WebSpy Limited

ABN 60 066 153 982

AND CONTROLLED ENTITIES

2006 Annual Report

WEBSPY LIMITED
AND CONTROLLED ENTITIES
CORPORATE DIRECTORY

DIRECTORS

Mr Jack Andrys –Chief Executive Officer/Managing Director
Mr Tom McGellin – Executive Director
Mr Joseph Chua – Non-executive Director
Mr Ian Gibson – Non-executive Director

COMPANY SECRETARY

Mr Anthony Ho

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AUDITORS

Grant Thornton Western Australian Partnership
256 St George's Terrace
PERTH WA 6000

SHARE REGISTRAR

Security Transfers Registrars Pty Ltd
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APPLECROSS WA 6153
Telephone: 61 8 9315-2333
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PERTH WA 6000

ASX CODE

WSY – Ordinary Shares

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AND CONTROLLED ENTITIES
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WEBSPY LIMITED AND CONTROLLED ENTITIES

CHIEF EXECUTIVE OFFICER'S LETTER

Fellow Shareholders,

The Company has seen many changes over the past year leading to the release of new products, the engagement of new management in the WebSpy business unit, the formation of new partnerships and further reduction of costs.

The Company's result for the year nearly saw a break even position with a loss $227,372 coming about through delays in projects worth $220,000 in the last quarter being pushed into this financial year. With the commencement of the new financial year's activities it is envisaged that the current year's projected revenues coupled with cost reductions made in the second half of last year will see cash accumulation and a profitable year.

WebSpy continues the operation of its two business units WebSpy® Internet Management products and Netlink Inspection products and services for the oil and gas industry. The past year saw a reduction in the WebSpy sales growth from just under 30% to 2%, whilst at the same time seeing an increase in activity and revenue from Netlink Inspection.

The WebSpy® Internet Management business unit's reduced revenue increase can be attributed to senior management turnover in all three offices during the year together with the launch of a new generation of product in January 2006. The unit has adjusted operations and reduced cost to compensate and has set realistic targets for the current year for a positive contribution to the company. The Business Unit has commenced on a path to engage master distributors and strategic and OEM partners instead of its previous high reliance on direct sales.

The Netlink Inspection business unit's activity has seen the deployment of its products and services into more clients and new locations including now the North Sea via Aberdeen Scotland, Singapore, Philippines, Indonesia, Qatar, Malaysia and Australia in the North West, Timor Sea and Bass Strait. The unit has also signed a JV agreement with Ionik Consulting which provides a very important strategic marketing channel through Ionic Consulting and its parent companies JP Kenny and the Wood Group. Netlink Inspection is currently increasing its manning levels for current activity as well as expected activity through the JV. The oil and gas industry is currently very receptive to the types of products and services Netlink Inspection is offering.

Over the past three years the Company's results for the year have seen constant improvement from a loss of $1.1million in 2003-2004 to $556,488 in 2004-05 and $227,372 in 2005-2006. We all look forward to continuing the trend in the current year.

Jack Andrys
Chief Executive Officer
Managing Director
WebSpy Ltd

29th September 2006

WebSpy Operational Summary

Re-positioning and preparing for future growth was the focus in 2006 and will continue into the first part of 2007. The introduction of a new suite of products in January of 2006 now positions WebSpy as one of the leaders in reporting and analysing activity in the ubiquitous internet and security markets. The year has also seen the implementation of a new global Customer Relationship Management system that enables pro-active, timely and accurate tracking of each lead and opportunity for the sales force as well as providing valuable management reporting at a corporate level.

Our continued drive of our solutions into the larger enterprise has produced good results with a number of global organizations now added to the client list, including Daimler Chrysler, Philip Morris, Protective Life Corporation, Thomson, Tyco AAPT and Shell. Further the extended use of our products in Education, local, state and federal governments around the world is further testimony to the importance now being placed on the reporting of activity in the internet space.

Marketing & Sales

Even with adverse trading conditions in our key market during the summer of 2005, overall sales revenues have increased by 2% to around $2.4 million whilst achieving a significant operational cost reduction, the benefits of which are expected to be derived fully in 2007. A new channel sales model in our European operations and a push towards strategically imbedding our technology within other vendors' solutions places the business unit in a good position for expanded market penetration with minimal cost increases required.

Vantage – *"A position, condition, or opportunity that is likely to provide superiority or an advantage".*

The general release of Vantage has been well received from both existing and new customers. From a market perspective, this product is well placed to leverage the opportunities in the Security Information and Event Management (SIEM) market space. The SIEM market is a major IT security segment already valued at US$330 million. It is also one of the fastest growing segments, with a 30% Compound Annual Growth Rate (CAGR). A significant component of this segment is driven by increased monitoring and reporting needs to meet regulatory compliance requirements (Sarbanes Oxley, HIPAA, etc) and enhance user productivity. One of the major IT-related regulatory obligations is data security and confidentiality. Without comprehensive Internet monitoring in place is it very difficult to ensure that confidentiality has not been broken by employees making inappropriate use of data. In the event of a detected policy breach, our product has a powerful engine for drilling into very large log files and evidencing any violations.

European Sales

The slow start to the year due to the terrorist attacks in London in July of 2005 put immense pressure on sales for the rest of the year, but with the introduction of a new channel sales model and with some significant new customer acquisitions we were able to increase total revenue. The delivery of the administrative and accounting functions for that region were centralized into corporate in the second half of the year bringing substantial savings to the ongoing operation of the UK office. Europe contributed over 50% of the revenues for the year and remains a key focus area for operational improvements and increased sales potential.

Americas Sales

Our Americas operations were re-structured during the year with the departure of the VP of Business Development in July 2005 and the Sales Manager in April 2006. That unit now reports directly into the COO and even though there has been a slight drop in sales revenue, the corresponding reduction in costs has created a positive overall outcome. The Americas is a very large market opportunity and North America does not have the complexities associated with the disparate markets in Europe. The focus for next year is to maintain the direct sales revenue but grow the channel business through the establishment of key distribution partners both in North and South America.

Asia Pacific Sales

The operations in this region continue to deliver consistent results and given that the team is the smallest of the business unit, the contribution per salesperson is one of the highest. Much of this contribution is as a direct result of the relationship with ContentKeeper and the deployment of our reporting module as part of their blocking and filtering solutions. Much of next years focus will be on further development of our home market through complementary vendor alliances and security focused distribution channels.

Product Development

The first half of the year was focused on our latest product offering, Vantage, which was released to the market in January 2006. This was a major re-development of both the functionality and technology platform and it was completed over a two year period. A project team of six developers was involved in this and with the release of the product that project was disbanded and two members were retained for ongoing maintenance and support of the product. The functionality now enables businesses to provide richer analysis and reporting against their ever increasing complex security systems and devices. The product is built on Microsoft's.NET Web Services platform which provides the ability to quickly build, deploy, manage, and use connected, security-enhanced solutions.

Key benefits to businesses of the new Vantage products are:

- Enablement, visually of Internet policy compliance and trends to senior management.
- The ability to easily integrate into Unified Threat Management appliances, Firewalls, Blocking and Filtering solutions and provide vendors of those solutions an added compelling case for imbedding the technology.
- Provision of a single point to view and analyse all activity within a disparate security environment.

Lagis Zavros
Chief Operating Officer
WebSpy Ltd

Netlink Operations Summary

The 2005-2006 was a solid year for Netlink Inspection consolidating our position as a profitable inspection services and software company in the global oil & gas market.

Revenue was slightly up on the previous year's results (to $890k) and the 20% gross margin was also a good improvement in a year where the world oil price has remained at record highs and there has been strong activity in offshore exploration and construction.

Inspection Services

Once again Netlink personnel, software and equipment were out on the water in the oil fields of Australia and South-East Asia working in the full range of offshore conditions.

Onshore, the ongoing support of our clients has also continued to extend from the realms of product support to include management of client data and analysis work to assist with engineering and integrity decision making.

This activity continues to bring enormous benefits to both the Netlink Inspection team and our software.

The Year's Services Highlights:

- Inspection personnel employed offshore in Australia (NW Shelf & Bass Strait), Singapore, Philippines, Indonesia and the Timor Sea.
- Personnel employed in client-representative roles in the North West Shelf for the Wandoo Production Alliance and Apache Energy Ltd.
- Support to Ionik Consulting in execution of asset integrity management contracts in Indonesia.
- Continuation of maintenance contracts with Apache Energy, ConocoPhillips, Qatar Gas, SeaQuill Inspection Services and Woodside Energy.

The Products

Netlink Inspection maintains a suite of integrated commercial software products which together provide a total asset integrity management system for life-of-field asset control.

This year has seen significant development and a restructuring of our enterprise level products to better suit market trends and requirements. The new versions are due for release in September 2006 and, in summary, are:

Asset Integrity Manager (AIM)	The core database application provides the backbone of our integrity management system. The database provides the ability to manage asset and inspection data for <u>any</u> asset type, to plan work schedules, track and manage anomalies and produce comprehensive reports.
AIM with 4-Site	The '4-Site' upgrade is a tool for preparing risk assessments and managing a risk-based-inspection (RBI) system. The risk elements are completely customisable to meet any industry or company standard and all calculations and assumptions are visible to the end user.
Web Overview	Web Overview is a powerful view of the AIM database across the Web by means of a standard browser. By this means the data can be securely opened up to a large number of employees in an organisation without the need for specialised training.
Inspection Manager (IM)	Inspection data collection is performed using Inspection Manager. The system has an impressive track record in subsea inspection where the system is interfaced to ROV systems and dive spreads for both structure and pipeline surveys.
Digital Video Recorder (DVR)	The DVR provides single or multiple channels, full frame digital video capture and many other features with full integration to IM and AIM.

The Year's Software Highlights:

- The restructuring and significant development of the product range for the field of asset integrity.
- First sale of Inspection Manager Enterprise and 4-Site to the UK (North Sea) for Maersk Oil, UK.
- Sale of Asset Integrity Manager, Inspection Manager and DVR to Maersk Oil, Qatar.
- Sale of Asset Integrity Manager with 4-Site to ConocoPhillips, Indonesia.
- Further sales of Digital Video Recorder to subsea service companies in the region.

Joint Venture

The year also saw the company further our strategic relationship with Ionik Consulting and enter the final stages of a Joint Venture agreement. The purpose of the Joint Venture is to promote Ionik's asset integrity services on the back of Netlink's products.

It is expected that this agreement will serve to dramatically accelerate the global awareness of Netlink's software products and will lead to significant growth and expansion opportunities over the next five years.

Ionik Consulting is a specialist business unit of the one of the world's leading engineering houses, the Wood Group. Through firms such as the JP Kenny, Mustang Engineering and Frontier Engineering the Wood Group employs some 14,000 people in 36 countries with global sales of $2.3b.

Looking Ahead

The year ahead is again full of positives for Netlink Inspection. The current activity level in the global oil & gas market is set to continue for some time. Interest in systematic asset integrity management only continues to strengthen as existing assets age and new fields come online.

As sales of our asset integrity and inspection software begin to gather pace worldwide, and the benefits of our Joint Venture begin to come to the fore, we see some exciting growth opportunities for the company and our product market.

Mason Linden
Operations Manager
Netlink Inspection Pty Ltd

The Directors present their Report together with the financial report of WebSpy Limited (the "Parent Entity") and of the Economic Entity, being the Company and its controlled entities, for the year ended 30 June 2006 and the auditor's report thereon.

Directors

The Directors of the economic entity at any time during or since the end of the financial year are:

Managing Director – Mr Jack Andrys (appointed 16 August 1999)

Mr Andrys was appointed to the Board on 16 August 1999 as WebSpy's Chief Executive Officer and Managing Director, prior to which he was Netlink's Managing Director and founder. Mr Andrys has worked in the information technology industry since 1992 and founded Netlink in 1994. Prior to this he spent a decade working in the oil and gas industry, initially as a commercial diver and finally as the Operations Co-ordinator of Australia's largest underwater intervention services provider, Contract Diving Services.

Executive Director – Mr Tom McGellin (appointed 28 May 2004)

Mr McGellin was a founding partner and director of Netlink WA Pty Ltd from 1994 to 1999 when it was acquired by WebSpy Ltd. Subsequent to this he became active and familiar with the Company's products and management team in his role as a past director of one of WebSpy's wholly owned subsidiaries. Mr McGellin is currently a director of other non listed public companies.

Non-Executive Director – Mr Joseph Chua (appointed 30 November 2001)

Mr Chua graduated in 1982 with a Bachelor of Arts, Honours degree in Business Law from City of London Polytechnic, UK and was called to the Bar at Gray's Inn at the end of 1983. Following his stay at the Gray's Inn and Inner Temple from 1983 to 1984, he returned to Malaysia and joined Kim Hin Industry Berhad as its Marketing Director in 1985. He is currently the executive chairman of Kim Hin Industry Berhad. Mr Chua represents the single largest shareholder group in WebSpy Ltd.

Non-Executive Director – Mr Ian Gibson (appointed 28 January 2005)

Mr Gibson has a Bachelor of Business and a Bachelor of Laws from the University of Technology, Sydney, NSW and has received a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia. Mr Gibson has over 12 years experience in investment markets, via the funds management and stockbroking industries. He has experience with equity research, valuation, corporate advice and investor relations. He also has a broad scope of financial market experience relevant to small-medium listed and unlisted companies.

Company Secretary – Mr Anthony Ho (appointed 10 April 1996)

Mr Ho graduated in 1980 with a Bachelor of Commerce from the University of Western Australia. He qualified as a Chartered Accountant in 1983. Mr Ho is presently the principal of a public practice, specialising in the corporate and financial administration of companies listed on the ASX.

Directors' Meetings

The number of Directors' meetings and the number of meetings attended by each of the Directors of the Company during the financial year are:

	Board Meetings	
Director	**Held while Director**	**Attended**
Mr J Andrys	5	5
Mr T McGellin	5	5
Mr J Chua	5	1
Mr I Gibson	5	5

The size of the Company is such that an audit committee is not considered warranted. All audit matters are considered by the Board of Directors.

Directorships of Other Listed Companies

No directors held directorships of other listed companies in the 3 years immediately before the end of the financial year.

Principal Activity

The principal activity of the parent and economic entity during the course of the financial year was software development, sales and the provision of services. There have been no changes in this activity since the previous year.

Results

The result of the economic entity for the year ended 30 June 2006 was a loss after income tax of $227,372 (2005: $556,488).

The result of the parent entity for the year ended 30 June 2006 was a loss after income tax of $52,042 (2005: $906,174).

Operating and Financial Review

Investments for Future Performance

The economic entity remains in the development phase of its business. During the year ended 30 June 2006, significant costs were incurred in ongoing sales and marketing efforts in both the Australian and key overseas markets including the United States and Europe. The continuing costs of marketing and development were incurred and expensed during the year.

Impact of legislation and other external requirements

The economic entity's operations are not subject to any significant environmental regulations under either Commonwealth or State legislation. However, the Board believes that the economic entity has adequate systems in place for the management of its environmental regulations and is not aware of any breach of those environmental requirements as they apply to the economic entity.

There were no changes in environmental or other legislative requirements during the year that have significantly affected the results or operations of the economic entity.

Significant Changes in the State of Affairs

Significant changes in the state of affairs of the economic entity during the financial year were as follows:

a) An increase in contributed equity of $200,000 (from $17,261,804 to $17,500,386) on the issue of 11,678,770 shares upon the conversion of unsecured notes to equity; and

b) An increase in net working capital of $68,163 (from $92,590 to $160,753).

Other changes in the state of affairs of the Group are set out in the Chief Executive Officer's Review and Operations Review.

Dividends

The directors do not recommend the payment of a dividend and no amount has been paid or declared by way of a dividend to the date of this Report.

State of Affairs

Other than the matters set out above, there were no significant changes in the state of affairs of the economic entity during the financial year.

Events Subsequent to Balance Date

There are no events subsequent to balance date that would have a material financial effect on the financial statements for the year ended 30 June 2006.

Likely Developments

The economic entity will continue with its software development and sales business in Australia, the United States and Europe. Future prospects and business strategies of the operations of the economic entity and the expected results of those operations have not been included in this report as the directors believe, on reasonable grounds, that the inclusion of such information be likely to result in unreasonable prejudice to the economic entity.

Environmental Regulation

The economic entity's operations are not subject to any significant environmental regulations under United States, Europe, Commonwealth or State legislation. However, the directors believe that the economic entity has adequate systems in place for the management of its environmental regulations and are not aware of any breach of those environmental requirements as they apply to the economic entity.

Directors' Interests

The relevant interest of each director in the shares and options issued by the Company at the date of this report is as follows:

Director	*Shares*	*Options*
Mr J Andrys(1)	8,753,878	8,000,000
Mr T McGellin(2)	7,277,686	8,000,000
Mr J Chua	13,695,167	-
Mr I Gibson	5,849,754	-

Note (1) 3,800 shares held indirectly by Com.Air Pty Ltd of which Mr Andrys is a director.

4,000,000 options exercisable at 5.5 cents each on or before 31 December 2006 held indirectly by Blueman Pty Ltd of which Mr Andrys is director.

4,000,000 options exercisable at 7 cents each on or before 31 December 2007 held indirectly by Blueman Pty Ltd of which Mr Andrys is director.

Note (2) 2,476,100 shares held indirectly by the Underpass Superannuation Fund of which Mr McGellin is a trustee.

4,801,586 shares held indirectly by Underpass Holdings Pty Ltd of which Mr McGellin is a director.

4,000,000 options exercisable at 5.5 cents each on or before 31 December 2006 held indirectly by Underpass Holdings Pty Ltd of which Mr McGellin is director.

4,000,000 options exercisable at 7 cents each on or before 31 December 2007 held indirectly by Underpass Holdings Pty Ltd of which Mr McGellin is director.

Share Options

Grants of options

During or since the end of the financial year, no options were granted.

Unissued shares under option

At the date of this report, unissued ordinary shares of the Company under option are:

Expiry Date	Exercise Price	Number of Options	Category
31 December 2006	$0.055	8,000,000	Director
31 December 2007	$0.07	8,000,000	Director

These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

Shares issued on exercise of options

During or since the end of the financial year, there were no ordinary shares issued as a result of the exercise of options.

Options granted to directors and officers of the Company

No options have been granted to directors and officers of the Company during or since the end of the financial year.

At the date of this report, the following directors of the Company have options over unissued ordinary shares in WebSpy Limited for no consideration as part of their remuneration.

The options below form part of the 2005 remuneration.

	Number of options granted	Exercise price	Expiry date
Directors			
Mr J Andrys	4,000,000	$0.055	31 December 2006
	4,000,000	$0.07	31 December 2007
Mr T McGellin	4,000,000	$0.055	31December 2006
	4,000,000	$0.07	31 December 2007

Note (1) 21,492,501 Listed options exerciseable at 8 cents each on or before 31 May 2006 have lapsed

6,000,000 Directors options exerciseable at 4.5 cents each on or before 31 December 2005 have lapsed.

Lapse of Options

During or since the end of the financial year, the following options lapsed:

Expiry Date	Exercise Price	Number of Options	Category
31 May 2006	$0.08	21,492,501	Listed
31 December 2005	$0.045	6,000,000	Director

Indemnification and insurance of directors

Indemnification

The Company has agreed to indemnify the directors of the Company against liability incurred to a third party (not being the Company or any related company) that may arise from their position as directors of the Company and its controlled entities, unless the liability arises out of conduct involving a lack of good faith.

The Company has also agreed to cover liability for costs and expenses incurred in successfully defending civil or criminal proceedings, or in connection with a successful application for relief under the Corporations Act 2001. It also provides indemnity against costs and expenses in connection with an application where a court grants relief to a director under the Corporations Act 2001.

Insurance premiums

Since the end of the previous financial year the Company has not paid any insurance premiums in respect of directors' and officers liability and legal expenses' insurance contracts, for current and former directors and officers.

Non-audit Services

Following shareholders approval on 16 February 2006, KPMG was removed from the position of the Company's auditors and Grant Thornton were appointed as auditors of the Company after receiving recommendation to change the auditor from a member.

Grant Thornton has not provided any other services during the year. Accordingly, the directors are satisfied that the auditors have remained independent during the year.

Auditor's Independence Declaration

A copy of the auditors' independence declaration, which forms part of this report, as required under Section 307C of the Corporations Act is set out on page 18.

Details of the amounts paid to the auditor of the Company, Grant Thornton for audit services and to other parties i during the year are set out below.

	Economic 2006 $	Economic 2005 $
Statutory audit:		
Auditors of the Company:		
➢ audit and review of financial reports – Grant Thornton	16,000	-
Other auditors		
➢ audit of financial reports (non-Grant Thornton)	3,800	9,993
	19,800	9,993

Adoption of Australian Equivalents to International Financial Reporting Standards

As a result of the introduction of Australian equivalents to International Financial Reporting Standards (AIFRS), the Company's financial report has been prepared in accordance with those Standards. A reconciliation of adjustments arising on the transition to AIFRS is included in Note 1(u) to this report.

Remuneration Report

The Board as a whole is responsible for considering remuneration policies and packages applicable both to Board members and executives of the Group. Broadly, the Group's remuneration policy is to ensure that any remuneration package properly reflects the person's duties and responsibilities and that it is competitive.

Directors

Executive directors and key management personnel are remunerated by way of a salary or consultancy fees. Remuneration levels are competitively set to attract and retain appropriately qualified and experienced directors and executives.

The Board has not formally constituted a nomination committee or remuneration committee. The whole Board conducts the functions of a nomination committee and remuneration committee.

The Company does not have any scheme relating to retirement benefits for non-executive Directors.

Fixed Compensation

Fixed compensation consists of base compensation (which is calculated on a total cost basis), as well as employer contributions to superannuation funds.

Compensation levels are reviewed annually through a process that considers individual and overall performance of the consolidated entity. In addition, external consultants provide advice to ensure the directors' and senior executives' compensation is competitive in the market place. Compensation is also reviewed in the event of promotion.

Performance-linked Compensation

The Company has established the WebSpy Limited Staff Option Incentive Scheme (Scheme) to provide a means by which employees of the Company, including Directors, upon whom the responsibilities for the successful growth of the Company rest, can share in such growth, thereby strengthening their commitment to the Company. Pursuant to the Scheme, and subject to any approvals required by the corporations Act and the ASX Listing Rules, the Directors may, from time to time, resolve to grant such numbers of Options, at such exercise price to such employees of the Company as determined by the Directors.

No grants of options were made under the Scheme during the financial year.

The Company may also provide performance-linked compensation to its senior executives. There have been no performance-linked payments made by the Company.

Service Contract

There are no service contracts with Directors or senior executives of the Company.

Consequence of performance on shareholders wealth

In considering disclosure required by s.300A of the Corporations Act, with respect to this matter, the Directors note that historic consideration of various measures is considered inappropriate as the Company has yet to record a profit or paid a dividend.

Non-executive Directors

Total remuneration for all non-executive directors, last voted upon by shareholders at the 2005 Annual General Meeting, is not to exceed $75,000 per annum. Fees are set with reference to fees paid to other non-executive directors of comparable companies.

Details of the nature and amount of each major element of remuneration of each director of the Company are:

	SHORT TERM		POST EMPLOYMENT	SHARE BASED PAYMENTS			
	Salary/ fees $	Other Benefits $	Superannuation benefits $	Options $	Termination benefits $	Total $	Value of options as proportion of remuneration %
Directors							
Mr J Chua	10,000	-	-	-	-	10,000	-
Mr I Gibson	16,667	-	900	-	-	17,567	-
Mr J Andrys	210,137	36,666	5,250	-	-	252,053	-
Mr T McGellin	36,000	-	1,350	-	-	37,350	-
Total	272,804	36,666	7,500	-	-	316,970	

Value of options issued to directors

The following table discloses the value of options granted, exercised or lapsed during the year:

	Options Granted	Options exercised	Options lapsed	Total value of options granted, exercised and lapsed	Value of options included in remuneration for the year
	Value at Grant Date $	Value at Exercise Date $	Value at time of lapse $	$	$
Directors					
Mr J Andrys	-	-	(2,574)	(2,574)	-
Mr T McGellin	-	-	(2,574)	(2,574)	-

Dated at Perth, Western Australia this 27th day of September 2006.

Signed in accordance with a resolution of the Directors:

J Andrys
Director

This statement summarises the corporate governance practices adopted by the Board. WebSpy Limited's objective is to achieve best practice in corporate governance, and the Company's officers and employees are committed to achieving this objective.

ASX Best Practice Recommendations

The ASX Listing Rules require listed companies to include in their Annual Report a statement disclosing the extent to which they have complied with the ASX Best Practice Recommendations in the reporting period. The recommendations are not prescriptive and if a company considers that a recommendation is inappropriate having regard to its particular circumstances, the company has the flexibility not to adopt it. Where the Company considered it was not appropriate to presently comply with a particular recommendation the reasons are set out in the latter part of this statement.

Board of Directors

Role of the Board

The Board's primary responsibility is to oversee the Company's business activities and management for the benefit of shareholders by:

- setting objectives, goals and strategic direction with management with a view to maximising shareholder value;
- overseeing the financial position and monitoring the business and affairs of the Company;
- establishing corporate governance, ethical, environmental and health and safety standards;
- ensuring significant business risks are identified and appropriately managed; and
- ensuring the composition of the Board is appropriate, selecting directors for appointment to the Board and reviewing the performance of the Board and the contributions of individual directors.

The Board has delegated responsibilities and authorities to management to enable management to conduct the Company's day to day activities. Matters which are not covered by these delegations, such as approvals which exceed certain limits, require Board approval.

Board composition

The Board comprises four Directors including two executive Directors.

The Directors are subject to election by shareholders. All Directors, apart from the Managing Director, are subject to re-election by rotation within every three years. The Company's Constitution provides that one-third of the Directors retire by rotation at each AGM. Those Directors who are retiring may submit themselves for re-election by shareholders, including any Director appointed to fill a casual vacancy since the date of the previous AGM. The composition of the Board is reviewed at least annually to ensure the balance of skills and experience is appropriate. The Directors have a broad range of qualifications, experience and expertise in the information technology and finance industries. The skills, experience and expertise of Directors are set out in the Directors' Report.

The names of the Directors in office at the date of this Report, the date of their appointment, their status as non-executive, executive or independent Directors, are set out in the Directors' Report.

Independence of non-executive directors

The Board considers an independent director to be a non-executive director who meets the criteria for independence included in the ASX Best Practice Recommendations. A majority of the Board of directors is not comprised of independent directors under this definition however each individual member of the Board is satisfied that whilst the Company may not comply with best practice recommendations 2.1, 2.2 and 2.3, the Board always acts with independence and in accordance with the Statement of Corporate Governance.

Independent professional advice

The Board has adopted a formal policy on access to independent professional advice which provides that Directors are entitled to seek independent professional advice for the purposes of the proper performance of their duties. The advice is at the Company's expense, subject to the prior approval of the Chairman. Advice so obtained is to be made available to all Directors.

Meetings

The Board held 5 scheduled meetings during the reporting period and no unscheduled meetings were held during that year. Senior management attended and made presentations at the Board Meetings as considered appropriate and were available for questioning by Directors.

Board committees

The Board has not formally constituted an audit committee. The entire board currently undertakes the duties of an audit committee which includes:

- supervising the engagement of the external auditor and monitoring their performance;
- reviewing the effectiveness of management information and other systems of internal control;
- reviewing all areas of significant financial risk and arrangements in place to contain those to acceptable levels;
- reviewing significant transactions that are not a normal part of the Company's business;
- reviewing the year-end and interim financial information and ASX reporting statements;
- monitoring the internal controls and accounting compliance with the Corporations Act, ASX Listing Rules, external audit reports and ensuring prompt remedial action where required; and
- reviewing the Company's financial statements and accounting procedures.

The Board has not formally constituted a nomination committee or remuneration committee. The whole Board conducts the functions of a nomination committee and remuneration committee.

Evaluation of Board performance

During the reporting period an evaluation of the Board and key executives was carried out on an informal basis. As the activities of the Company develop, it will establish more formal evaluation procedures, including quantitative measures of performance.

Remuneration policies

Executive Directors and key executives are remunerated by way of a salary or consultancy fees, commensurate with their required level of services. Non-executive Directors receive a fixed monthly fee for their services.

The amount of remuneration for all directors and the five highest paid executives, including all monetary and non-monetary components, are detailed in Note 21 to the financial report. All remuneration paid to executives is valued at the cost to the company and expensed. Shares given to executives are valued as the difference between the market price of those shares and the amount paid by the executive. Options are valued using the Black-Scholes methodology.

Attendance at Board and Committee meetings

The attendance of Directors at Board meetings during the year is detailed in the Directors' Report.

Managing business risks and internal control framework

The Board acknowledges that it is responsible for the overall internal control framework, but recognises that no cost effective internal control system will preclude all errors and irregularities. To assist in discharging this responsibility the Board has instigated an internal control framework that includes the following:

- Financial reporting – there is a comprehensive budgeting and forecasting system with updates provided to the Board at each Board meeting. Periodic reports are provided to the Board. Quarterly, half yearly and annual reports are prepared in accordance with the Corporations Act 2001 and ASX Listing Rules.
- The Managing Director and the Company Secretary are required to confirm in writing that the Company's financial reports present a true and fair view, in all material respects, of the Company's financial condition and operational results are in accordance with relevant accounting standards.
- The Company has written policies covering health and safety.

Ethical standards

The Board is committed to promoting the practice of high ethical standards. All directors and employees are expected to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the Company in the following areas:

- professional conduct;
- dealings with suppliers, advisers and regulators;
- dealings with the community; and
- dealings with other employees.

Trading in the Company's securities by directors and employees

The Board has adopted a policy in relation to dealings in the securities of the Company which applies to all Directors and employees. Under the policy, Directors are prohibited from short term trading in the Company's securities whilst in possession of price sensitive information. The Board must be notified of any proposed transaction and must give clearance for the transaction to proceed.

Privacy

The Company has resolved to comply with the National Privacy Principles contained in the Privacy Act 1988, to the extent required for a company the size and nature of WebSpy Limited.

Information disclosure

The Board is committed to the promotion of investor confidence by ensuring that trading in the Company's securities takes place in an efficient, competitive and informed market. In accordance with the continuous disclosure requirements under the ASX Listing Rules, the Company has procedures in place to ensure that all price sensitive information is identified, reviewed by management and disclosed to the ASX in a timely manner and that all information provided to the ASX is immediately available to shareholders and the market on the Company's website.

Analysts and press briefings may be conducted following the release of half-year results, full-year results and major announcements and, from time to time, briefings with major shareholders may be conducted in order to promote a better understanding of the Company. In conducting briefings, the Company takes care to ensure that any price sensitive information included in the content of briefings has already been made available to all shareholders and the market.

Shareholders

The Board aims to ensure that shareholders are kept informed of all major developments affecting the Company. Information is communicated to shareholders through:

- continuous disclosure in the form of public announcements on ASX;
- annual reports to shareholders;
- investor briefings;
- the meeting Chairman's address delivered at the Annual General Meeting; and
- notices of all meetings of shareholders and explanatory notes of proposed resolutions.

In addition, information for shareholders is available on WebSpy's website: www.webspy.com, including recent announcements, presentations, past and current reports to shareholders, biographical information on Directors and information relating to operations.

Shareholders are encouraged at annual general meetings to ask questions of Directors and senior management and also the Company's external auditors, who are required to be in attendance.

Retirement benefits for non-executive directors

The Company does not have any scheme relating to retirement benefits for non-executive Directors.

ASX Guidelines on Corporate Governance

Pursuant to ASX Listing Rules, WebSpy Limited must provide a statement disclosing the extent to which the ASX best practice recommendations have not been followed in the reporting period. The Company sets out below an explanation of the areas where it does not presently comply with ASX best practice recommendations.

Composition of the Board

A majority of the Board of directors is not comprised of independent directors under the ASX definition of independence, as set out in the ASX Corporate Governance Council Best Practice Recommendations. Each individual member of the Board is satisfied that whilst the Company may not comply with best practice recommendations 2.1, 2.2 and 2.3, the Board always acts with independence and in accordance with the Statement of Corporate Governance.

Website

The ASX guidelines also prescribe that the Company should maintain a dedicated corporate governance information section on its website. Such a dedicated information section is not presently available on the Company's website, although the annual financial report will be posted to the website and the Statement of Corporate Governance can be viewed there.

Board committees

The Company does not presently have a separate audit, nomination or remuneration committee as required by best practice recommendations 4.2, 2.4 and 9.2, respectively. The Company is in its early stages of development and as such, the entire Board conducts the function of such committees. The duties of such committees have been considered and adopted by the Board. The board invites persons with relevant industry and financial experience when required to carry out the functions of such committees.

Grant Thornton

Grant Thornton Western Australian Partnership
ABN 21 965 022 882
Chartered Accountants, Business Advisers and Consultants

AUDITOR'S INDEPENDENCE DECLARATION

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of WebSpy Limited and Controlled Entities for the period 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.

GRANT THORNTON WESTERN AUSTRALIAN PARTNERSHIP

GREG LEGUIER
Partner

Dated 28 September 2006

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WEBSPY LIMITED
AND CONTROLLED ENTITIES
CONSOLIDATED INCOME STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Revenue		3,335,419	3,759,727	14,762	24,300
Less: Discount on sales		(356,741)	(473,442)	-	-
Net revenue	2	2,978,678	3,286,285	14,762	24,300
Cost of sales		(220,875)	(362,856)	-	-
Gross profit		2,757,803	2,923,429	14,762	24,300
Other Income	2	96,179	131,784	93,485	129,607
Corporate and administrative expenses		(394,283)	(621,948)	(283,282)	(695,714)
Technical expenses		(204,511)	(138,743)	-	-
Marketing and selling expenses		(2,323,030)	(2,580,797)	-	(10,992)
Research & development expenses		(456,954)	(581,603)	(45,461)	(133,519)
Borrowing costs		(43,837)	(13,631)	(7,718)	(13,342)
Provision for impairment of loan to controlled entity	3(a)	-	-	(165,089)	(531,535)
Loss before income tax	3(b)	(568,633)	(881,509)	(393,303)	(1,231,195)
Income tax credit	4	341,261	325,021	341,261	325,021
Loss for the year attributable to members of the parent entity	20	(227,372)	(556,488)	(52,042)	(906,174)
Basic loss per share	6	(0.19 cents)	(0.52 cents)		

The Company's potential ordinary shares are not considered dilutive and accordingly the basic loss per share is the same as diluted loss per share.

These Consolidated Income Statements are to be read in conjunction with the notes to the financial statements.

WEBSPY LIMITED
AND CONTROLLED ENTITIES
CONSOLIDATED BALANCE SHEETS
AS AT 30 JUNE 2006

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
CURRENT ASSETS					
Cash and cash equivalents	7	162,733	337,593	1,646	11,708
Trade and other receivables	8	645,619	810,354	51,929	3,663
Inventories	9	26,541	21,509	-	-
Other assets	10	30,908	20,407	-	-
Total Current Assets		865,801	1,189,863	53,575	15,371
NON CURRENT ASSETS					
Trade and other receivables	8	16,860	69,860	151,075	173,177
Other financial assets	11	-	-	-	-
Property, plant & equipment	12	79,779	135,477	1,609	33,689
Intangible assets	13	-	-	-	-
Total Non Current Assets		96,639	205,337	152,684	206,866
TOTAL ASSETS		**962,440**	**1,395,200**	**206,259**	**222,237**
CURRENT LIABILITIES					
Trade and other payables	14	535,594	729,252	146,980	81,353
Interest bearing liabilities	15	22,960	213,351	22,960	213,351
Short-term provisions	16	146,495	154,670	4,080	43,252
Total Current Liabilities		705,049	1,097,273	174,020	337,956
NON CURRENT LIABILITIES					
Trade and other payables	14	22,186	38,826	-	-
Total Non Current Liabilities		22,186	38,826	-	-
TOTAL LIABILITIES		**727,235**	**1,136,099**	**174,020**	**337,956**
NET ASSETS/(DEFICIENCY)		**235,205**	**259,101**	**32,239**	**(115,719)**
EQUITY					
Issued Capital	18	17,500,386	17,261,804	17,500,386	17,261,804
Reserves	19	(42,160)	(7,054)	-	38,582
Accumulated losses	20	(17,223,021)	(16,995,649)	(17,468,147)	(17,416,105)
TOTAL EQUITY/(DEFICIENCY)		**235,205**	**259,101**	**32,239**	**(115,719)**

These Consolidated Balance Sheets are to be read in conjunction with the notes to the financial statements.

WEBSPY LIMITED
AND CONTROLLED ENTITIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2006

Economic Entity	Issued Capital $	Reserves $	Accumulated Losses $	Total $
Balance as at 1 July 2004	17,261,804	38,582	(16,439,161)	861,225
Currency translation differences	-	(45,636)	-	(45,636)
Total income and expense for period recognised directly in equity	17,261,804	(7,054)	(16,439,161)	815,589
Loss for the year	-	-	(556,488)	(556,488)
At 30 June 2005	17,261,804	(7,054)	(16,995,649)	259,101
Lapsing of options	38,582	(38,582)	-	-
Currency translation differences	-	3,476	-	3,476
Loss for the year	-	-	(227,372)	(227,372)
Conversion of convertible notes to shares	200,000	-	-	200,000
At 30 June 2006	**17,500,386**	**(42,160)**	**(17,223,021)**	**235,205**

Parent Entity	Issued Capital $	Reserves $	Accumulated Losses $	Total $
Balance as at 1 July 2004	17,261,804	38,582	(16,509,931)	790,455
Currency translation differences	-	-	-	-
Total income and expense for period recognised directly in equity	17,261,804	38,582	(16,509,931)	790,455
Loss for the year	-	-	(906,174)	(906,174)
At 30 June 2005	17,261,804	38,582	(17,416,105)	(115,719)
Lapsing of options	38,582	(38,582)	-	-
Currency translation differences	-	-	-	-
Loss for the year	-	-	(52,042)	(52,042)
Conversion of convertible notes to shares	200,000	-	-	200,000
At 30 June 2006	**17,500,386**	**-**	**(17,468,147)**	**32,239**

These Consolidated Statements of Changes in Equity is to be read in conjunction with the notes to the financial statements.

WEBSPY LIMITED
AND CONTROLLED ENTITIES
CONSOLIDATED STATEMENTS OF CASHFLOWS
FOR THE YEAR ENDED 30 JUNE 2006

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Cash flows from operating activities					
Cash receipts in the course of operations		3,602,887	3,230,177	93,485	129,607
Cash payments in the course of operations		(4,115,914)	(3,875,684)	(304,656)	(635,434)
Interest received		6,788	11,515	944	117
Income tax refunds		341,261	325,021	341,261	325,021
Borrowing costs paid		(43,837)	(11,998)	(7,718)	(11,998)
Net cash provided by/(used in) operating activities	25(b)	(208,815)	(320,969)	123,316	(192,687)
Cash flows from investing activities					
Purchases of property, plant and equipment		(28,159)	(37,412)	-	(2,700)
Proceeds from Term Deposit		-	356,000	-	-
Payments to Term Deposit		-	(37,933)	-	-
Loans from/(to) controlled entities		-	-	(142,985)	64,124
Net cash provided by/(used in) investing activities		(28,159)	280,655	(142,985)	61,424
Cash flows from financing activities					
Release of Security from Term Deposit		53,000	-	-	-
Proceeds from borrowings		44,873	200,000	44,873	200,000
Repayment of interest bearing liabilities		(35,266)	(59,554)	(35,266)	(59,554)
Net cash provided by financing activities		62,607	140,446	9,607	140,446
NET INCREASE/(DECREASE) IN CASH HELD		(174,367)	100,132	(10,062)	9,183
Cash at the beginning of the financial year		337,593	272,997	11,708	2,525
Effects of exchange rate fluctuations on the balance of cash held in foreign currencies		(493)	(35,536)	-	-
Cash at the end of the financial year	25(a)	**162,733**	**337,593**	**1,646**	**11,708**

These Consolidated Statements of Cash Flows are to be read in conjunction with the notes to the financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of this financial report are:

(a) Basis of preparation

First time adoption of Australian Equivalents to International Financial Reporting Standards.

The financial report is a general purpose financial report which has been prepared in accordance with Accounting Standards, Urgent Issues Group Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

It has been prepared on the basis of historical costs and the accruals basis and except where stated, does not take into account changing money values or fair values of assets.

(b) Statement of Compliance

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

The entity has not elected to early adopt the following accounting standards and amendments:

- AASB 119 *Employee Benefits* (December 2004)
- AASB 2004-3 *Amendments to Australian Accounting Standards* (December 2004) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 101 *Presentation of Financial Statements* and AASB 124 *Related Party Disclosures*
- AASB 2005-1 *Amendments to Australian Accounting Standards* (May 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*
- AASB 2005-3 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 119 *Employee Benefits* (December 2004)
- AASB 2005-4 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004).
- AASB 2005-5 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), and AASB 139 *Financial Instruments: Recognition and Measurement*
- AASB 2005-6 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 3 *Business Combinations*
- AASB 2006-1 *Amendments to Australian Accounting Standards* (January 2006) amending AASB 121 *The Effects of Changes in Foreign Exchange Rates* (July 2004)
- AASB 7 *Financial instruments: Disclosure* (August 2005) replacing the presentation requirements of financial instruments in AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007
- AASB 2005-9 *Amendments to Australian Accounting Standards* (September 2005) requires that liabilities arising from the issue of financial guarantee contracts are recognised in the balance sheet. AASB 2005-9 is applicable for annual reporting periods beginning on or after 1 January 2006
- AASB 2005-10 *Amendments to Australian Accounting Standards* (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosures and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(c) Statement of Compliance (cont'd)

The consolidated entity plans to adopt AASB 7, AASB 2005-9 and AASB 2005-10 in the 2007 financial year.

The initial application of these standards and amendments is not expected to have an impact on the financial results of the Company and the consolidated entity as the standard and the amendment are concerned only with disclosures.

The financial report is prepared on the historical cost basis.

The preparation of a financial report in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report and in preparing an opening AIFRS balance sheet at 1 July 2004 for the purposes of the transition to Australian Accounting Standards – AIFRS.

The accounting policies have been applied consistently by all entities in the consolidated entity.

(d) Financial Position

The financial statements have been prepared on the going concern basis accounting which assumes that the economic entity will be able to meet its commitments, realise its assets and discharge its liabilities in the ordinary course of the business.

The economic entity's ability to continue as a going concern is contingent upon the continuous support of the entity's creditors as well as the conversion of trade receivables to cash under the normal terms of trade. If this support is not forthcoming and the company is unable to convert its trade receivables to cash within normal trading terms, as a result the going concern basis may not be appropriate and the entity may have to realise its assets and extinguish its liabilities other than in the ordinary course of business and at amounts different from those stated in the financial report. No allowance for such circumstances has been made in the financial report.

(e) Principles of consolidation

A controlled entity is any entity WebSpy Limited has the power to control the financial and operating policies of so as to obtain benefits from its activities.

A list of controlled entities is contained in Note 27 to the financial statements. All controlled entities have a June financial year-end.

All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the parent entity.

Where controlled entities have entered or left the economic entity during the year, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

(f) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the Australian Tax Office (ATO). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of the item of the expense.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(f) Goods and services tax (cont'd)

Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

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

(g) Acquisition of assets

All assets acquired including plant and equipment and intangibles other than goodwill are initially recorded at their cost of acquisition at the date of acquisition, being the fair value of the consideration provided plus incidental costs directly attributable to the acquisition. When equity instruments are issued as consideration, their market price at the date of acquisition is used as fair value. Transaction costs arising on the issue of equity instruments are recognised directly in equity subject to the extent of proceeds received, otherwise expensed.

(h) Plant and equipment

Plant and equipment is stated at cost less accumulated depreciation (see below) and any impairment in value (see accounting policy (p)).

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful life of the asset. The depreciation rates used for each class of depreciable asset are:

Plant and equipment	27 - 33%
Leasehold improvements	50%

(i) Revenue recognition

Sale of goods

Sales revenue comprises revenue earned (net of the amount of goods and services tax (GST), returns, discounts and allowances) from the provision of products to entities outside the economic entity. Sales revenue is recognised when the control of goods passes to the customer.

Rendering of services

Revenue from rendering services is recognised in the period in which the service is provided, having regard to the stage of completion of the contract.

Government Grants

Government grants are recognised at fair value where there is reasonable assurance that the grant will be received and all grant conditions will be met. Grants relating to expense items are recognised as income over the periods necessary to match the grant to the costs they are compensating. Grants relating to assets are credited to deferred income at fair value and are credited to income over the expected useful life of the asset on a straight-line basis.

Interest revenue

Interest revenue is recognised on a proportionate basis taking into account interest rates applicable to the financial assets.

(j) Income Tax

The charge for current income tax expense is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using the tax rates that have been enacted or are substantially enacted by the balance sheet date.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(j) Income Tax (cont'd)

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets are recognised to the extent that it is probable that future tax profits will be available against which deductible temporary differences can be utilised.

The amount of benefits brought to account or which may be released in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law

(k) Foreign Currency Transactions and Balances

Functional and presentation currency

The functional currency of each of the group's entities is measured using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars which is the parent entity's functional and presentation currency.

Transaction and balances

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the year-end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognised directly in equity to the extent that the gain or loss is directly recognised in equity, otherwise the exchange difference is recognised in the income statement.

Group companies

The financial results and position of foreign operations whose functional currency is different from the group's presentation currency are translated as follows:

- Assets and liabilities are translated at year-end exchange rates prevailing at that reporting date;
- Income and expenses are translated at average exchange rates for the period; and
- Retained earnings are translated at the exchange rates prevailing at the date of the transaction.

Exchange differences arising on translation of foreign operations are transferred directly to the group's foreign currency translation reserve in the balance sheet. These differences are recognised in the income statement in the period in which the operation is disposed.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(l) Leased assets

Leases of fixed assets where substantially all the risks and benefits incidental to the ownership of the asset, but not the legal ownership that is transferred to entities in the economic entity, are classified as finance leases.

Finance leases are capitalised by recording an asset and a liability at the lower of the amounts equal to the fair value of the leased property or the present value of the minimum lease payments, including any guaranteed residual values. Lease payments are allocated between the reduction of the lease liability and the lease interest expense for the period.

Leased assets are depreciated on a straight line basis over the shorter of their estimated useful lives or the lease term.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred.

Lease incentives under operating leases are recognised as a liability and amortised on a straight-line basis over the life of the lease term.

(m) Research and development costs

Expenditure during the research phase of a project is recognised as an expense when incurred. Development costs are capitalised only when technical feasibility studies identify that the project will deliver future economic benefits and these benefits can be measured reliably.

Development costs have a finite life and are amortised on a systematic basis matched to the future economic benefits over the useful life of the project.

(n) Employee benefits

Wages, salaries and annual leave

Provision is made for the company's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs. Employee benefits payable later than one year have been measured at the present value of the estimated future cash outflows to be made for those benefits.

Share-based payment transactions

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

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

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

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ('vesting date').

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date reflects (i) the extent to which the vesting period has expired and (ii) the number of awards that, in the opinion of the directors of the Group, will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(n) Employee benefits (cont'd)

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

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

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(o) Impairment of assets

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

For intangible assets that are not yet available for use, the recoverable amount is estimated annually.

An impairment loss is recognised whenever the carrying amount of an asset of its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement.

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

Goodwill and indefinite-lived intangible assets were tested for impairment at 1 July 2004, the date of transition to AIFRS, even though no indication of impairment existed.

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

(p) Borrowing costs

Borrowing costs include interest and are expensed as incurred.

(q) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of manufactured products includes direct materials, direct labour and an appropriate portion of variable and fixed overheads. Overheads are applied on the basis of normal operating capacity. Costs are assigned on the basis of weighted average costs.

(r) Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within short-term borrowings in current liabilities on the balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(s) Financial Instruments

Recognition

Financial instruments are initially measured at cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

(t) Available-for-sale financial assets

Available-for-sale financial assets include any financial assets not included in the above categories.

Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changed in fair value are taken directly to equity.

(u) Impact of adoption of AIFRS

The impacts of adopting AIFRS on the total equity and profit after tax as reported under Australian Accounting Standards applicable before 1 January 2005 ('AGAAP') are illustrated below.

(i) Reconciliation of equity as presented under AIFRS to that under AGAAP

	Economic Entity		Parent Entity	
	30 Jun 2005	**1 Jul 2004**	**30 Jun 2005**	**1 Jul 2004**
	$	**$**	**$**	**$**
Total equity under AGAAP	270,447	831,487	168,995	831,487
Adjustments to accumulated losses				
Foreign exchange currency effect	(11,346)	(7,211)	(284,714)	(41,032)
Recognition of foreign currency translation reserves	45,636	-	-	-
Adjustments to reserves				
Recognition of foreign currency translation reserves	(45,636)	-	-	-
Total equity under IFRS	259,101	824,276	(115,719)	790,455

(1) Translation differences that arose prior to the date of transition to AIFRS in respect of all foreign entities have been presented as a separate component of equity. On disposal of any foreign operation, the related cumulative translation difference will be transferred to the income statement as part of the gain or loss on disposal. The exemption available under AIFRS has not been utilised.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(u) Impact of adoption of AIFRS (cont'd)

(ii) Reconciliation of losses as presented under AIFRS to that under AGAAP

	Economic Entity 30 Jun 2005 $	Parent Entity 30 Jun 2005 $
Net loss for the year under AGAAP	(561,040)	(662,492)
Foreign exchange currency effect	4,552	(243,682)
Net loss for the year under AIFRS	(556,488)	(906,174)

(iii) Explanation of material adjustments to the cash flow statements

There are no material differences between the cash flow statements presented under AIFRS and those presented under AGAAP.

	Economic Entity		Parent Entity	
	2006 $	2005 $	2006 $	2005 $
2. REVENUE				
Sale of goods revenue	1,722,306	2,155,789	-	-
Rendering of service revenue	1,235,852	1,106,196	-	-
Interest Revenue	20,520	24,300	14,762	24,300
Total revenue from ordinary activities	2,978,678	3,286,285	14,762	24,300
Other income				
Proceeds from government grant	93,485	129,607	93,485	129,607
Other income	2,694	2,177	-	-
Total other income	96,179	131,784	93,485	129,607

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
3. LOSS BEFORE INCOME TAX				
(a) Individually significant items included in loss before income tax benefit				
Provision for impairment of loan to controlled entity	-	-	165,089	531,535
(b) Loss before income tax credit has been arrived at after charging the following items:				
Profit/(loss) on sale of plant and equipment	-	(10,941)	-	-
Depreciation and amortisation of:				
- plant and equipment	(52,632)	(54,464)	(1,876)	(3,331)
- leasehold improvements	(32,237)	(70,776)	(30,204)	(66,920)
Total depreciation and amortisation expense	(84,870)	(125,240)	(32,080)	(70,251)
Finance charges on capitalised leases	(3,806)	(4,631)	(3,806)	(4,342)
Interest on convertible notes	(3,912)	(9,000)	(3,912)	(9,000)
Total borrowing costs	(7,718)	(13,631)	(7,718)	(13,342)
Lease rental expense – operating leases	(223,631)	(142,817)	-	-
Net foreign exchange loss	6,948	(63,465)	-	-
Provision for employee entitlements	(17,648)	(60,780)	(3,214)	(43,252)
Provision for impairment	36,182	(42,356)	36,182	(42,356)

4. INCOME TAX

(a) Income tax benefit

(b) Numerical reconciliation between tax credit and pre-tax net loss

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Loss before income tax credit	(568,633)	(881,509)	(393,303)	(1,231,195)
Income tax credit calculated at 30%	170,590	264,453	117,991	369,359
Tax effect on amounts which are not tax deductible:				
• Sundry items	(562)	(793)	(501)	(560)
• Research and development expenditure	(273,009)	(260,017)	(273,009)	(260,017)
Deferred tax asset applied	444,242	321,378	496,780	216,239
Income tax credit	341,261	325,021	341,261	325,021

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
4. INCOME TAX (cont'd)				
(c) Tax losses				
Unused tax losses for which no deferred tax asset has been recognised (as recovery is currently not probable)				
Potential at 30% (2005: 30%)	1,919,917	2,364,159	1,138,558	1,635,338
(d) Unrecognised temporary differences				
Temporary differences for which deferred tax assets have not been recognised:				
Employee benefits provision	43,949	46,401	1,224	12,976
Provision for impairment	67,431	78,286	2,251,559	2,212,887
Unrecognised deferred tax assets relating to the above temporary differences	111,380	124,687	2,252,783	2,225,863
Temporary differences for which deferred tax liabilities have not been recognised:				
Prepayments	9,273	6,122	-	-
Unrecognised deferred tax liabilities relating to the above temporary differences	9,273	6,122	-	-

(e) Tax Rates

The potential tax benefit at 30 June 2006 in respect of tax losses not brought to account has been calculated at 30% for Australian entities. This same rate applied for the year ended 30 June 2005.

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
5. AUDITOR'S REMUNERATION				
Amounts received or due and receivable by the auditor for:				
Audit services – Grant Thornton	16,000	-	16,000	-
– other auditors	3,800	9,993	3,800	-
	19,800	9,993	19,800	-

6. LOSS PER SHARE

The calculation of basic loss per share at 30 June 2006 was based on the loss attributable to ordinary shareholders at $271,372 (2005: $556,488) and a weighted average number of ordinary shares outstanding during the financial year ended 30 June 2006 of 116,645,538 (2005: 107,462,505) calculated as follows:

	2006 Number	2005 Number
Issued ordinary shares at 1 July 2005	107,462,505	107,462,505
Effect of shares issued on 16 September 2005	9,183,033	-
Used as the denominator in calculating basic loss per share for the year	116,645,538	107,462,505

Diluted loss per share does not show an inferior view of the earnings performance of the Company than is shown by loss per share and is not disclosed for this reason.

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
7. CASH AND CASH EQUIVALENTS					
Cash at bank and on hand		162,733	337,593	1,646	11,708
Effective interest rate: 4.25% (2005: 4%).					
8. TRADE AND OTHER RECEIVABLES					
Current					
Trade receivables		537,418	721,220	-	-
Term debtors		162,266	148,448	162,266	148,448
Provision for impairment		(112,266)	(148,448)	(112,266)	(148,448)
Other receivables		135,310	143,415	1,929	3,663
Provision for impairment		(112,506)	(112,506)	-	-
Deposits	(a)	35,397	58,225	-	-
		645,619	810,354	51,929	3,663
Non-current					
Deposits	(a)	16,860	69,860	-	-
Loans to controlled entities		-	-	7,544,006	7,401,019
Provision for impairment of loans		-	-	(7,392,931)	(7,227,842)
		16,860	69,860	151,075	173,177

(a) Deposits

The deposit represents $2,915 [2005 $2,837] lodged as security pursuant to a property rental agreement in the United States, $32,482 [2005: $55,388] as security pursuant to a property rental agreement in the United Kingdom and $16,860 [2005: $69,860] as security pursuant to a property rental agreement in Western Australia.

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
9. INVENTORIES		26,541	21,509	-	-

10. OTHER ASSETS

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Current				
Prepayments	30,908	20,407	-	-

11. OTHER FINANCIAL ASSETS

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Available-for-Sale Financial Assets				
Controlled entities				
Unlisted units, at cost	-	-	898,553	898,553
Unlisted shares, at cost	-	-	93,237	93,237
Less: provision for impairment	-	-	(991,790)	(991,790)
Total other financial asset	-	-	-	-

12. PROPERTY, PLANT & EQUIPMENT

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Plant and equipment, at cost	736,354	687,257	73,674	73,674
Less: Accumulated depreciation	(656,781)	(583,846)	(72,065)	(70,189)
	79,573	103,411	1,609	3,485
Leasehold improvements, at cost	175,017	174,701	163,704	163,704
Less: Accumulated amortisation	(174,811)	(142,635)	(163,704)	(133,500)
	206	32,066	-	30,204
Total plant and equipment	79,779	135,477	1,609	33,689

Reconciliations

Reconciliations of the carrying amount of each class of property, plant and equipment are set out below:

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Plant and equipment				
Balance at the beginning of the year	103,411	132,791	3,485	4,116
Additions	27,779	46,930	-	2,700
Disposals	-	(10,941)	-	-
Depreciation	(52,632)	(54,464)	(1,876)	(3,331)
Exchange Adjustment at 30 June 2006	1,015	(10,905)	-	-
Balance at the end of the year	79,573	103,411	1,609	3,485
Leasehold improvements				
Balance at the beginning of the year	32,066	102,842	30,204	97,124
Additions	377	-	-	-
Amortisation	(32,237)	(70,776)	(30,204)	(66,920)
Balance at the end of the year	206	32,066	-	30,204

		Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
13.	**INTANGIBLE ASSETS**					
	Capitalised development expenditure		1,574,718	1,574,718	-	-
	Less: Accumulated amortisation		(1,574,718)	(1,574,718)	-	-
			-	-	-	-
14.	**TRADE AND OTHER PAYABLES**					
	Current					
	Trade creditors		163,031	258,637	68,146	25,328
	Other creditors and accruals		343,653	441,260	66,564	43,310
	Unclaimed monies		12,270	12,715	12,270	12,715
	Unexpired rental		16,640	16,640	-	-
			535,594	729,252	146,980	81,353
	Non-current					
	Unexpired rental		22,186	38,826	-	-
15.	**INTEREST BEARING LIABILITIES**					
	Current					
	Lease liabilities	23	22,960	11,995	22,960	11,995
	Convertible Notes		-	201,356	-	201,356
			22,960	213,351	22,960	213,351
16.	**SHORT-TERM PROVISIONS**					
	Employee entitlements		146,495	154,670	4,080	43,252
17.	**AMOUNTS PAYABLE/RECEIVABLE IN FOREIGN CURRENCIES**					
	The Australian dollar equivalents of unhedged amounts payable/receivable in foreign currencies calculated at year-end exchange rates, are as follows:					
	United States dollars					
	Amounts payable:					
	Current		(21,437)	(85,529)	-	-
	Amounts receivable:					
	Current		89,988	115,071	-	-
	British pounds					
	Amounts payable:					
	Current		(156,990)	(124,649)	-	-
	Amounts receivable:					
	Current		157,218	148,020	-	-

	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
18. ISSUED CAPITAL				
Share capital				
119,141,275 (2005: 107,462,505) fully paid ordinary shares	17,461,804	17,261,804	17,461,804	17,261,804
Lapsing of options	38,582	-	38,582	-
	17,500,386	17,261,804	17,500,386	17,261,804

The following movements in share capital occurred during the year:

	Number of Ordinary Fully Paid Shares	Issued Capital $
Balance 1 July 2005	107,462,505	17,261,804
➢ Lapsing of options	-	38,582
➢ Issue of shares on 15 September 2005 through conversion of Convertible Note	5,829,016	100,000
➢ Issue of shares on 16 September 2005 through conversion of Convertible Note	5,849,754	100,000
Balance 30 June 2006	119,141,275	17,500,386

There were no movements in share capital in the previous corresponding year.

Options

The following options lapsed during the year:

- 21,492,501 options exercisable at $0.08 on or before 31 May 2006; and
- 6,000,000 options exercisable at $0.045 on or before 31 December 2005.

The following options to subscribe for ordinary fully paid shares are outstanding as at balance date:

- 8,000,000 options exercisable at $0.055 cents each on or before 31 December 2006; and
- 8,000,000 options exercisable at $0.07 cents each on or before 31 December 2007.

No options were exercised during the year.

	Economic Entity		Parent Entity	
	2006	2005	2006	2005
	$	$	$	$
19. RESERVES				
Share option reserve	-	38,582	-	38,582
Foreign currency translation reserve (a)	(42,160)	(45,636)	-	-
	(42,160)	(7,054)	-	38,582

Nature and purpose of reserve

(a) Foreign currency translation reserve

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognised directly in equity to the extent that the gain or loss is directly recognised in equity, otherwise the exchange difference is recognised in the income statement.

	Economic Entity 2006	Economic Entity 2005	Parent Entity 2006	Parent Entity 2005
Balance 1 July 2005	(45,636)	-	-	-
Currency translation differences arising during the year	3,476	(45,636)	-	-
Balance 30 June 2006	(42,160)	(45,636)	-	-

	Economic Entity		Parent Entity	
	2006	2005	2006	2005
	$	$	$	$
20. ACCUMULATED LOSSES				
Accumulated losses at beginning of year	(16,995,649)	(16,439,161)	(17,416,105)	(16,509,931)
Loss after income tax	(227,372)	(556,488)	(52,042)	(906,174)
Accumulated losses at end of year	(17,223,021)	(16,995,649)	(17,468,147)	(17,416,105)

21. KEY MANAGEMENT PERSONNEL COMPENSATION

Details of key management personnel

Key Management Person	Position
Mr J Andrys	Managing Director
Mr T McGellin	Executive Director
Mr J Chua	Non-Executive Director
Mr I Gibson	Non-Executive Director

There are no specified executives of WebSpy Limited.

Remuneration of key management personnel by the consolidated entity

Executive Directors and key executives are remunerated by way of a salary or consultancy fees, commensurate with their required level of services. Non-executive Directors receive a fixed monthly fee for their services.

The Board has not formally constituted a nomination committee or remuneration committee. The whole Board conducts the functions of a nomination committee and remuneration committee.

The Company does not have any scheme relating to retirement benefits for non-executive Directors.

The following table provides the details of the nature and amount of the elements of specified directors' and executives' remuneration for the financial year.

2006	SHORT TERM		POST EMPLOYMENT	SHARE BASED PAYMENTS			
	Salary / fees $	Other Benefits $	Superannuation benefits $	Options (Note A) $	Termination benefits $	Total $	Value of options as proportion of remuneration %
Directors							
Non-executive							
Mr J Chua	10,000	-	-	-	-	10,000	-
Mr I Gibson	16,667	-	900	-	-	17,567	-
Executive							
Mr J Andrys	210,137	36,666	5,250	-	-	252,053	-
Mr T McGellin	36,000	-	1,350	-	-	37,350	-
Total	272,804	36,666	7,500	-	-	(2)316,970	

(1) The fair value of the options is calculated at the date of grant using a Black-Scholes model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options allocated to this reporting period. In valuing the options market conditions have been taken into account.

(2) No remuneration is performance-based.

21. KEY MANAGEMENT PERSONNEL COMPENSATION (cont'd)

Remuneration of key management personnel by the consolidated entity (cont'd)

2005	SHORT TERM		POST EMPLOYMENT	SHARE BASED PAYMENTS			
	Salary / fees $	Other Benefits $	Superannuation benefits $	Options $	Termination benefits $	Total $	Value of options as proportion of remuneration %
Directors							
Non-executive							
Mr J Chua	20,000	-	-	-	-	20,000	-
Mr I Gibson	6,667	-	150	-	-	6,817	-
Executive							
Mr J Andrys	192,262	(1)235,056	7,500	(2)13,961	-	448,779	3.1%
Mr T McGellin	44,000	-	-	(2)13,961	-	57,961	24.1%
Total	262,929	235,056	7,650	27,922	-	533,557	

(1) Once-off reimbursable costs of $200,000 paid for the period from 1 March 2000 to 31 December 2004 in relation to the relocation of the Director to and from the United States.

Leave payouts totalling $35,056.

(2) The fair value of the options is calculated at the date of grant using a Black-Scholes model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options allocated to this reporting period. In valuing the options market conditions have been taken into account.

The following factors and assumptions were used in determining the fair value of options on grant date:

Grant date	***Expiry Date***	***Fair value per option***	***Exercise price***	***Price of shares on grant date***	***Estimated volatility***	***Risk free interest rate***	***Dividend yield***
6 Dec. 2004	31 Dec. 2005	$0.000858	$0.045	$0.028	36%	5.89%	0.00%
6 Dec. 2004	31 Dec. 2006	$0.001365	$0.055	$0.028	36%	5.89%	0.00%
6 Dec. 2004	31 Dec. 2007	$0.001482	$0.07	$0.028	36%	5.89%	0.00%

21. KEY MANAGEMENT PERSONNEL COMPENSATION (cont'd)

Equity instruments

Option holdings

Unlisted Director Options

The movement during the reporting period in the number of options over ordinary shares held directly, indirectly or beneficially by each specified director and specified executive, including their personally-related entities, is as follows:

	Held at 1 July 2005	Held at date of appointment	Granted as remuneration	Lapsed	Held at 30 June 2006
Specified director					
Mr J Andrys	1,609,496	N/A	-	1,609,496	-
	3,000,000	N/A	-	3,000,000	-
	4,000,000	N/A	-	-	4,000,000
	4,000,000	N/A	-	-	4,000,000
Mr T McGellin	992,317	N/A	-	992,317	-
	3,000,000	N/A	-	3,000,000	-
	4,000,000	N/A	-	-	4,000,000
	4,000,000	N/A	-	-	4,000,000
Mr J Chua	1,556,000	N/A	-	1,556,000	-
Mr I Gibson	-	-	-	-	-

All options vested on the date of issue. No options held by specified directors are vested but not exercisable.

Note (1) 4,000,000 options exercisable at 5.5 cents each on or before 31 December 2006.
4,000,000 options exercisable at 7.0 cents each on or before 31 December 2007.

Equity holdings and transactions of key management personnel

The movement during the reporting period in the number of ordinary shares held directly, indirectly or beneficially by each specified director, including their personally-related entities, is as follows:

	Held at 1 July 2005	Purchases	Held at 30 June 2006
Specified director			
Mr J Andrys	8,753,878	-	8,753,878
Mr T McGellin	6,277,686	1,000,000	7,277,686
Mr J Chua	13,695,167	-	13,695,167
Mr I Gibson[1]	-	5,849,754	5,849,754

Conversion of $100,000 Convertible Note at a conversion price of 1.709 cents per share on 16 September 2005.

22. EMPLOYEE OPTION PLAN

The Company has in place an incentive scheme known as the Webspy Limited Staff Option Incentive Scheme ("Scheme"). No options to subscribe for ordinary fully paid shares were issued or exercised under the Scheme during the year, and there are no options on issue at balance date.

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
23. COMMITMENTS					
Operating lease commitments					
Future operating lease rentals not provided for in the financial statements and payable:					
- Not later than one year		220,734	181,212	138,421	83,131
- Later than one year but not later than five years		201,890	287,910	184,562	193,973
		422,624	469,122	322,983	277,104

The lease rentals are subject to review periodically to market rental rates or CPI increases, whichever is higher.

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Finance lease commitments					
Finance lease rentals for leasehold improvements are payable as follows:					
- Not later than one year		24,153	36,438	24,153	36,438
- Later than one year but not later than five years		-	24,153	-	24,153
Less: finance charges		(1,193)	(4,741)	(1,193)	(4,741)
		22,960	55,850	22,960	55,850
Lease liabilities provided for in the financial statements					
- Current	15	22,960	11,995	22,960	11,995
		22,960	11,995	22,960	11,995

24. SEGMENT INFORMATION

	Australia $		North America $		Europe $		Economic Entity $	
Primary reporting Geographical segments	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Revenue								
External sales	1,330,752	1,374,103	630,887	806,425	996,519	1,081,457	2,958,158	3,261,985
Unallocated revenue							20,520	24,300
							2,978,678	3,286,285
Result								
Segment result	(810,398)	(1,169,644)	98,525	16,291	122,720	247,542	(589,153)	(905,811)
Unallocated revenue and income tax benefit							361,781	349,323
							(227,372)	(556,488)
Depreciation and amortisation	72,794	112,718	4,594	9,744	7,482	2,778	84,870	125,240
Assets								
Segment assets	455,408	646,219	118,981	152,912	225,318	258,476	799,707	1,057,607
Unallocated assets							162,733	337,593
Consolidated total assets							962,440	1,395,200
Liabilities								
Segment liabilities	(522,415)	(897,210)	(28,076)	(99,875)	(176,743)	(139,014)	(727,234)	(1,136,099)
Acquisition of non current segment assets	24,103	43,555	1,088	1,893	2,966	1,482	28,157	46,930

Secondary reporting
Business segments

The principal activity of the economic entity is software development and sales. More than 90% of segment revenue and segment profits/(losses), and more than 90% of segment assets, relate to these operations.

	Economic Entity		Parent Entity	
	2006	2005	2006	2005
	$	$	$	$
25. NOTES TO THE STATEMENTS OF CASHFLOWS				
(a) Reconciliation of cash:				
For the purposes of the statements of cash flows, cash includes cash on hand and at bank and other funds held at call, net of outstanding bank overdrafts. Cash at the end of the financial year as shown in the statements of cash flows is reconciled to the related items in the balance sheet as follows:				
Cash and cash equivalents	162,733	337,593	1,646	11,708
(b) Reconciliation of after income tax to net cash used in operating activities				
Loss after income tax	(227,372)	(556,488)	(52,042)	(906,174)
Add/(less) non-cash items:				
Disposal of assets	-	10,491	-	-
Provision for doubtful term debtor	36,182	42,356	36,182	42,356
Provision for controlled entity receivables	-	-	165,089	531,535
Provision for employee entitlements	(8,175)	61,121	(39,172)	43,252
Depreciation	52,632	54,464	1,876	3,331
Amortisation	32,237	70,776	30,204	66,920
Foreign exchange loss	493	35,536	-	-
Net cash provided by/(used in) operating activities before changes in assets and liabilities	(114,003)	(281,744)	142,137	(218,780)
Changes in assets and liabilities during the financial year:				
Decrease/(Increase) in receivables	219,092	(352,266)	(24,807)	(13,742)
Decrease in prepayments	(10,501)	21,525	-	-
Increase in inventories	(5,032)	(21,509)	-	-
Increase/(Decrease) in payables	(298,371)	313,025	5,986	39,835
Net cash provided by/(used in) operating activities	(208,815)	(320,969)	123,316	(192,687)

26. FINANCIAL INSTRUMENTS DISCLOSURE

(a) Interest rate risk exposure

The economic entity's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial assets and financial liabilities, is set out below:

2006	Weighted Average effective interest rate %	Variable interest rate $	Fixed interest rate maturity Less than 1 year $	1-5 years $	Non - interest bearing $	Total $
Financial assets						
Cash	6.61	162,733	-	-	-	162,733
Receivables	9.0	-	50,000	-	612,479	662,479
Total financial assets		162,733	50,000	-	612,479	825,212
Financial liabilities						
Payables		-	-	-	557,780	557,780
Lease liabilities	8.9	-	22,960	-	-	22,960
Total financial liabilities		-	22,960	-	557,780	580,740

2005	Weighted Average effective interest rate %	Variable interest rate $	Fixed interest rate maturity Less than 1 year $	1-5 years $	Non - interest bearing $	Total $
Financial assets						
Cash	5.24	284,593	53,000	-	-	337,593
Receivables	9.0	-	-	-	880,214	880,214
Total financial assets		337,593	-	-	880,214	1,217,807
Financial liabilities						
Payables		-	-	-	768,078	768,078
Lease liabilities	9.0	-	213,351	-	-	213,351
Total financial liabilities		-	213,351	-	768,078	981,429

Receivables

Receivables include a loan of $162,266 (2005: $148,448) to Templar Resources Ltd (refer Note 8) with an interest rate of 9% per annum. A provision for impairment of this loan of $112,266 (2005: $148,448) has been made.

26. FINANCIAL INSTRUMENTS DISCLOSURE (cont'd)

(a) Interest rate risk exposure (cont'd)

Interest bearing liabilities

Interest bearing liabilities comprises of a finance lease of $22,960 (2005: $11,995) as set out in Note 15 at an interest rate of 8.9% per annum.

(b) Credit risk exposures

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the economic entity

The credit risk on financial assets, excluding investments, of the economic entity which have been recognised on the balance sheet, is the carrying amount, net of any provision for doubtful debts.

The economic entity minimises concentrations of credit risk by undertaking transactions with a large number of customers in various countries.

The Company is not materially exposed to any individual overseas country or individual customer.

(c) Foreign exchange risk exposure

The economic entity is exposed to exchange rate fluctuations due to potential revenues and expenses of the economic entity being in both United States dollars and English pounds. Therefore, movements in the rate of exchange between the United States dollar and the Australian dollar as well as between the English pound and the Australian dollar will affect both revenues and expenses denominated in those foreign currencies.

(d) Net fair values of financial assets and liabilities

The financial assets and liabilities included in current assets and liabilities in the Balance Sheet are carried at amounts that approximate net fair values

The carrying amounts and net fair value of financial assets and liabilities as at the reporting date are as follows:

	2006		2005	
	Carrying amount	Net fair Value	Carrying amount	Net fair Value
	$	$	$	$
Financial assets				
Cash assets	162,733	162,733	337,593	337,593
Receivables	662,479	662,479	880,214	880,214
Total financial assets	825,212	825,212	1,217,807	1,217,807
Financial liabilities				
Payables	557,780	557,780	768,078	768,078
Lease liabilities	22,960	22,960	213,351	213,351
Total financial liabilities	580,740	580,740	981,429	981,429

27. PARTICULARS IN RELATION TO CONTROLLED ENTITIES

		2006	2005
Parent entity		%	%
WebSpy Limited			
Controlled entities			
WebSpy UK Limited	(i)	100%	100%
Netlink Unit Trust	(ii)	100%	100%
Netlink (WA) Pty Ltd	(ii)	100%	100%
Webspy US Inc	(iii)	100%	100%
Netlink Inspection Pty Ltd	(iv)	100%	-

(i) Incorporated in the United Kingdom
(ii) Established in Australia
(iii) Incorporated in the United States
(iv) Incorporated in Australia on 1 July 2005

28. NON-DIRECTOR RELATED PARTIES

Non-director related parties are the Company's wholly-owned controlled entities.

Details of the Company's interest in wholly-owned controlled entities are set out in Note 27. Details of dealings with these entities are set out below.

Transactions

The loans to controlled entities are unsecured, interest-free and of no fixed term. The loans are provided primarily for the successful distribution of the Group's software products and accordingly, their recoupment is dependent upon sales.

Receivables

Aggregate amounts receivable from non-director related parties:

	Parent Entity	
	2006	2005
	$	$
Non-current		
Wholly-owned controlled entities	7,544,006	7,401,019
Provision for impairment	(7,392,931)	(7,227,842)
	151,075	**173,177**

29. EVENTS SUBSEQUENT TO REPORTING DATE

There are no events subsequent to balance date that would have a material financial effect on the financial statements for the year ended 30 June 2006.

In the opinion of the directors of WebSpy Ltd:

(a) the financial statements and notes, set out on pages 19 to 46 are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Parent Entity and Economic Entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and

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

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

The Chief Executive Officer and Chief Financial Officer have each declared that:

- the financial records of the Company for the financial year have been properly maintained in accordance with section 286 of the Corporations Act 2001;
- the financial statements and notes for the financial year comply with the Accounting Standards; and
- the financial statements and notes for the financial year give a true and fair view.

Signed in accordance with a resolution of the directors:

J Andrys
Director

Dated at Perth, Western Australia, this 29th day of September 2006

Grant Thornton Western Australian Partnership
ABN 21 965 022 862
Chartered Accountants, Business Advisers and Consultants

INDEPENDENT AUDIT REPORT TO MEMBERS OF WEBSPY LIMITED AND CONTROLLED ENTITIES

Scope

The Financial Report and Directors' Responsibility

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

The directors of the company are responsible for 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.

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INDEPENDENT AUDIT REPORT TO MEMBERS OF WEBSPY LIMITED AND CONTROLLED ENTITIES (cont)

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.

Our audit did not involve an analysis of the prudence of business decisions made by the directors or management.

We have read the other information in the annual report to determine whether it contained any material inconsistencies with the financial report.

Independence

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

In accordance with ASIC Class Order 05/83, we declare to the best of our knowledge and belief that the auditor's independence declaration has not changed as at the date of providing our audit opinion.

Audit opinion

In our opinion, the financial report of WebSpy Limited and Controlled Entities 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 2006 and of their performance for the year ended on that date; and
   (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and

b) other mandatory financial reporting requirements in Australia.

Inherent Uncertainty Regarding Continuation as a Going Concern

Without qualification to the audit opinion expressed above, attention is drawn to the following matter. As a result of the matters described in Note 1 (d) to the financial statements, there is significant uncertainty whether the consolidated entity 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 WESTERN AUSTRALIAN PARTNERSHIP

GREG LEGUIER
Partner

Perth, WA
Dated this 28th day of September 2006

Details of shares and options as at 10 October 2006:

Voting Rights

The voting rights attaching to ordinary shares are:

On a show of hands every member present in person or by proxy shall have one vote and upon a poll each share shall have one vote.

Options do not carry any voting rights.

Restricted Securities

The Company has no restricted securities.

Substantial shareholders

The number of shares held by substantial shareholders and their associates are set out below:

Substantial shareholder	Number of Shares
Kim Hin (Malaysia) Sdn Bhd	16,282,500
Mr William Paul Brooks	13,834,601
Mr Johnnie Chua	13,685,167
Mr Jack Paul Andrys	8,750,078

On-Market Buy Back

There is no current on-market buy-back.

Distribution schedules

Distribution of each class of security as at 10 October 2006:

Ordinary fully paid shares

Range	Holders	Units	%
1 - 1,000	33	29,958	0.03
1,001 - 5,000	109	353,104	0.30
5,001 - 10,000	101	864,640	0.73
10,001 - 100,000	335	12,194,141	10.24
100,001 - Over	98	105,699,432	86.03
Total	676	119,141,275	100.00

Unlisted options

Range	Holders	Units	%
1 - 1,000	0	0	0.00
1,001 - 5,000	0	0	0.00
5,001 - 10,000	0	0	0.00
10,001 - 100,000	0	0	0.00
100,001 - Over	2	16,000,000	100.00
Total	2	16,000,000	100.00

Unmarketable parcels

Holdings less than a marketable parcel of ordinary shares (being 18,519 as at 10 October 2006):

Holders	Units
300	2,069,981

Top holders

The 20 largest registered holders of each class of security as at 10 October 2006 were:

Fully paid ordinary shares

Name	No. of Shares	%
1. Kim Hin (Malaysia) Sdn Bhd	16,282,500	13.67
2. Mr JSH Chua	13,685,167	11.49
3. Mr Jack Paul Andrys	8,750,078	7.34
4. Baracus Pty Ltd	8,005,585	6.72
5. Gibson Capital Pty Ltd	5,849,754	4.91
6. Mr William Paul Brooks <Brooks Super Fund>	5,829,016	4.89
7. Underpass Holdings Pty Ltd	4,501,586	3.78
8. Casir (Australia) Pty Ltd	2,967,500	2.49
9. Mr Thomas McGellin and Cynthia Lyon	2,863,600	2.40
10. Pacific Link Global Enterprises	2,685,945	2.25
11. Siaw Yian Chong	2,295,002	1.93
12. Mr Ben Rockefeller	2,160,000	1.81
13. Prosperity Finance Co. Ltd	2,068,916	1.74
14. Paul Bernard McCarthy	2,000,000	1.68
15. Chui Tham Chua	1,985,000	1.67
16. Annagrove Pty Ltd	1,500,000	1.26
17. Royal Sunset Pty Ltd	1,370,000	1.15
18. Wai Heng Ho	1,283,524	1.08
19. Jaylin Pty Ltd <Linden Super Fund>	973,460	0.82
20. Microvision Consultations Pty Ltd	725,000	0.61
	87,781,633	73.69

Unlisted Options exercisable at $0.055 on or before 31 December 2006

Name	No. of Options	%
1. Blueman Pty Ltd	4,000,000	50.00
2. Underpass Holdings Pty Ltd	4,000,000	50.00
	8,000,000	100.00

Unlisted Options exercisable at $0.07 on or before 31 December 2007

Name	No. of Options	%
1. Blueman Pty Ltd	4,000,000	50.00
2. Underpass Holdings Pty Ltd	4,000,000	50.00
	8,000,000	100.00