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

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

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

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

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report; and

- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

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INDEPENDENT AUDIT REPORT
TO THE MEMBERS OF PORTLAND ORTHOPAEDICS LIMITED (cont)

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001

Audit opinion

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

(a) the Corporations Act 2001, including:

  (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2005 and of their performance for the year ended on that date; and

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

(b) other mandatory financial reporting requirements in Australia.

Inherent uncertainty regarding continuation as a going concern

Without qualification to the opinion expressed above, attention is drawn to the following matter. As a result of the matters discussed in Note 1(a), there is inherent uncertainty as to whether Portland Orthopaedics Limited will be able to continue as a going concern and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report.

Grant Thornton NSW

GRANT THORNTON NSW
Chartered Accountants

A J Archer

A J ARCHER
Partner

Sydney 1 December 2005