Electro Optic Systems Holdings Limited

A.C.N. 092 708 364
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http://www.eos-aus.com

This Preliminary Final Report (Appendix 4E) is provided to the Australian Stock Exchange (ASX) under ASX Listing Rule 4.3A
Audited Results for Announcement to the Market for the Financial Year Ended 31 December 2005

		Percentage Change		Amount
		%		$
Revenue from ordinary activities	Up	264	to	38,700,543
Loss from ordinary activities after tax attributable to members	Down	149	to	(14,731,196)
Net loss attributable to members	Down	149	to	(14,731,196)
		Amount per security		**Franked amount per security**
Final dividend		Nil		Nil
Interim dividend		Nil		Nil

Net Tangible assets	$37,400,072
Number of ordinary shares outstanding at year end	51,269,598
NTA per ordinary share at 31 December 2005	72.95 cents
NTA per ordinary share at 31 December 2004	10.93 cents

A review of operations is included in pages 3 to 6 of the attached signed Financial Report for the financial year ended 31 December 2005.

These results have been audited by Deloitte Touche Tohmatsu and their signed audit report is included on pages 20 and 21 of the attached audited financial statements for the financial year ended 31 December 2005.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
ACN 092 708 364

FINANCIAL REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CORPORATE DIRECTORY

Directors

Mr Fred Bart (Chairman)
Dr Ben Greene (Chief Executive Officer)
Mr Ian Dennis
Ms Cheryl Bart
Mr John Gordon
Mr Mark Ureda

Company Secretary

Mr Ian Dennis

Registered Office

Suite 2, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia

Telephone:- 612 9233 3915
Facsimile:- 612 9232 3411

Web site www.eos-aus.com

Share Registry

Computershare Investor Services Pty Limited
Level 3,
60 Carrington Street
Sydney NSW 2000
Australia

GPO Box 7045
Sydney NSW 1115

Telephone:- 1300 855 080 or 613 9611 5711 outside Australia
Facsimile:- 1300 137 341

Auditors
Deloitte Touche Tohmatsu
Chartered Accountants
8 Brindabella Circuit
Brindabella Business Park
Canberra Airport ACT 2609
Australia

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

REVIEW OF OPERATIONS

Overview

The consolidated entity continues to operate in the military and space business sectors.

Full-year income of A$40.4m (2004: A$14.1m) represents the first stage of the strong growth that the Company expected to commence during this period. Further strong growth for 2006 is projected.

Profit on operations was A$5.9m representing a 15% margin. Despite this profit, the Company incurred an overall net loss of $14.7m (2004: A$5.9m) due to significant expenses associated with business expansion (A$17.1m) and the cost of staff options (A$3.5m).

The charge of $3.5m relates to share-based payments in respect of options awarded to Directors on 29 April 2005 and options awarded to staff. This expense is a non cash operating expense and was required to be booked in accordance with A-IFRS.

The key areas of investment by the Company were:

• Expansion of military production capacity	A$5.7m
• Research and development for space products	A$3.8m
• Research and development for military products	A$2.0m
• Staff training	A$1.6m
• Process engineering (company ERP)	A$4.0m
	A$17.1m

Military Business.

During the full year to 31 December 2005 the Company completed a substantial investment program of A$16.5m aimed at establishing a production capacity of A$5m per month of military products from its Tucson Arizona and Queanbeyan Australia facilities. From this investment, the Company has expensed A$7.3m including A$1.6m in staff training costs and A$5.7m in production expansion costs. The balance of A$9.2m was invested in inventory.

These investments were successful overall, and at 31 December 2005 the Queanbeyan plant capacity exceeded projections and the Tucson plant capacity fell short by a similar amount. The plant capacities will be balanced and optimised against cost during 2006 to meet the demands of our customers.

During 2006 the combined plant capacity will be further increased to meet demand. This is expected to reach A$8m per month in the second half of 2006. Further expenses of A$1.5m are likely to be required to meet this increment in production capacity. The Company has had to significantly increase its inventory levels at 31 December 2005 to A$9.2m to cater for these increased production levels.

REVIEW OF OPERATIONS (cont)

The Company has sought new products that will be able to make use of the substantial investment in production capacity, and EOS released its new Redback™ Weapon System prototype at the Asian Aerospace and Asian Defence Technology Exhibitions in Singapore in February 2006.

A Teaming Agreement, signed EOS and Metal Storm in November 2005, will allow the two companies to co-develop and market new weapon systems, combining the unique features and benefits of EOS' combat-proven sensor and fire control systems with the versatility and firepower of Metal Storm weapons. Redback™ is the first weapon system to be produced from the collaboration between EOS and Metal Storm.

Redback™ is a lightweight (35% of the weight of CROWS), fast-reaction, remotely operated, weapon system. It is designed to provide intense directed firepower for short periods in applications such as vehicle protection, convoy defence, perimeter control, robotic systems and area denial.

The system is designed to include the following features and benefits:

- **Firepower.** Redback™ deploys multiple 40mm Metal Storm barrels firing a range of munitions at selectable rates of fire, including the ability to engage up to 3 targets in 1.2 seconds. With EOS precision sensors and control systems, this results in intense directed firepower.
- **Light.** Redback™ will be available in system weights from 70-100 kg - less than one conventionally-equipped combatant.
- **Fast.** Redback™ control and servo systems will allow multiple threats to be engaged within 1 second, fast enough to engage incoming missiles and projectiles for vehicle defence.
- **Intelligent.** Redback™ has proven networking capabilities that allow multiple systems to operate with a coordinated response to large threats.
- **Versatile.** Redback™ can carry a mixed load of munitions to allow non-lethal and lethal response at the same time. This range of response is an unmet market need for peacekeeping missions and urban warfare with non-combatants present.

Redback™ has successfully fired 40mm munitions jointly developed by ST Kinetics and Metal Storm.

Space Business.

Revenue for the telescope and space equipment sector increased significantly in 2005, however operating margins were reduced by cost over-run in some programs. Although the causes were identified during the third quarter, several months were needed to effect remedies.

In the full year to 31 December 2005 the Company outlaid A$3.8m towards the ongoing development of space surveillance and space ablation capabilities. This cost is expected to increase to A$8.9m in 2006. This development program continues to successfully meet customer program requirements and development milestones.

REVIEW OF OPERATIONS (cont)

EOS and Northrop Grumman are collaborating to focus this development effort towards market applications and opportunities as the technology matures.

Process Re-engineering

In order to accommodate the increased revenue and future revenue growth the Company made a commitment in the first half of 2005 to the acquisition and implementation of a company wide Enterprise Resource Planning ("ERP") system as well as cost and schedule control systems for major space projects.

The implementation of this system in the seven months to 31 December 2005 was A$4m, or A$2m over budget. This cost over-run is the largest single unplanned element of the financial year to 31 December 2005. The causes have been determined and remedied to the extent that was possible.

The process will continue, as it is essential for key elements of corporate management and governance as activities increase. Outlays for completion of the implementation will be around A$5m over the next 18 months.

Summary

Operating highlights include;

- Revenue growth to A$40.4m matched projections, and lays the foundation for further strong growth in 2006.
- Aggressive production capacity targets for 2005 were reached.
- The overall performance of the military sector was good. Product quality and operational performance remain strong, and product availability meets customer demands.
- Space sector technology research and development made strong advances and customer demonstration objectives were all met or exceeded.
- Strategic partnership development, including a new space relationship with Northrop Grumman that was concluded in January 2005.
- The company achieved a good cash position, with substantially more cash in hand at year end than at the beginning of the year.
- All businesses are positioned to contribute towards strong revenue growth in 2006.

Of concern during 2005 were the performance of space and military production projects in Tucson and cost over-runs in the Company's ERP implementation. By year end the project performance issues had been addressed and were of diminishing concern.

REVIEW OF OPERATIONS (cont)

The Company considers that the full year to 31 December 2005 has been successful, with major issues confronted and successfully addressed on the growth path towards significant revenues and profits from its strong technology base.

The Company's cash position is such that all working capital requirements can be met from existing reserves.

Ben Greene

Chief Executive Officer

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

DIRECTORS' REPORT

The directors of Electro Optic Systems Holdings Limited submit herewith the annual financial report of the company for the year ended 31 December 2005. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

Directors

The names and particulars of the directors of the company during or since the end of the financial year are:

Name	Particulars
Fred Bart	Chairman (Age 51). A director since 8 May 2000. He has been Chairman and Director of numerous private companies since 1980, specialising in manufacturing, property and technology. He is a member of the Australian Institute of Company Directors.
Dr Ben Greene	BE (Hons), Phd in Applied Physics (Age 54) is the Chief Executive Officer of Electro Optic Systems. Dr Greene was involved in the formation of Electro Optic Systems. He is widely published in the subject areas of laser tracking, space geodesy, quantum physics, satellite design, laser remote sensing, and the metrology of time, and is currently regarded as a world leader in these fields. Appointed to the Board on 11 April 2002.
Ian Dennis	BA, A.C.A. (Age 48) is a Chartered Accountant with experience as director and secretary in various public listed companies and trusts in Australia and overseas. He has been involved in the investment banking industry and stockbroking industry for the past twenty years. Prior to that, he was with KPMG, Chartered Accountants in Sydney. Appointed to the Board on 8 May 2000. He is a member of the Australian Institute of Company Directors and is a member of the Audit Committee. He is also company secretary of Electro Optic Systems Holdings Limited.
Cheryl Bart	BCom, LLB Non-executive director. Appointed to the Board on 7 September 2001. Cheryl Bart is a lawyer and company director. She is Chairman of South Australian Film Corporation and Adelaide Film Festival. She is a non-executive director of ETSA Utilities, the Alcohol Education and Rehabilitation Foundation, Defence Industry Advisory Board and Economic Development Board of South Australia. She is a fellow of the Australian Institute of Company Directors and a member of the Audit Committee.

DIRECTORS' REPORT (cont)

Dr Bob Dean	Non-executive director (Age 64). Appointed to the Board on 1 December 2002. Dr Bob Dean is a former senior executive of Boeing, Lockheed-Martin and Ball Corporation. He has extensive experience with US Governments, Space agencies and US defense contractors. He ceased to be an executive in December 2005 and resigned as a director on 8 March 2006.
John Gordon	Non-executive director (Age 59). Appointed to the Board on 18 November 2004. John Gordon has a distinguished career in US government service, retiring as a 4-star USAF General. He has served in senior positions in USAF Space Command, and brings strong technology and business credentials to the Board. He is Chairman of the Audit Committee.
Mark Ureda	Non- executive director (Age 51). Appointed to the Board on 28 April 2005. Mark is vice president, Strategy and Technology for Northrop Grumman Corporation, a global defence company. Mark received a bachelor's degree in Engineering from the University of California at Los Angeles, a master's degree in Acoustics from the Pennsylvania State University and a master's degree in Finance from the UCLA Graduate School of Management.

The above named directors held office during and since the end of the financial year except for Mr Mark Ureda who was appointed a director on 28 April 2005 and Dr Bob Dean who resigned on 08 March 2006.

Directorships of other listed companies

Name	Company	Period of directorship
Fred Bart	Genetic Technologies Limited	26 October 1996 to date
	Gtech International Resources Limited	7 November 1996 to date
	Global Properties Limited	5 September 2000 to date
Ian Dennis	Genetic Technologies Limited	24 November 1994 to 24 November 2005
	Gtech International Resources Limited	21 June 1996 to 30 June 2005
	Global Properties Limited	5 September 2000 to date
Cheryl Bart	Global Properties Limited	26 November 2001 to date
	Spark Infrastructure Group Limited	8 November 2005 to date
Bob Dean	Macdonald, Dettwiler and Associates Limited	22 October 2003 to date
John Gordon	Activcard Inc	18 August 2004 to 27 February 2006

DIRECTORS' REPORT (cont)

Principal activities

The principal activities of the consolidated entity are in the space systems and surveillance and defence products business.

The company is listed on the Australian Stock Exchange.

Review of operations

A detailed review of operations is included as an attachment to this financial report.

Changes to the state of affairs

There were no other significant changes in the state of affairs of the consolidated entity that occurred during the financial period not otherwise disclosed in the financial statements or notes thereto.

Subsequent events

There has not been any matter or circumstance, other than that referred to in the financial statements or notes thereto, that has arisen since the end of the financial year, that has significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in future financial years.

Future developments

The company will continue to operate in the space systems and surveillance and defence products business.

Further disclosure of information regarding likely developments in the operations of the consolidated entity in future financial years and the expected results of those operations is likely to result in unreasonable prejudice to the consolidated entity. Accordingly, this information has not been disclosed in this report.

Environmental Regulations

In the opinion of the directors the consolidated entity is in compliance with all applicable environmental legislation and regulations.

Dividends

The directors recommend that no dividend be paid and no amount has been paid or declared by way of dividend since the end of the previous financial year and up to the date of this report.

Share Options

Share options granted to directors and executives

During and since the end of the financial year an aggregate of 2,027,200 share options were granted to the following directors and executives of the company:

Directors and executives	Number of options granted	Issuing entity	Number of ordinary shares under option
Dr Ben Greene	1,045,200	Electro Optic Systems Holdings Limited	1,045,200
Dr Robert Dean	434,000	Electro Optic Systems Holdings Limited	434,000
Mr John Gordon	300,000	Electro Optic Systems Holdings Limited	300,000
Dr Craig Smith	108,000	Electro Optic Systems Holdings Limited	108,000
Mr Steven Juliver	60,000	Electro Optic Systems Holdings Limited	60,000
Ms Karen McGilvery	45,000	Electro Optic Systems Holdings Limited	45,000
Mr Ron Thompson	35,000	Electro Optic Systems Holdings Limited	35,000
	2,027,200		2,027,200

Share options on issue at year end or exercised during the year

Details of unissued shares or interests under option are:

Issuing entity	Number of shares under option	Class of shares	Exercise price of option	Expiry date of options
Electro Optic Systems Holdings Limited	983,500	Ordinary	$1.64	1 July 2006
Electro Optic Systems Holdings Limited	626,000	Ordinary	$2.58	30 April 2009
Electro Optic Systems Holdings Limited	1,279,200	Ordinary	$3.06	31 March 2009
Electro Optic Systems Holdings Limited	900,000	Ordinary	$3.50	30 September 2009
Electro Optic Systems Holdings Limited	108,000	Ordinary	$3.06	30 September 2009

DIRECTORS' REPORT (cont)

Share Options (cont)

Electro Optic Systems Holdings Limited	200,000	Ordinary	$2.56	31 March 2009
Electro Optic Systems Holdings Limited	300,000	Ordinary	$2.85	31 March 2009

The holders of such options do not have the right, by virtue of the option, to participate in any share issue or interest issue of any other body corporate or registered scheme.

Details of shares or interests issued during the financial year as a result of exercise of an option are:

Issuing entity	Number of shares issued	Class of shares	Amount paid for shares	Amount unpaid on shares
Electro Optic Systems Holdings Limited	4,917,663	Ordinary	$0.20	Nil
Electro Optic Systems Holdings Limited	116,000	Ordinary	$1.64	Nil
Electro Optic Systems Holdings Limited	14,000	Ordinary	$2.58	Nil

Indemnification and Insurance of Officers and Auditors

During the financial year, the company paid a premium in respect of a contract insuring the Directors and Officers of the Company and any related body corporate against a liability incurred as such a Director or Officer to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the coverage provided and the amount of the premium. The Company has agreed to indemnify the current Directors, Company Secretary and Executive Officers against all liabilities to other persons that may arise from their position as Directors or Officers of the Company and its controlled entities, except where to do so would be prohibited by law. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

The Company has not, during or since the financial year indemnified or agreed to indemnify an auditor of the company or of any related body corporate against any liability incurred as such an auditor.

DIRECTORS' REPORT (cont)

Directors' meetings

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (while they were a director or committee member). During the financial year, 12 Board meetings and 1 audit committee meetings were held.

	Board of directors		Audit committee	
Directors	**Held**	**Attended**	**Held**	**Attended**
Mr Fred Bart	12	12	-	-
Dr Ben Greene	12	12	-	-
Mr Ian Dennis	12	12	1	1
Ms Cheryl Bart	12	9	1	1
Dr Bob Dean	12	12	-	-
Mr John Gordon	12	11	1	1
Mr Mark Ureda	8	8	-	-

Directors' shareholdings

The following table sets out each Director's relevant interest in shares and options of the company or a related body corporate as at the date of this report.

Directors	Fully paid ordinary shares	Options
Mr Fred Bart	6,110,050	-
Dr Ben Greene	7,452,485	1,045,200
Mr Ian Dennis	160,050	200,000
Ms Cheryl Bart	290,000	200,000
Dr Bob Dean	-	634,000
Mr John Gordon	-	300,000
Mr Mark Ureda	-	-

Remuneration report

This report outlines the remuneration arrangements in place for Directors and Executives of the Company.

The Directors are responsible for remuneration policies and packages applicable to the Board members and executives of the company. The Company does not have a separate Nomination and Remuneration Committee. The broad remuneration policy is to ensure the remuneration package properly reflects the persons duties and responsibilities.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

Remuneration structure

In accordance with best practice corporate governance, the structure of Non-Executive Director and senior manager remuneration is separate and distinct.

Non-Executive Director remuneration

Objective

The Board seeks to set aggregate remuneration at a level which provides the Company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost which is acceptable to shareholders.

Structure

The Company's Constitution and the Australian Stock Exchange Listing Rules specify the aggregate remuneration of Non- Executive Directors shall be determined from time to time by a General Meeting of shareholders. An amount not exceeding the amount determined is then divided between the Directors as agreed. The latest determination was at the Annual General Meeting held on 11 April 2002, when shareholders approved an aggregate remuneration of $230,000 per year. The Board considers that in light of this level of fees, and the present situation of the Company, it is appropriate for options to be made available to Directors.

The amount of aggregate remuneration sought to be approved by shareholders, the manner in which it is apportioned amongst Directors, and the policy of granting options to Directors, are reviewed annually.

Each Non-Executive Director receives a fee for serving as a Director of the Company. No additional fees are paid to any Director for serving on a committee of the Board. A company associated with Mr Ian Dennis receives a fee in recognition of services provided to the Company.

Executive Director and Senior Management remuneration

Objective

The Company aims to award Executives with a level and mix of remuneration commensurate with their position and responsibilities within the Company and so as to:

- reward Executives for Company and individual performance against targets set by reference to suitable benchmarks;
- align the interests of Executives with those of shareholders; and
- ensure that the total remuneration paid is competitive by market standards.

Remuneration Report (cont)

Structure

The remuneration paid to Executives is set with reference to prevailing market levels and typically comprises a fixed salary and option component. Options are granted to Executives in line with their respective levels of experience and responsibility. Details of the amounts paid and the number of options granted to Executives during the 2005 financial year are disclosed elsewhere in the Directors' Report.

Employment contracts

There are no employment contracts in place with any Non-Executive Director of the Company. There are standard Contracts of Employment with Executive Directors and Senior Management which contain no unusual terms. The contracts provide for a termination period in respect of Ben Greene of 180 days and 90 days in respect of other senior executives.

Director remuneration

The following tables disclose the remuneration of the directors of the Company:

2005	Primary		Post Employment	Equity	Other	Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Options $	Benefits $	$
Mr Fred Bart	30,000	-	-	-	-	30,000
Dr Ben Greene*	344,270	34,462	23,040	1,586,292	-	1,988,064
Mr Ian Dennis	78,000	-	-	-	-	78,000
Ms Cheryl Bart	17,500	-	-	-	-	17,500
Dr Bob Dean*	350,028	13,095	-	831,140	-	1,194,263
Mr John Gordon	17,573	-	-	472,923	-	490,496
Mr Mark Ureda	-	-	-	-	-	-
	837,371	47,557	23,040	2,890,355	-	3,798,323
* Executive Directors during the financial year						

Remuneration Report (cont)

2004	Primary		Post Employment	Equity	Other	Total
	Salary & Fees $	Non-monetary $	Super-annuation$	Options $	Benefits $	$
Mr Fred Bart	10,000	-	-	-	-	10,000
Dr Ben Greene*	161,514	48,513	30,000	-	-	240,027
Mr Ian Dennis	46,000	-	-	-	-	46,000
Ms Cheryl Bart	10,000	-	-	-	-	10,000
Dr Bob Dean*	325,600	47,311	-	-	-	372,911
Mr John Gordon	-	-	-	-	-	-
	553,114	95,824	30,000	-	-	678,938
* Executive Directors during the financial year						

Executive remuneration

The following table discloses the remuneration of the five highest remunerated executives of the company and group executives of the consolidated entity:

2005	Primary		Post Employment	Equity	Other	Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Options $	Benefits $	$
Mr Ron Thompson	127,838	-	11,210	5,287	-	144,335
Dr Craig Smith	182,475	-	16,301	143,640	-	342,416
Ms Karen McGilvery (1)	88,739	-	7,987	6,798	-	103,524
Mr Jack Elliot (2)	158,703	15,899	-	-	42,802	217,404
Mr Steven Juliver	134,571	14,251	-	13,931	-	162,753
	692,326	30,150	35,498	169,656	42,802	970,432

1. Commenced employment on 20 January 2005.
2. Commenced on 25 October 2004 and ceased on 12 December 2005.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

2004	Primary		Post Employment	Equity	Other	Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Options $	Benefits $	$
Mr Ron Thompson	73,234	62,400	27,669	-	-	163,303
Dr Craig Smith	137,663	-	26,671	-	-	164,334
Mr Bruce Cook	115,545	16,524	-	4,244	-	136,313
Mr Robert Meeks	102,000	1,107	-	6,368	-	109,475
Mr Steven Juliver	74,861	12,459	-	6,368	-	93,688
	503,303	92,490	54,340	16,980	-	667,113

Non-monetary includes the provision for motor vehicles and heath benefits.

Benefits include the provision of motor vehicles and health benefits.

<u>Value of options issued to directors and executives</u>

The following table discloses the value of options granted and exercised during the year:

	Options Granted Value at grant date $	**Options Exercised Value at exercise date $**	**Total value of options granted and exercised (1) $**	**Value of options included in remuneration for the year (2) $**	**Percentage of total remuneration for the year that consists of options %**
Dr Ben Greene (1)	1,586,292	-	1,586,292	1,586,292	79.8
Dr Robert Dean	831,140	-	831,140	831,400	69.6
Mr John Gordon	660,000	-	660,000	472,923	96.4
Mr Craig Smith	143,640	-	143,640	143,640	41.9
Mr Ron Thompson	40,600	-	40,600	5,287	3.7
Ms Karen McGilvery	52,200	-	52,200	6,798	6.6
Mr Steven Juliver	69,600	-	69,600	9,064	85.6

1. The options exercised by Dr Ben Greene during the year were vendor and CEO options issued on 11 April 2002, not employee related options and accordingly do not form part of remuneration.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

Value of options – basis of calculation

(1) The total value of options granted and exercised is calculated based on the following:

- Fair value of the option at grant date multiplied by the number of options granted during the year; plus
- Fair value of the option at the time it is exercised multiplied by the number of options exercised during the year.

(2) The total value of options included in remuneration for the year is calculated as follows:

- The value of the options is determined at grant date, and are included in remuneration on a proportionate basis from grant date to vesting date. Where the options immediately vest the full value of the option is recognised in remuneration in the current year.
- The options issued to Dr Ben Greene, Dr Bob Dean and Mr Craig Smith vest at the date of issue. The options issued to Mr John Gordon vest over a two year period with the first tranche of 150,000 vesting on 18 November 2005 (one year after his appointment as a director) and the balance of 150,000 vesting on 18 November 2006. In respect of the 900,000 options issued to staff on 30 September 2005, these vest on the basis of 20% on 30 September 2006 (one year after the date of issue), 30% on 30 September 2007 and 50% on 30 September 2008.

Elements of remuneration related to performance

There are no performance conditions attached to the above remuneration to directors and executives. Directors and senior executives receive options as disclosed in the above tables which are not subject to specific performance conditions. The overall performance of the company as determined by the share price will determine whether the options are exercised and whether the director or executive receives any benefit form these options. Options issued to certain directors and executives are also subject to vesting provisions as disclosed above.

DIRECTORS' REPORT (cont)

Audit Committee

The Board of Directors resolved to form an Audit Committee at its meeting held on 28 April 2005. The Board appointed three non-executive directors to form the committee, with a majority of independent directors and the Chairman being an independent person. The members of the committee are Mr John Gordon (Chairman), Mr Ian Dennis and Ms Cheryl Bart.

Non-audit services

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors have formed this view based on the fact that the nature and scope of each type of non-audit service provided means that the audit independence was not compromised.

Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are contained in note 9 to the financial statements.

Auditor's independence declaration

The auditor's independence declaration is included on page 19 of the financial report.

Signed in accordance with a resolution of directors made pursuant to s.298(2) of the Corporations Act 2001.

On behalf of the Directors

I A Dennis
Director
Dated at Sydney this 10 day of March 2006

Deloitte

Deloitte Touche Tohmatsu
ABN 74 490 121 060

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The Board of Directors
Electro Optic Systems Holdings Limited
Level 12
75 Elizabeth Street
Sydney NSW 2000

10 March 2006

Dear Board Members

Electro Optic Systems Holdings Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Electro Optic Systems Holdings Limited.

As lead audit partner for the audit of the financial statements of Electro Optic Systems Holdings Limited for the financial year ended 31 December 2005, I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

D. Black.

David Black
Partner
Chartered Accountants

Member of
Deloitte Touche Tohmatsu

Deloitte.

Deloitte Touche Tohmatsu
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Independent audit report to the members of Electro Optic Systems Holdings Limited

Scope

The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, cash flow statement, statement of recognised income and expense, a summary of significant accounting policies and other explanatory notes and the directors' declaration for both Electro Optic Systems Holdings Limited (the company) and the consolidated entity, for the financial year ended 31 December 2005 as set out on pages 22 to 103. The consolidated entity comprises the company and the entities it controlled at the year end or from time to time during the financial year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with Accounting Standards in Australia and the Corporations Act 2001. This includes responsibility for the maintenance of adequate financial 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 have conducted an independent audit of the financial report in order to express an opinion on it to the members of the company. Our audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal controls, 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 form an opinion whether, in all material respects, the financial report is presented fairly in accordance with Accounting Standards in Australia and the Corporations Act 2001 so as to present a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and performance as represented by the results of their operations, their changes in equity and their cash flows.

Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial report, and the evaluation of accounting policies and significant accounting estimates made by the directors.

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

The audit opinion expressed in this report has been formed on the above basis.

Audit Opinion

In our opinion, the financial report of Electro Optic Systems Holdings Limited is in accordance with the Corporations Act 2001, including:

(a) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2005 and of their performance for the year ended on that date; and

(b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

D. Black

David Black
Partner
Chartered Accountants
Canberra, 10 March 2006

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

DIRECTORS' DECLARATION

The directors declare that:

(a) in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;

(b) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity; and

(c) the directors have been given the declarations required by s.295A of the Corporations Act 2001.

Signed in accordance with a resolution of the directors made pursuant to s.295(5) of the Corporations Act 2001.

On behalf of the Directors

I A Dennis
Director

Dated at Sydney this 10 day of March 2006.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

INCOME STATEMENT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005

	Note	Consolidated		Company	
		31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
Revenue	2	38,700,543	10,630,490	704,442	250,299
Other income	2	1,678,817	3,441,106	-	79,101
Changes in inventories of finished goods and work in progress		8,123,442	260,329	-	-
Raw materials and consumables used		(34,553,347)	(7,882,369)	-	-
Employee benefits expense		(20,508,777)	(8,193,985)	(3,614,474)	(306,371)
Administration expenses		(4,097,875)	(2,754,183)	(522,436)	(206,442)
Finance costs		(113,289)	(104,297)	-	-
Depreciation expense		(1,135,754)	(422,322)	(913)	(418)
Loss on disposal of fixed assets		(34,436)	-	-	-
Foreign exchange losses		-	(160,809)	-	-
Lease expenses		(31,294)	(36,682)	-	-
Occupancy costs		(1,646,994)	(626,207)	(21,640)	(39,952)
Provision for non-recovery of loan		-	-	(6,436,448)	(3,650,560)
Other expenses		(1,112,232)	(167,191)	(69,774)	(98,506)
(Loss) before income tax benefit	2	(14,731,196)	(6,016,120)	(9,961,243)	(3,972,849)
Income tax benefit	4	-	100,000	-	-
(Loss) for the period	22	(14,731,196)	(5,916,120)	(9,961,243)	(3,972,849)
Earnings per share					
Basic (cents per share)	3	(34.6)	(17.1)		
Diluted (cents per share)	3	(34.6)	(17.1)		

Notes to the financial statements are included on pages 28 to 103.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

BALANCE SHEET AS AT 31 DECEMBER 2005

	Note	Consolidated December 2005 $	Consolidated December 2004 $	Company December 2005 $	Company December 2004 $
CURRENT ASSETS					
Cash and cash equivalents	24	21,434,803	3,686,742	17,976,534	3,517,202
Trade and other receivables	6	13,799,654	4,192,238	67,110	9,477
Inventories	7	9,189,427	1,065,985	-	-
Other	8	115,210	170,979	-	-
TOTAL CURRENT ASSETS		44,539,094	9,115,944	18,043,644	3,526,679
NON-CURRENT ASSETS					
Property, plant and equipment	10	6,717,694	1,657,120	3,026	628
Investment property	11	-	-	-	-
Other financial assets	5	-	-	841,325	841,325
Other	8	-	-	24,114,006	-
Goodwill	12	5,505,764	5,505,764	-	-
TOTAL NON-CURRENT ASSETS		12,223,458	7,162,884	24,958,357	841,953
TOTAL ASSETS		56,762,552	16,278,828	43,002,001	4,368,632
CURRENT LIABILITIES					
Trade and other payables	13	9,219,677	4,841,272	96,165	60,847
Borrowings	14	735,747	354,186	-	-
Provisions	15	2,492,132	1,122,618	-	-
Other	18	90,391	-	-	-
TOTAL CURRENT LIABILITIES		12,537,947	6,318,076	96,165	60,847
NON-CURRENT LIABILITIES					
Borrowings	14	1,054,826	588,689	-	-
Provisions	15	-	99,465	-	-
Other	18	263,943	-	-	-
TOTAL NON-CURRENT LIABILITIES		1,318,769	688,154	-	-
TOTAL LIABILITIES		13,856,716	7,006,230	96,165	60,847
NET ASSETS		42,905,836	9,272,598	42,905,836	4,307,785
EQUITY					
Issued capital	19	67,833,722	22,805,829	67,833,722	22,805,829
Reserves	21	3,602,138	265,597	3,807,772	276,371
Accumulated losses	22	(28,530,024)	(13,798,828)	(28,735,658)	(18,774,415)
TOTAL EQUITY		42,905,836	9,272,598	42,905,836	4,307,785

Notes to the financial statements are included on pages 28 to 103.

STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	Consolidated		Company	
		31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
Translation of foreign operations: Exchange differences taken to equity		(194,860)	(10,774)	-	-
Net expense recognised directly in equity		(194,860)	(10,774)	-	-
Loss for the period		(14,731,196)	(5,916,120)	(9,961,243)	(3,972,849)
Total recognised expense for the period		(14,926,056)	(5,926,894)	(9,961,243)	(3,972,849)

Notes to the financial statements are included on pages 28 to 103.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
Cash flows from operating activities					
Receipts from customers		29,345,111	14,588,675	-	79,101
Payments to suppliers and employees		(51,730,424)	(18,166,612)	(719,238)	(357,316)
Interest received		724,457	273,344	704,442	250,299
Interest and other costs of finance paid		(113,289)	(104,297)	-	-
Net cash outflows from operating activities	24(b)	(21,774,145)	(3,408,890)	(14,796)	(27,916)
Cash flows from investing activities					
Advances to wholly-owned controlled entities		-	-	(30,550,454)	(3,650,560)
Proceeds from sale of property		-	1,806,987	-	1,806,987
Amounts advanced to non related parties		-	(200,000)	-	(200,000)
Amounts received from non related parties		-	200,000	-	200,000
Payment for property, plant and equipment		(4,701,980)	(328,164)	(3,311)	-
Net cash (outflows)/ inflows from investing activities		(4,701,980)	1,478,823	(30,553,765)	(1,843,573)
Cash flows from financing activities					
Proceeds from issue of ordinary shares		43,905,893	175,281	43,905,893	175,281
Payment for issue of shares		(1,122,000)	-	(1,122,000)	
Repayment of borrowings		(809,675)	(484,536)	-	-
Proceeds from borrowings		-	-	-	-
Net cash inflows/ (outflows) from financing activities		44,218,218	(309,255)	45,027,893	175,281

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Notes	Consolidated		Company	
		31 December 2005	31 December 2004	31 December 2005	31 December 2004
		$	$	$	$
Net increase/ (decrease) in cash and cash equivalents		17,742,093	(2,239,322)	14,459,332	(1,696,208)
Cash and cash equivalents at the beginning of the financial year		3,686,742	5,929,848	3,517,202	5,213,410
Effects of exchange rate fluctuations on the balances of cash held in foreign currencies		5,968	(3,784)	-	-
Cash and cash equivalents at the end of the financial year	24(a)	21,434,803	3,686,742	17,976,534	3,517,202

Notes to the financial statements are included on pages 28 to 103.

1. Summary of Accounting Policies

Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with the Corporations Act 2001, Accounting Standards and Urgent Issues Group Interpretations, and complies with other requirements of the law. Accounting Standards include Australian equivalents to International Financial Reporting Standards ("A-IFRS"). Compliance with A-IFRS ensures that the consolidated financial statements and notes of the consolidated entity comply with International Financial Reporting Standards ("IFRS"). The parent entity financial statements and notes also comply with IFRS except for the disclosure requirements in IAS 32 "Financial Instruments: Disclosure and Presentation" as the Australian equivalent Accounting Standard, AASB 132 "Financial Instruments: Disclosure and Presentation" does not require such disclosures to be presented by the parent entity where its separate financial statements are presented together with the consolidated financial statements of the consolidated entity.

The financial statements were authorised for issue by the Directors on 9 March 2006.

Basis of preparation

The financial report has been prepared on the basis of historical cost. Cost is based on the fair values of the consideration given in exchange for assets.

In the application of A-IFRS management is required to make judgments, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgments. Actual results may differ from these estimates.
The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.
Judgments made by management in the application of A-IFRS that have significant effects on the financial statements and estimates with a significant risk of material adjustments in the next year are disclosed, where applicable, in the relevant notes to the financial statements.
Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.
The consolidated entity changed its accounting policies on 1 January 2005 to comply with A-IFRS. The transition to A-IFRS is accounted for in accordance with Accounting Standard AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards', with 1 January 2004 as the date of transition. An explanation of how the transition from superseded policies to A-IFRS has affected the company's and consolidated entity's financial position, financial performance and cash flows is discussed in note 33.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

1. Summary of Accounting Policies (cont)

The accounting policies set out below have been applied in preparing the financial statements for the year ended 31 December 2005, the comparative information presented in these financial statements for the year ended 31 December 2004, and in the preparation of the opening A-IFRS balance sheet at 1 January 2004 (as disclosed in note 33), the consolidated entity's date of transition, except for the accounting policies in respect of financial instruments. The consolidated entity has not restated comparative information for financial instruments, including derivatives, as permitted under the first-time adoption transitional provisions. The accounting policies for financial instruments applicable to the comparative information and the impact of changes in these accounting policies on 1 January 2005, the date of transition for financial instruments, is discussed further in note 1(x).

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

(a) Borrowings

Borrowings are recorded initially at fair value, net of transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between the initial recognised amount and the redemption value being recognised in profit and loss over the period of the borrowing using the effective interest rate method.

(b) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash in banks and investments in money market instruments, net of outstanding bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities in the balance sheet.

1. **Summary of Accounting Policies (cont)**

(c) Construction contracts and work in progress
Construction work in progress is valued at cost plus profit recognised to date, less any provision for anticipated future losses. Costs include both variable and fixed costs relating to specific contracts, and those costs that are attributable to the contract activity in general and can be allocated on a reasonable basis.

Construction profits are recognised on the percentage completion basis measured using the proportion of costs incurred to date as compared to expected total costs. Where losses are anticipated they are provided in full.

Construction revenue has been recognised on the basis of the terms of the contract adjusted for any variations or claims allowable under the contract.

Deferred revenue is represented by advance billings on contracts and the basis of recognition is the percentage of completion basis.

(d) Embedded derivatives
Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit and loss.

(e) Employee benefits
Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Defined contribution plans - Contributions to defined benefit contribution superannuation plans are expensed when incurred.

1. **Summary of Accounting Policies (cont)**

(f) Financial assets

Subsequent to initial recognition, investments in subsidiaries are measured at cost.

Other financial assets are classified into the following specified categories: held to maturity investments and loans and receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of the initial recognition.

Held to maturity investments

Bills of exchange are recorded at amortised cost using the effective interest method less impairment, with revenue recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Loans and receivables

Trade receivables, loans and other receivables are recorded at amortised cost less impairment.

(g) Financial instruments issued by the company

Debts and equity instruments

Debts and equity instruments are classified as either liabilities or as equity in accordance with the substance of the contractual arrangement.

Transaction costs on the issue of equity instruments

Transaction costs arising on the issue of equity instruments are recognised directly in equity as a reduction of the proceeds of the equity instruments to which the costs relate. Transaction costs are the costs that are incurred directly in connection with the issue of those equity instruments and which would not have been incurred had those instruments not been issued.

Interest

Interest is classified as an expense consistent with the balance sheet classification of the related debt.

1. **Summary of Accounting Policies (cont)**

(h) Foreign currency

Foreign currency transactions

All foreign currency transactions during the financial year are bought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined.

Exchange differences are recognised in profit and loss in the period they arise.

Foreign operations

On consolidation, the assets and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit and loss on disposal of the foreign operation.

(i) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:
i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
ii. for receivables and payables which are recognised inclusive of GST.

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

Cash flows are included in the cash flow statement on a gross basis. The GST component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified as operating cash flows.

1. **Summary of Accounting Policies (cont)**

(j) Goodwill

Goodwill, representing the excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired, is recognised as an asset and not amortised, but tested for impairment annually and whenever there is an indication that the goodwill may be impaired. Any impairment is recognised immediately in the profit and loss and is not subsequently reversed. Refer also note 1(l).

(k) Government grants

Government grants are assistance by the government in the form of transfers of resources to the consolidated entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. Government grants include government assistance where there are no conditions specifically relating to the operating activities of the consolidated entity other than the requirement to operate in certain regions or industry sectors.

Government grants relating to income are recognised as income over the periods necessary to match them with the related costs. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the consolidated entity with no future related costs are recognised as income of the period in which it becomes receivable.

(l) Impairment of assets

At each reporting date, the consolidated entity reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the consolidated entity estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. An impairment of goodwill is not subsequently reversed. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

1. **Summary of Accounting Policies (cont)**

(l) Impairment of assets (cont)

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit and loss immediately.

(m) Income tax

Current tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of business combination) which affects neither taxable income nor accounting profit. Furthermore, a deferred tax liability is not recognised in relation to taxable temporary differences arising from goodwill.

1. **Summary of Accounting Policies (cont)**

(m) Income tax (cont)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the consolidated entity is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with these investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the assets and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the consolidated entity expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company/consolidated entity intends to settles its current tax assets and liabilities on a net basis.

<u>Current and deferred tax for the period</u>

Current and deferred tax is recognised as an expense or income in the income statement, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

<u>Tax consolidation</u>

The company and all its wholly-owned Australian resident entities are part of a tax consolidated group under Australian taxation law. Electro Optic Systems Holdings Limited is the head entity in the tax-consolidated group. Tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within the group' approach.

1. **Summary of Accounting Policies (cont)**

(m) Income tax (cont)

Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax-consolidated group are recognised by the company (as head entity in the tax-consolidated group).

There are no formal tax funding arrangements within companies within the tax-consolidated entity.

(n) Intangible assets

Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Where no internally-generated intangible assets can be recognised, development expenditure is recognised as an expense in the period as incurred.

(o) Inventories

Inventories are measured at the lower of cost and net realisable value. Costs are assigned on a first-in first-out basis and include direct materials and overheads. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(p) Investment property

Investment property, which is properly held to earn rentals and/or for capital appreciation, is measured at its fair value at the reporting date. Gains or losses arising from changes in the fair value of the investment property are included in the profit and loss in the period in which they arise.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

1. **Summary of Accounting Policies (cont)**

(q) Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Consolidated entity as lessee

Assets held under finance leases are initially recognised at their fair value or, if lower, at amounts equal to the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Finance leased assets are amortised on a straight line basis over the estimated useful life of the asset.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Lease incentives

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefits of incentives are recognised as a reduction of rental expenses on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

(r) Payables

Trade payable and other accounts payable are recognised when the consolidated entity becomes obliged to make future payments resulting from the purchase of goods and services.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

1. **Summary of Accounting Policies (cont)**

(s) Principles of consolidation

The consolidated financial statements are prepared by combining the financial statements of all the entities that comprise the consolidated entity, being the company (the parent entity) and its subsidiaries as defined in Accounting Standard AASB 127 Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the consolidated financial statements.

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If, after reassessment, the fair values of the identifiable net assets acquired exceeds the cost of acquisition, the deficiency is credited to profit and loss in the period of acquisition.

The consolidated financial statements include the information and results of each subsidiary from the date on which the company obtains control and until such time as the company ceases to control such entity.

In preparing the consolidated financial statements, all inter-company balances and transactions and unrealised profits within the consolidated entity are eliminated in full.

(t) Property, plant and equipment

Plant and equipment, leasehold improvements and equipment under finance lease are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of an item. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of acquisition.

Depreciation is provided on property, plant and equipment. Depreciation is calculated so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter, using the straight line method. The estimated useful lives, residual values and depreciation method is reviewed at the end of each annual accounting period.

1. **Summary of Accounting Policies (cont)**

(t) Property, plant and equipment (cont)

The following estimated useful lives are used in the calculation of depreciation:

Plant and equipment	5 to 15 years
Leasehold improvements	5 years
Equipment under finance lease	5 years
Office equipment	5 to 15 years
Furniture, fixture and fittings	5 to 15 years

(u) Provisions

Provisions are recognised when the consolidated entity has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is probable that recovery will be received and the amount of the receivable can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Warranties – Provisions for warranty costs are recognised at the date of sale of the relevant products, at the directors best estimate of the expenditure required to settle the consolidated entity's liability.

(v) Revenue recognition

Construction revenue is recognised on the basis of the terms of the contract adjusted for any variations or claims allowable under the contract.

Rental revenue comprises revenue earned from the rental of the investment property at 40 Frankston Road, Dandenong, Victoria. Rental revenue is recognised when the rent in respect of the premises is receivable.

1. **Summary of Accounting Policies (cont)**

(v) Revenue recognition (cont)

Interest income is recognised as it accrues.

Revenue from the sale of goods is recognised when the consolidated entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

(w) Share based payments

Equity–settled share-based payments granted after 7 November 2002 that were unvested as of 1 January 2005, are measured at fair value at the date of the grant. Fair value is measured by use of a modified Cox-Rubenstein binomial model. The expected life used in the model has been adjusted, based on management best estimates, for the effects of non-transferability, exercise restrictions and behavioural considerations.
The fair value determined at the grant date of the equity-settled share based payments is expensed on a straight-line basis over the vesting period, based on the consolidated entity's estimate of shares that will eventually vest.

(x) Comparative information – financial instruments

The consolidated entity has elected not to restate comparative information for financial instruments within the scope of AASB132 'Financial Investments: Disclosure and Presentation' and AASB 139 'Financial Instruments: Recognition and Measurement' as permitted under the first-time adoption transitional provisions. The accounting policies for financial instruments applicable to the comparative information are consistent with those adopted and disclosed in the lodged 2004 annual financial report:

- **Accounts Payable:** Liabilities are recognised for amounts to be paid in the future for goods purchased or services rendered, whether or not billed to the company of consolidated entity.
- **Interest-Bearing Liabilities**: Bills of exchange are recorded at an amount equal to the net proceeds received, with the premium or discount amortised over the period until maturity – Interest expense is recognised on an effective yield basis. Bank loans and other loans are recorded at an amount equal to the net proceeds received – Interest expense is recognised on an accrual basis. Ancillary costs incurred in connection with the arrangement of borrowings are expensed as incurred.
- **Receivables**: Trade receivables and other receivables are recorded at amounts due less any allowance for doubtful debts.

However the directors do not believe that the effect of changes in the accounting policies for financial instruments would be material to the financial statements of neither the company nor the consolidated entity.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

(y) AASB Accounting Standards not yet effective

The entity has not elected to early adopt the following accounting standards which have been issued or revised by the AASB but are not yet effective:

- AASB 2004-3 'Amendments to Australian Accounting Standards' (December 2004) amending AASB 119 'Employee Benefits', AASB 1 'First Time Adoption of Australian Equivalents to International Financial Reporting Standards (July 2004), AASB 101 Presentation of Financial Statements, AASB 124 Related Party Disclosures. The application date of the Accounting Standard is 1 January 2006 and the consolidated entity will adopt it at that date. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.
- AASB 2005-1 'Amendments to Australian Accounting Standards' (May 2005) amending AASB 139 'Financial Instruments: Recognition and Measurement'. The application date of the Accounting Standard is 1 January 2006 and the consolidated entity will adopt it at that date. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.
- AASB 2005-4 'Amendments to Australian Accounting Standards' (June 2005) and AASB 2005-5 'Amendments to Australian Accounting Standards' (June 2005), both amending AASB 139 'Financial Instruments: Recognition and Measurements', AASB 1 'First Time Adoption of Australian Equivalents to International Financial Reporting Standards'. The application date of the Accounting Standard is 1 January 2006 and the consolidated entity will adopt it at that date. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.
- AASB 2005-6 'Amendments to Australian Accounting Standards' (June 2005) amending AASB 3 'Business Combinations'. The application date of the Accounting Standard is 1 January 2006 and the consolidated entity will adopt it at that date. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.
- UIG 4 'Determining whether an Arrangement contains a Lease'. The application date of the UIG is 1 January 2006 and the consolidated entity will adopt it at that date. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.
- AASB7 'Financial Instruments: Disclosure' (September 2005) is effective for all periods commencing on or after 1 January 2007 The consolidated entity will adopt the new Accounting Standard from 1 January 2007. Application of the new Accounting Standard is not expected to have a material impact on the consolidated entity's financial position or results.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $

2. (Loss) from operations

(a) Revenue

Revenue from operations consisted of the following items:

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
Revenue from the sale of goods	15,481,464	1,656,037	-	-
Revenue from the rendering of services	1,411,636	450,140		
Construction contract revenue	21,038,378	8,235,945	-	-
	37,931,478	10,342,122	-	-
Interest revenue:				
Bank deposits	724,457	273,344	704,442	250,299
Other	44,608	15,024	-	-
	38,700,543	10,630,490	704,442	250,299

(b) (Loss) before income tax

(Loss) before income tax has been arrived at after crediting the following gains and losses

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
Grant revenue	1,037,883	2,267,026	-	-
Rental revenue	-	79,101	-	79,101
Insurance proceeds received	-	1,094,979	-	-
Foreign exchange gain	640,934	-	-	-
	1,678,817	3,441,106	-	79,101

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
2. (Loss) from operations (cont)				
(Loss) before income tax has been arrived at after charging the following expenses:				
Borrowing costs				
Finance lease finance charges	113,248	74,321	-	-
Interest paid – Other entities	41	29,976	-	-
Contributions to defined contribution superannuation plans	873,213	535,347	-	-
Depreciation – property, plant and equipment	1,086,689	422,322	913	418
Amortisation – property plant and equipment	49,065	-	-	-
Provision for non-recovery of loan – wholly-owned controlled entity	-	-	6,436,448	3,650,560
Research and development costs immediately expensed	3,695,575	6,009,352	-	-
Provision for doubtful debts	99,301	-	-	-
Loss on sale of property, plant and equipment	34,436	-	-	-
Share based payments:				
Equity settled share-based payments	3,531,401	276,371	3,531,401	276,371
Termination benefits	42,802	-	-	-
Foreign exchange loss	-	160,809	-	-
Operating lease rental expenses:				
Minimum lease payments	1,649,425	626,207	21,640	39,952

	Consolidated 31 December 2005 $	31 December 2004 $
3. Earnings per Share		
Basic earnings (loss) per share	(34.6 cents)	(17.1 cents)
Diluted earnings (loss) per share	(34.6 cents)	(17.1 cents)
Basic Earnings per Share		
Earnings (loss) (a)	(14,731,196)	(5,916,120)
Weighted average number of ordinary shares (b)	42,601,805	34,543,544

(a) Earnings used in the calculation of basic earnings per share are the same as the net (loss) in the income statement.

(b) Options are considered to be potential ordinary shares and are therefore excluded from the weighted average number of shares used in the calculation of basic earnings per share. Where dilutive, potential ordinary shares are included in the calculation of diluted earnings per share (see below).

	Consolidated 31 December 2005 $	31 December 2004 $

3. Earnings per Share (cont)

Diluted Earnings per Share

Earnings (a)	(14,731,196)	(5,916,120)
Weighted average number of ordinary shares (b)	42,601,805	34,543,544

(a) Earnings used in the calculation of diluted earnings per share are the same as the net (loss) in the income statement.

(b) The weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share are as follows.

Weighted average number of shares used in the calculation of basic earnings per share	42,601,805	34,543,544
Vendor options	-	-
CEO options	-	-
Directors options	-	-
Staff Share plan	-	-
Weighted average number of shares used in the calculation of diluted earnings per share	42,601,805	34,543,544

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated	
	31 December 2005 $	31 December 2004 $

3. Earnings per Share (cont)

(c) The following potential ordinary shares are not dilutive and therefore excluded from the weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share:

Vendor options	-	353,738
CEO options	-	4,563,925
Directors options	2,379,200	600,000
Staff Share plan	2,017,500	1,251,000
	4,396,700	6,768,663

(d) Weighted average number of converted, lapsed, or cancelled potential ordinary shares used in the calculation of diluted earning per share:

Vendor options	-	-
Staff Share plan	-	-
	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $

4. Income Tax

(a) The prima facie income tax benefit on pre-tax accounting (loss) from operations reconciles to the income tax benefit in the financial statements as follows:

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
(Loss) from operations	(14,731,196)	(6,016,120)	(9,961,243)	(3,972,849)
Income tax benefit calculated at 30%	(4,419,359)	(1,804,836)	(2,988,373)	(1,191,855)
Non-deductible provision for non-recovery of loan	-	-	1,930,934	1,095,168
Share based payments	1,084,342	82,911	1,084,342	82,911
Other assessable/ (deductible) items	-	-	-	-
Other non-deductible/ non assessable items	(16,468)	57,780	(81,223)	38,249
	(3,351,485)	(1,664,145)	(54,320)	24,473
Over provision from prior year	-	(100,000)	-	-
Previously unrecognised and unused tax losses and tax offsets now recognised	-	-	-	(24,473)
Unused tax losses and tax offsets not recognised as deferred tax assets	3,351,485	1,664,145	54,320	-
Income tax attributable to operating loss	-	(100,000)	-	-

The tax rate used in the above reconciliation is the corporate tax rate of 30% payable by Australian corporate entities on taxable profits under Australian tax law. There has been no change in the corporate tax rate when compared with the previous reporting period.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
4. Income Tax (Cont)				
(b) Unrecognised deferred tax balances				
The following deferred tax assets have not been bought to account as assets				
Tax losses - revenue	7,601,033	5,207,183	5,261,503	5,207,183
Temporary differences	1,041,894	84,259	-	-
	8,642,927	5,291,442	5,261,503	5,207,183

Tax consolidation

Relevance of tax consolidation to the consolidated entity

The company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 January 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Electro Optic Systems Holdings Limited. The members of the tax-consolidated entity group are identified in Note 26.

Nature of tax funding arrangements and tax sharing agreements

There are no formal tax funding or tax sharing arrangements within the tax-consolidated group.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
5. Other financial assets				
Non-Current				
Unlisted shares in controlled entities – at cost (2004: cost)	-	-	841,325	841,325

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
6. Trade and other receivables				
Current				
Trade receivables	7,259,580	1,489,182	-	-
Allowance for doubtful debts	(99,301)	-	-	-
	7,160,279	1,489,182	-	-
GST receivable	194,824	78,025	10,259	8,961
Amounts due from customers under construction contracts (Note 32)	6,439,571	2,613,742	-	-
Other debtors	4,980	11,289	56,851	516
	13,799,654	4,192,238	67,110	9,477

The average credit period on sales of goods is 30 days. No interest is charged on late payments and no general allowance for doubtful debts has been made as most contracts are with governments and government agencies. The allowance for doubtful debt is in respect of one specific telescope contract and the movement in the allowance of $99,301 was recognised in the profit and loss for the current financial year.

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
7. Current Inventories				
Raw materials – at cost	5,482,805	1,065,985	-	-
Work in progress – at cost	3,706,622	-	-	-
	9,189,427	1,065,985	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
8. Other Assets				
Current				
Prepayments	109,091	6,839	-	-
Other	6,119	164,140	-	-
	115,210	170,979	-	-
Non-current				
Amounts due from wholly-owned controlled entity	-	-	46,865,942	16,315,488
Less Allowance for uncollectible amounts	-	-	(22,751,936)	(16,315,488)
	-	-	24,114,006	-
9. Auditors Remuneration				
(a) Auditor of the Parent Entity				
Audit or review of the financial report	78,000	59,100	78,000	59,100
Taxation services	22,400	16,000	22,400	16,000
	100,400	75,100	100,400	75,100

The auditor of Electro Optic Systems Holdings Limited is Deloitte Touche Tohmatsu

(b) Other Auditors				
Auditing the financial report	51,460	19,185	-	-
	51,560	19,185	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
10. Property, Plant and Equipment				
(a) Plant and equipment – at cost	3,968,126	1,132,503	-	-
Less accumulated depreciation	(948,915)	(726,346)	-	-
	3,019,211	406,157	-	-
(b) Leased assets – at cost	2,792,086	1,432,868	-	-
Less accumulated amortisation	(892,315)	(564,132)	-	-
	1,899,771	868,736	-	-
(c) Office Equipment – at cost	2,252,869	1,978,653	5,491	2,180
Less accumulated depreciation	(1,331,960)	(1,661,870)	(2,465)	(1,552)
	920,909	316,783	3,026	628
(d) Furniture, fixtures and fittings – at cost	399,857	221,854	-	-
Less accumulated depreciation	(97,403)	(156,410)	-	-
	302,454	65,444	-	-
(e) Leasehold improvements – at cost	625,109	-	-	-
Less accumulated depreciation	(49,760)	-	-	-
	573,349	-	-	-
Total net book value of Property, Plant and Equipment	6,717,694	1,657,120	3,026	628

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
10. Property, Plant and Equipment (cont)				
<u>Cost</u>				
Plant and equipment				
Balance as at 31 December 2004	1,132,503	1,319,327	-	-
Additions	2,958,578	74,807	-	-
Disposals	(152,970)	(237,140)	-	-
Net foreign currency exchange differences	30,015	(24,491)	-	-
Balance as at 31 December 2005	3,968,126	1,132,503	-	-
Leased Plant and equipment				
Balance as at 31 December 2004	1,432,868	967,733	-	-
Additions	1,657,373	577,768	-	-
Disposals	(340,011)	(98,531)	-	-
Net foreign currency exchange differences	41,856	(14,102)	-	-
Balance as at 31 December 2005	2,792,086	1,432,868	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

10. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
Office equipment				
Balance as at 31 December 2004	1,978,653	1,979,712	2,180	2,180
Additions	847,439	224,079	3,311	-
Disposals	(621,820)	(192,110)	-	-
Net foreign currency exchange differences	48,597	(33,028)	-	-
Balance as at 31 December 2005	2,252,869	1,978,653	5,491	2,180
Furniture, fixtures and fittings				
Balance as at 31 December 2004	221,854	200,640	-	-
Additions	270,854	29,278	-	-
Disposals	(104,333)	-	-	-
Net foreign currency exchange differences	11,482	(8,064)	-	-
Balance as at 31 December 2005	399,857	221,854	-	-
Leasehold improvements				
Balance as at 31 December 2004	-	-	-	-
Additions	625,109	-	-	-
Net foreign currency exchange differences	-	-	-	-
Balance as at 31 December 2005	625,109	-	-	-

	Consolidated		Company	
	31 December 2005	31 December 2004	31 December 2005	31 December 2004
	$	$	$	$

10. Property, Plant and Equipment (cont)

Accumulated Depreciation/Amortisation

Plant and equipment

Balance as at 31 December 2004	(726,346)	(875,400)	-	-
Depreciation expense	(320,093)	(108,127)	-	-
Disposals	126,489	237,140		
Net foreign currency exchange differences	(28,965)	20,041	-	-
Balance as at 31 December 2005	(948,915)	(726,346)	-	-

Leased plant and equipment

Balance as at 31 December 2004	(564,132)	(360,563)	-	-
Depreciation expense	(536,662)	(244,038)	-	-
Disposals	227,942	27,257	-	-
Net foreign currency exchange differences	(19,463)	13,212	-	-
Balance as at 31 December 2005	(892,315)	(564,132)	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

10. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
Office equipment				
Balance as at 31 December 2004	(1,661,870)	(1,825,259)	(1,552)	(1,134)
Depreciation expense	(204,322)	(52,929)	(913)	(418)
Disposals	566,161	185,609	-	-
Net foreign currency exchange differences	(31,929)	30,709	-	-
Balance as at 31 December 2005	(1,331,960)	(1,661,870)	(2,465)	(1,552)
Furniture, fixtures and fittings				
Balance as at 31 December 2004	(156,410)	(145,461)	-	-
Depreciation expense	(25,612)	(17,228)	-	-
Disposals	90,159	-	-	-
Net foreign currency exchange differences	(5,540)	6,279	-	-
Balance as at 31 December 2005	(97,403)	(156,410)	-	-
Leasehold improvements				
Balance as at 31 December 2004	-	-	-	-
Amortisation expense	(49,065)	-	-	-
Net foreign currency exchange differences	(695)	-	-	-
Balance as at 31 December 2005	(49,760)	-	-	-

Aggregate depreciation and amortisation allocated during the period is recognised as an expense and disclosed in Note 2 to the financial statements.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
11. Investment Property				
Strata Title commercial property				
Balance at start of financial year	-	1,806,987	-	1,806,987
Disposal during the year	-	(1,806,987)	-	(1,806,987)
Balance as end of financial year	-	-	-	-
12. Goodwill				
Gross carrying amount				
Balance at beginning of financial year	5,505,764	5,505,764	-	-
Balance at end of financial year	5,505,764	5,505,764	-	-

Allocation of goodwill to cash-generating units

Goodwill has been allocated for impairment testing purposes to three individual cash-generating units. The carrying value of goodwill allocated to the three cash-generating units that are significant individually or in aggregate is as follows:

Space Systems - Global	1,652,153	1,652,153	-	-
Space Surveillance - Global	1,652,153	1,652,153	-	-
Fire Control Systems – Global	2,201,458	2,201,458	-	-
	5,505,764	5,505,764	-	-

The basis for determining the recoverable amount of goodwill has been the assessment by the Directors that the fair value of the goodwill in each cash-generating unit is supported by the future prospects for each cash-generating unit.

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $

13. Current trade and other payables

Trade payables	5,079,552	2,054,819	37,140	22,847
Accruals	729,294	68,240	59,025	38,000
Amounts due to customers under construction contracts (Note 32)	3,410,831	2,718,213	-	-
	9,219,677	4,841,272	96,165	60,847

The average credit period on purchases of goods is 30 days and no interest is payable on goods purchased within agreed credit terms. The consolidated entity has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
14. Borrowings				
Secured				
At amortised cost (2004: cost)				
Current				
Finance lease liabilities – secured (Note 28)	735,747	354,186	-	-
Non-current				
Finance lease liabilities – secured (Note 28)	1,054,826	588,689	-	-

The finance lease liabilities are secured by the leased assets. The average weighted interest rate charged on the finance leases was 8.58% (2004 – 9.32%)

	Consolidated 31 December 2005 $	Consolidated 31 December 2004 $	Company 31 December 2005 $	Company 31 December 2004 $
15. Provisions				
Current				
Employee benefits (Note 17)	1,737,345	1,122,618	-	-
Warranty (Note 16)	754,787	-	-	-
	2,492,132	1,122,618	-	-
Non-current				
Employee benefits (Note 17)	-	99,465	-	-
	-	99,465	-	-
Number of employees at year end	238	116	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005	31 December 2004	31 December 2005	31 December 2004
	$	$	$	$

16. Warranty Provisions

Movement in warranty provision

Balance at 1 January 2005	-	-	-	-
Additional provisions recognised	754,787	-	-	-
Balance as at 31 December 2005	754,787	-	-	-

The provision for warranty claims represents the present value of the directors' best estimate of the future sacrifice of economic benefits that will be required under the consolidated entity's 12-month warranty program for our military products. The estimate has been made on the basis of historical industry accepted warranty trends and may vary as a result of new materials, altered manufacturing processes or other events affecting product quality.

17. Employee Benefits

The aggregate employee benefits liability recognised in the financial statements is as follows:
Provision for employee entitlements

Current (Note 15)	1,737,345	1,122,618	-	-
Non Current (Note 15)	-	99,465	-	-
	1,737,345	1,222,083	-	-

18. Other liabilities

Lease incentives				
Current	90,391	-	-	-
Non Current	263,943	-	-	-
	354,334	-	-	-

The lease incentives relate to the leased premises at 3160 East Transcon Way, Tucson, Arizona, USA.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
19. Issued capital				
Balance at the beginning of the financial year -Ordinary shares	22,805,829	22,630,548	22,805,829	22,630,548
Add				
Placement of Ordinary shares for cash at $4.50	22,500,000	-	22,500,000	-
Placement of Ordinary shares for cash at $3.40	22,440,000	-	22,440,000	-
Exercise of employee options for cash	226,360	160,720	226,360	160,720
Exercise of vendor options for cash	70,748	14,561	983,533	14,561
Exercise of CEO options for cash	912,785	-	-	-
Less				
Issue costs on placement of ordinary shares	(1,122,000)	-	(1,122,000)	-
Balance at the end of the financial year	67,833,722	22,805,829	67,833,722	22,805,829

Changes to the then Corporations Law abolished the authorised capital and par value concept in relation to share capital from 1 July 1998. Therefore, the company does not have a limited amount of authorised capital and issued shares do not have a par value.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005	31 December 2004	31 December 2005	31 December 2004
19. Issued capital (Cont)				
Fully Paid Ordinary Shares	**Number**	**Number**	**Number**	**Number**
Balance at the beginning of financial year	34,621,935	34,451,128	34,621,935	34,451,128
Placement for cash at $4.50	5,000,000	-	5,000,000	-
Placement for cash at $3.40	6,600,000	-	6,600,000	-
Exercise of employee options	130,000	98,000	130,000	98,000
Exercise of CEO options	4,563,925	-	4,563,925	-
Exercise of vendor options	353,738	72,807	353,738	72,807
Balance at end of financial year	51,269,598	34,621,935	51,269,598	34,621,935

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

20. Vendor, Directors and Employee Share Option Plan

(a) Unlisted Vendor and CEO Options

As part of the acquisition of the issued capital of Electro Optic Systems Pty Limited in April 2002, the Company issued 1,729,953 unlisted vendor options at an exercise price of 20 cents, exercisable on or before 31 December 2005. The Company also issued 4,563,925 unlisted CEO options to the Chief Executive Officer, Dr Ben Greene exercisable at an exercise price of 20 cents on or before 31 December 2005. All these vendor and CEO options were exercised prior to 31 December 2005. Each vendor and CEO option converts into one ordinary share of Electro Optic Systems Holdings Limited on exercise.

	2005	2004
	Number	**Number**
Balance at the beginning of the financial year (i)	4,917,663	4,990,470
Exercised during the period (ii)	(4,917,663)	(72,807)
Balance at the end of the financial year (iii)	-	4,917,663

20. **Vendor, Directors and Employee Share Option Plan (cont)**

(i) Balance at the beginning of the year

2005	**Number**	**Grant date**	**Expiry date**	**Exercise Price**	**Fair value at grant date ***
Vendor options	353,738	11/4/02	31/12/05	$0.20	-
CEO Options	4,563,925	11/4/02	31/12/05	$0.20	-
	4,917,663				-
2004					
Vendor options	426,545	11/4/02	31/12/05	$0.20	-
CEO Options	4,563,925	11/4/02	31/12/05	$0.20	-
	4,990,470				-

Vendor options carry no rights to dividends and no voting rights.

In accordance with the terms of the vendor and CEO options, options can be exercised at any time from the date of their issue to the date of expiry.

* Issued prior to the requirement to fair value options at grant date.

(ii) Vendor Options Exercised during the financial year

	Number of Options Exercised	**Grant Date**	**Exercise Date**	**Expiry Date**	**Exercise Price**	**Fair Value Received**	**Share price at exercise date**	**Fair Value of Shares at Date of Issue**
2005								
Vendor Options	57,771	11/4/02	8/2/05	31/12/05	$0.20	$11,554	$5.10	$294,632
Vendor Options	295,967	11/4/02	30/12/05	31/12/05	$0.20	$59,194	$3.30	97,669
CEO	4,563,925	11/4/02	20/5/05	31/12/05	$0.20	$912,785	$3.84	17,525,472
	4,917,663					$983,533		17,917,773
2004								
Vendor Options	72,807	11/4/02	21/4/04	31/12/05	$0.20	14,561	$2.70	$196,579

20. Vendor, Directors and Employee Share Option Plan (cont)

Fair value of consideration received is measured as the nominal value of the cash receipts on conversion. The fair value of shares at the date of issue is measured as the market value at the close of trade on the date of their issue.

(iii) Balance at the end of the financial year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date *
2005					
Vendor options	-	11/4/02	31/12/05	$0.20	-
CEO Options	-	11/4/02	31/12/05	$0.20	-
	-				-
2004					
Vendor options	353,738	11/4/02	31/12/05	$0.20	-
CEO Options	4,563,925	11/4/02	31/12/05	$0.20	-
	4,917,663				-

Vendor options carry no rights to dividends and no voting rights.

In accordance with the terms of the vendor and CEO options, options can be exercised at any time from the date of their issue to the date of expiry.

* Issued prior to the requirement to fair value options at grant date.

Consideration received on the exercise of vendor options is recognised in issued capital. During the financial year $983,533 (2004 – $14,561) was recognised in issued capital arising from the exercise of vendor options.

20. Vendor, Directors and Employee Share Option Plan (cont)

(b) Unlisted Options issued under the Employee Share Option Plan

On 28 June 2002, shareholders approved the adoption of an Employee Share Option Plan. On 1 July 2002 the Company issued a total of 1,108,000 options exercisable at $1.64 per share on or before 1 July 2006. On 23 October 2003, at the Annual General Meeting, shareholders approved the issue of 200,000 unlisted options to Dr Bob Dean (Director) exercisable at $1.64 per share on or before 1 July 2006. On 7 May 2004 Directors approved the issue of 700,000 unlisted options to staff at an exercise price of $2.58 exercisable on or before 30 April 2009. On 30 September 2005 Directors approved the issue of 900,000 unlisted options to staff at an exercise price of $3.50 exercisable on or before 30 September 2009 as well as 108,000 unlisted options to one staff member at an exercise price of $3.06 exercisable on or before 30 September 2009. At the shareholders meeting held on 29 April 2005, shareholders approved the issue of options to directors expiring on 31 March 2009 as follows:

(a) 200,000 Options at an exercise price of $2.56 to Mr Bob Dean;
(b) 300,000 Options at an exercise price of $2.85 to Mr John Gordon;
(c) 80,400 Options per month at an exercise price of $3.06 to Dr Ben Greene, commencing on 1 December 2004;
(d) 18,000 Options per month at an exercise price of $3.06 to Mr Bob Dean, commencing on 1 December 2004.

The consolidated entity has an ownership-based compensation scheme for employees (including directors) of the company. In accordance with the provisions of the scheme, as approved by shareholders at a previous annual general meeting, employees with more than three months service with the company may e granted options to purchase ordinary shares at exercise prices determined by the directors based on market prices at the time the issue of options were made.

Each share option converts to one ordinary share in Electro Optic Systems Holdings Limited. No amounts are paid or payable by the recipient on receipt of the options. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of expiry.

The number of options granted is determined by the directors and takes into account the company's and individual achievements against both qualitative and quantitive criteria.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

20. **Vendor, Directors and Employee Share Option Plan (cont)**

(b) Unlisted Options issued under the Employee Share Option Plan (cont)

	2005		**2004**	
	Number	**Weighted average exercise price $**	**Number**	**Weighted average exercise price $**
Balance at the beginning of the financial year (i)	1,851,000	2.00	1,249,000	1.64
Granted during the year (ii)	2,787,200	3.15	700,000	2.58
Exercised during the year (iii)	(130,000)	1.73	(98,000)	1.64
Lapsed during the year (iv)	(111,500)	2.15	-	-
Balance at the end of the financial year (v)	4,396,700	2.73	1,851,000	2.00

(i) Balance at the beginning of the year

	Number	**Grant date**	**Expiry date**	**Exercise Price**	**Fair value at grant date**
2005					
Option – Series					
Staff Options	551,000	1/7/02	1/7/06	$1.64	551,000
Staff Options	700,000	7/5/04	30/4/09	$2.58	882,000
Director Options	200,000	23/10/03	1/7/06	$1.64	330,000
Director Options	400,000	1/7/02	1/7/06	$1.64	400,000
	1,851,000				2,163,000

20. **Vendor, Directors and Employee Share Option Plan (cont)**

(b) Unlisted Options issued under the Employee Share Option Plan (cont)

	Number	**Grant date**	**Expiry date**	**Exercise Price**	**Fair value at grant date**
2004					
Option – Series					
Staff Options	649,000	1/7/02	1/7/06	$1.64	649,000
Director Options	200,000	23/10/03	1/7/06	$1.64	330,000
Director Options	400,000	1/7/02	1/7/06	$1.64	400,000
	1,249,000				1,379,000

Staff and Director options carry no rights to dividends and no voting rights.

In accordance with the terms of the Employee Share Option Plan, options issued at $1.64 on 1 July 2002 can be exercised at any time from the date of their issue to the date of expiry. Options granted on 7 May 2004 at an exercise price of $2.58 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

20. **Vendor, Directors and Employee Share Option Plan (cont)**

(b) Unlisted Options issued under the Employee Share Option Plan (cont)

(ii) Granted during the year

	Number	Grant Date	Expiry Date	Exercise Price	Fair Value Received	Fair value at grant date
2005						
Directors	200,000	29/4/05	31/3/09	$2.56	-	476,000
Directors	300,000	29/4/05	31/3/09	$2.85	-	660,000
Directors	393,600	29/4/05	31/3/09	$3.06	-	822,624
Directors	295,200	30/6/05	31/3/09	$3.06	-	410,328
Directors	295,200	30/9/05	31/3/09	$3.06	-	369,000
Directors	295,200	30/12/05	31/3/09	$3.06	-	339,480
Staff options	108,000	30/9/05	30/9/09	$3.06	-	143,640
Staff options	900,000	30/9/05	30/9/09	$3.50	-	1,044,000
	2,787,200				-	4,265,072
2004						
Staff options	700,000	7/5/04	30/4/09	$2.58	-	882,000
	700,000				-	882,000

The 900,000 options granted on 30 September 2005 at an exercise price of $3.50 to staff vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

All other options granted during the year to directors and staff vest immediately apart from the 300,000 options issued to John Gordon which vest over a two year period from his date of appointment which was 18 November 2004.

The weighted average fair value of the share options granted during the financial year is $1.53 (2004: 1.26). Options were priced using a modified Cox- Rubenstein bionomial pricing model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions (including the probability of meeting market conditions attached to the option), and behavioural conditions. Expected volatility is based on the historical share price volatility over a two year period adjusted for unusual events.

20. Vendor, Directors and Employee Share Option Plan (cont)

The following inputs were used in the model for grants during the years ended 31 December 2005 and 2004:

	2005	2004
Dividend yield	-	-
Expected volatility (linearly interpolated)	36%	52%
Risk free interest rate	5.25%	5.25%
Expected life of options	4 years	5 years

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

20. Vendor, Directors and Employee Share Option Plan (cont)

(iii) Exercised during the year

	Number of Options Exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Fair Value of Shares at Date of Issue
2005								
Staff	20,000	1/7/02	27/1/05	1/7/06	$1.64	20,000	$32,800	85,000
Staff	1,500	7/5/04	27/1/05	30/4/09	$2.58	1,500	$3,870	6,375
Staff	17,500	1/7/02	1/2/05	1/7/06	$1.64	17,500	$28,700	96,250
Staff	12,000	1/7/02	7/2/05	1/7/06	$1.64	12,000	$18,680	63,600
Staff	10,000	1/7/02	15/2/05	1/7/06	$1.64	10,000	$16,400	50,500
Staff	12,000	1/7/02	24/2/05	1/7/06	$1.64	12,000	$18,680	61,800
Staff	5,000	7/5/04	4/3/05	30/4/09	$2.58	5,000	$12,900	25,250
Staff	5,000	1/7/02	10/3/05	1/7/06	$1.64	5,000	$8,200	25,000
Staff	1,000	1/7/02	24/3/05	1/7/06	$1.64	1,000	$1,640	4,910
Staff	5,000	1/7/02	2/5/05	1/7/06	$1.64	5,000	$8,200	19,750
Staff	3,000	7/5/04	30/5/05	30/4/09	$2.58	3,000	$7,740	11,100
Staff	1,500	7/5/04	29/6/05	30/4/09	$2.58	1,500	$3,970	5,550
Staff	10,000	1/7/02	4/8/05	1/7/06	$1.64	10,000	$16,400	41,500
Staff	7,000	1/7/02	9/8/05	1/7/06	$1.64	7,000	$11,480	28,910
Staff	7,500	1/7/02	28/10/05	1/7/06	$1.64	7,500	$12,300	25,050
Staff	3,000	7/5/04	21/11/05	30/4/09	$2.58	3,000	$7,740	10,920
Staff	5,000	1/7/02	25/11/05	1/7/06	$1.64	5,000	$8,200	19,000
Staff	4,000	1/7/02	7/12/05	1/7/06	$1.64	4,000	$6,560	14,000
	130,000					130,000	$224,460	594,465
2004								
Staff	10,000	1/7/02	12/1/04	1/7/06	$1.64	10,000	$16,400	$22,700
Staff	20,000	1/7/02	30/4/04	1/7/06	$1.64	20,000	$32,800	$52,000
Staff	7,500	1/7/02	11/5/04	1/7/06	$1.64	7,500	$12,300	$18,000
Staff	6,000	1/7/02	21/7/04	1/7/06	$1.64	6,000	$9,840	$15,600
Staff	17,000	1/7/02	20/9/04	1/7/06	$1.64	17,000	$27,880	$44,030
Staff	17,500	1/7/02	21/9/04	1/7/06	$1.64	17,500	$28,700	$45,500
Staff	3,000	1/7/02	22/11/04	1/7/06	$1.64	3,000	$4,920	$9,000
Staff	12,500	1/7/02	26/11/04	1/7/06	$1.64	12,500	$20,500	$41,875
Staff	4,500	1/7/02	15/12/04	1/7/06	$1.64	4,500	$7,380	$13,950
	98,000					98,000	$160,720	$262,655

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

20. Vendor, Directors and Employee Share Option Plan (cont)

(iv) Lapsed during the year

	Number of Options Lapsed	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Fair Value of Shares at Date of Issue
2005								
Staff	51,500	1/7/02	-	1/7/06	$1.64	-	-	-
Staff	60,000	7/5/04	-	30/4/09	$2.58	-	-	-
	111,500					-	-	-

Fair value of consideration received is measured as the nominal value of the cash receipts on conversion. The fair value of shares at the date of issue is measured as the market value at the close of trade on the date of their issue.

(v) Balance at the end of the financial year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
2005					
Option – Series					
Director options	400,000	1/7/02	1/7/06	$1.64	400,000
Director options	200,000	23/10/03	1/7/06	$1.64	330,000
Staff options	383,500	1/7/02	1/7/06	$1.64	383,500
Staff options	626,000	7/5/04	30/4/09	$2.58	788,760
Director options	200,000	29/4/05	31/3/09	$2.56	476,000
Director options	300,000	29/4/05	31/3/09	$2.85	660,000
Director options	393,600	29/4/05	31/3/09	$3.06	822,624
Director options	295,200	30/6/05	31/3/09	$3.06	410,328
Director options	295,200	30/9/05	31/3/09	$3.06	369,000
Director options	295,200	31/12/05	31/3/09	$3.06	359,480
Staff options	108,000	30/9/05	30/9/09	$3.06	143,640
Staff options	900,000	30/9/05	30/9/09	$3.50	1,044,000
	4,396,700				6,187,332

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

20. Vendor, Directors and Employee Share Option Plan (cont)

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
2004					
Option – Series					
Director options	400,000	1/7/02	1/7/06	$1.64	400,000
Director options	200,000	23/10/03	1/7/06	$1.64	330,000
Staff options	551,000	1/7/02	1/7/06	$1.64	551,000
Staff options	700,000	7/5/04	30/4/09	$2.58	882,000
	1,851,000				2,163,000

Staff and Director options carry no rights to dividends and no voting rights.

In accordance with the terms of the Employee Share Option Plan, options issued at $1.64 on 1 July 2002 can be exercised at any time from the date of their issue to the date of expiry. Options granted on 7 May 2004 at an exercise price of $2.58 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

Options granted on 30 September 2005 at an exercise price of $3.50 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

All other options granted during the year ended 31 December 2005 to directors and staff vest immediately apart from the 300,000 options issued to John Gordon which vest over a two year period from his date of appointment which was 18 November 2004.

The difference between the total market value of the options issued during the financial year, at the date of issue, and the total amount received from employees (nil) is recognised in the financial statements as disclosed in Note 23 to the financial statements. The amounts are disclosed in remuneration in respect of the financial year in which the entitlement was earned.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $

21. Reserves

Foreign currency translation	(205,634)	(10,774)	-	-
Employee equity-settled benefits	3,807,772	276,371	3,807,772	276,371
	3,602,138	265,597	3,807,772	276,371

Foreign currency translation

Balance at beginning of financial year	(10,774)	-	-	-
Translation of foreign operations	(194,860)	(10,774)	-	-
Balance at end of financial year	(205,634)	(10,774)	-	-

Exchange differences relating to the translation from US dollars, being the functional currency of the consolidated entity's foreign controlled entities in the USA, and from Euros, being the functional currency of the consolidated entity's foreign controlled entity in Germany, into Australian dollars are bought to account by entries made directly to the foreign currency translation reserve.

Employee equity-settled benefits

Balance at beginning of financial year	276,371	-	276,371	-
Share based payment	3,531,401	276,371	3,531,401	276,371
Balance at end of financial year	3,807,772	276,371	3,807,772	276,371

The employee equity-settled benefits reserve arises on the grant of share options to directors and executives under the Employee Share Option plan. Further information about share-based payments to employees is made in note 23 to the financial statements.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
22. Accumulated Losses				
Balance at beginning of financial year	(13,798,828)	(7,882,708)	(18,774,415)	(14,801,566)
Net (loss) attributable to members of the parent entity	(14,731,196)	(5,916,120)	(9,961,243)	(3,972,849)
Balance at end of financial year	(28,530,024)	(13,798,828)	(28,735,658)	(18,774,415)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

23. Key management personnel compensation

The key management personnel of Electro Optic Systems Holdings Limited during the year were:

Mr Fred Bart (Chairman, non executive)
Dr Ben Greene (Chief Executive Officer)
Dr Bob Dean (Chief Executive Officer EOST until July 2005 and non-executive director) resigned 8 March 2006
Mr Ian Dennis (Non-executive)
Ms Cheryl Bart (Non-executive)
Mr John Gordon (Non-executive)
Mr Mark Ureda (Non-executive) appointed 28 April 2005
Mr Ron Thompson (General Manager)
Dr Craig Smith (Chief Executive Officer of EOS Space Systems Pty Limited)
Mr Jack Elliot (Operations Manager EOS Technologies Inc) resigned 12 December 2005
Ms Karen McGilvery (Director of Finance - Electro Optic Systems Pty Limited) appointed 20 January 2005
Mr Steven Juliver (Executive Vice President)

Key management personnel compensation policy

The board reviews the remuneration packages of all key management personnel on an annual basis. Remuneration packages are reviewed and determined with regard to current market rates and are benchmarked against comparable industry salaries, adjusted by a performance factor to reflect changes in the performance of the company.

The aggregate compensation of the key management personnel of the consolidated entity and company is set out below:

	Consolidated		Company	
	2005	2004	2005	2004
	$	$	$	$
Short-term employee benefits	1,607,404	1,244,731	143,073	66,000
Post-employment benefits	58,538	84,340	-	-
Share-based payment	3,060,011	16,980	3,060,011	16,980
Termination benefits	42,802	-	-	-
	4,768 755	1,346,051	3,203,084	66,000

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

23. Key management personnel compensation (Cont)

The compensation of the directors is paid by the holding company and is the same for both the holding company and the consolidated entity.

2005	Short term		Post Employment	Share based payments	Termin-ation	Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Options $	Benefits $	$
Mr Fred Bart	30,000	-	-	-	-	30,000
Dr Ben Greene*	344,270	34,462	23,040	1,586,292	-	1,988,064
Mr Ian Dennis	78,000	-	-	-	-	78,000
Ms Cheryl Bart	17,500	-	-	-	-	17,500
Dr Bob Dean*	350,028	13,095	-	831,140	-	1,194,263
Mr John Gordon	17,573	-	-	472,923	-	490,496
Mr Mark Ureda	-	-	-	-	-	-
Mr Ron Thompson	127,838	-	11,210	5,287	-	144,335
Dr Craig Smith	182,475	-	16,301	143,640	-	342,416
Ms Karen McGilvery (1)	88,739	-	7,987	6,798	-	103,524
Mr Jack Elliot (2)	158,703	15,899	-	-	42,802	217,404
Mr Steven Juliver	134,571	14,251	-	13,931	-	162,753
	1,529,697	77,707	58,538	3,060,011	42,802	4,768,755

* Executive directors

1. Commenced employment on 20 January 2005.
2. Commenced on 25 October 2004 and ceased on 12 December 2005.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

23. Key management personnel compensation (Cont)

2004	Short term		Post employment	Share based	Termin -ation	Total
	Salary & Fees $	Non-monetary $	Super-annuation $	payments $	benefits $	$
Mr Fred Bart	10,000	-	-	-	-	10,000
Dr Ben Greene*	161,514	48,513	30,000	-	-	240,027
Mr Ian Dennis	46,000	-	-	-	-	46,000
Ms Cheryl Bart	10,000	-	-	-	-	10,000
Dr Bob Dean*	325,600	47,311	-	-	-	372,911
Mr John Gordon	-	-	-	-	-	-
Mr Ron Thompson	73,234	62,400	27,669	-	-	163,303
Dr Craig Smith	137,663	-	26,671	-	-	164,334
Mr Bruce Cook	115,545	16,524	-	4,244	-	136,313
Mr Robert Meeks	102,000	1,107	-	6,368	-	109,475
Mr Steven Juliver	74,861	12,459	-	6,368	-	93,688
	1,056,417	188,314	84,340	16,980	-	1,346,051
* Executive directors						

Non-monetary includes the provision for motor vehicles and heath benefits.
Further details on options can be found in note 20.

24. Notes to the Cash Flow Statement

(a) Reconciliation of Cash and cash equivalents

For the purposes of the cash flow statement, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and net of 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 statement of financial position as follows:

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
24. Notes to the Cash Flow Statement (Cont)				
Cash and cash equivalents	21,434,803	3,686,742	17,976,534	3,517,202

(b) Reconciliation of (Loss)/ Profit for the period to net cash flows from operating activities

(Loss) for the period	(14,731,196)	(5,916,120)	(9,961,243)	(3,929,836)
(Gain)/ Loss on write-off of fixed assets	34,436	-	-	-
Increase (decrease) in current tax liability	-	(100,000)	-	-
Equity settled share-based payments	3,531,401	276,371	3,531,401	276,371
Other	-	-	-	43,013
Depreciation of fixed assets	1,135,754	422,322	913	418
Foreign exchange movements	(220,780)	(11,973)	-	-
Provision for non-recovery of loan	-	-	6,436,448	3,650,560
(Increase)/decrease in assets				
Current receivables	(9,607,416)	1,245,328	(57,633)	(4,081)
Inventories	(8,123,442)	(260,329)	-	-
Other current assets	55,769	(151,137)	-	-
Increase/(decrease) in liabilities				
Provisions for employee entitlements	515,262	231,481	-	-
Provision for warranty	754,787	-	-	-
Lease incentives	354,334	-	-	-
Current trade payables	2,986,733	169,295	35,318	21,665
Leases	148,541	241,290	-	-
Deferred revenues	692,618	462,814	-	-
Other liabilities	699,054	(18,232)	-	-
Net cash (outflows) from operating activities	(21,774,145)	(3,408,890)	(14,796)	(27,916)

24. Notes to the Cash Flow Statement (Cont)

(c) Non-Cash Financing and Investing Activities

During the financial period, the consolidated entity acquired via finance leases property plant and equipment with a cost value of $1,657,373 (2004 - $577,768). These acquisitions are not reflected in the cash flow statement.

25. Related party disclosures

(a) Equity interests in related parties

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 26.

(b) Key management personnel compensation

Details of key management personnel compensation are disclosed in Note 23.

(c) Loans to management personnel

None

(d) Key management personnel equity holdings (represented by holdings of fully paid ordinary shares in Electro Optic Systems Holdings Limited

2005	Balance at 1/1/05	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/05
	No.	No.	No.	No.	No.
Mr Fred Bart	6,110,050	-	-	-	6,110,050
Dr Ben Greene	2,592,593	-	4,859,892	-	7,452,485
Mr Ian Dennis	160,050	-	-	-	160,050
Ms Cheryl Bart	290,000	-	-	-	290,000
Dr Bob Dean	-	-	-	-	-
Mr John Gordon	-		-	-	-
Mr Mark Ureda	-	-	-	-	-
Mr Ron Thompson	232,700	-	-	79,545	312,245
Dr Craig Smith	-	-	-	24,300	24,300
Ms Karen McGilvery	-	-	-	-	-
Mr Jack Elliot	-	-	-	-	-
Mr Steven Juliver	-	-	-	-	-

25. Related party disclosures (cont)

2004	Balance at 1/1/04	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/04
	No.	No.	No.	No.	No.
Mr Fred Bart	6,110,050	-	-	-	6,110,050
Dr Ben Greene	2,592,593	-	-	-	2,592,593
Mr Ian Dennis	160,050	-	-	-	160,050
Ms Cheryl Bart	290,000	-	-	-	290,000
Dr Bob Dean	-	-	-	-	-
Mr John Gordon	-		-	-	-
Mr Mark Ureda	-	-	-	-	-
Mr Ron Thompson	232,700	-	-	-	232,700
Dr Craig Smith	-	-	-	-	-
Ms Karen McGilvery	-	-	-	-	-
Mr Jack Elliot	-	-	-	-	-
Mr Steven Juliver	-	-	-	-	-

(e) Key management personnel Option holdings

2005	Balance at 1/1/05	Granted as remuneration	Exercised	Balance at 31/12/05	Balance vested at 31/12/05	Options vested during year
	No.	No.	No.	No.	No.	
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	4,859,892	1,045,200	4,859,892	1,045,200	1,045,200	1,045,200
Mr Ian Dennis	200,000	-	-	200,000	200,000	-
Ms Cheryl Bart	200,000	-	-	200,000	200,000	-
Dr Bob Dean	200,000	634,000	-	834,000	834,000	634,000
Mr John Gordon	-	300,000	-	300,000	-	-
Mr Mark Ureda	-	-	-	-	-	-
Mr Ron Thompson	-	35,000	-	-	35,000	-
Dr Craig Smith	-	108,000	-	108,000	108,000	108,000
Ms Karen McGilvery	-	45,000	-	45,000	-	-
Mr Jack Elliot	-	-	-	-	-	-
Mr Steven Juliver	15,000	60,000	-	75,000	-	3,000

25. Related party disclosures (cont)

2004	Balance at 1/1/04 No.	Granted as remuneration No.	Exercised No.	Balance at 31/12/04 No.	Balance vested at 31/12/04 No.	Options vested during year
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	4,859,892	-	-	4,859,892	1,045,200	-
Mr Ian Dennis	200,000	-	-	200,000	200,000	-
Ms Cheryl Bart	200,000	-	-	200,000	200,000	-
Dr Bob Dean	200,000	-	-	200,000	834,000	-
Mr John Gordon	-	-	-	-	-	-
Mr Mark Ureda	-	-	-	-	-	-
Mr Ron Thompson	-	15,000	-	15,000	-	-
Dr Craig Smith	-	-	-	-	-	-
Ms Karen McGilvery	-	-	-	-	-	-
Mr Jack Elliot	-	-	-	-	-	-
Mr Steven Juliver	-	15,000	-	15,000	-	-

The 108,000 options issued to Craig Smith were fully vested. Refer to note 20 for further details.
Dr Ben Greene exercised 4,563,925 CEO options and 295,967 vendor options at an exercise price of $0.20 for a total of 4,859,892 ordinary shares.
Other Key Management Personnel options vest 20% after 12 months, 30% after 2 years and the balance after 3 years.

25. Related party disclosures (cont)

(f) Transactions with other related parties

Other related parties includes:
- the parent entity;
- entities with significant influence over the consolidated entity; and
- subsidiaries.

Amounts receivable from entities in the wholly-owned group are disclosed in note 8 to the financial statements.

Certain entities within the group have lent money to other entities within the wholly-owned group on an interest free basis. The amounts receivable by the ultimate parent entity in the wholly-owned group are disclosed in note 8 to the financial statements. The ultimate parent entity in the wholly-owned group has provided for part of this amount based upon the net asset position of the controlled entities.

(g) Other transactions with key management personnel

During the year, the Company paid a total of $47,500 (2004: $20,000) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees for Fred Bart and Cheryl Bart.

During the year, the Company paid $5,435 (2004: Nil) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of rental of the Sydney office premises.

During the year, the Company paid $15,807 (2004: $39,952) to Genetic Technologies Limited, a company of which Mr Fred Bart is a director, in respect of the rental of the Sydney office premises.

During the year, the Company paid $78,000 (2004: $46,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of director and consulting fees.

(h) Parent entity

The parent entity in the consolidated entity is Electro Optic Systems Holdings Limited.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

26. Controlled Entities

Name of Entity	Country of Incorporation	December 2005 %	December 2004 %
Parent Entity			
Electro Optic Systems Holdings Limited	Australia #		
Controlled Entities			
Electro Optic Systems Pty Limited	Australia #	100	100
Fire Control Systems Pty Limited	Australia #	100	100
FCS Technology Holdings Pty Limited	Australia #	100	100
EOS Space Systems Pty Limited	Australia #	100	100
EOS Optronics GmbH	Germany	100	-
EOS USA, Inc. (Inc in Nevada)*	USA	100	100
EOS Technologies, Inc. (Inc in Arizona)*	USA	100	100
EOS Defense Systems, Inc (Inc in Arizona)*	USA	100	-

* Not audited by Deloitte Touche Tohmatsu in 2004.

These companies form part of the Australian consolidated tax entity.

In July 2005, Electro Optic Systems Pty Limited purchased a new shelf company in Bavaria, Germany called EOS Optronics GmbH which is now a controlled entity.

In September 2005, EOS USA, Inc incorporated a new subsidiary in Arizona, USA called EOS Defense Systems, Inc which is now a controlled entity.

27. Contingent Liabilities

(a) Electro Optic Systems Pty Limited provided a guarantee to Fire Control Systems Pty Limited, a controlled entity, on 16 October 1996 to meet any genuine commitments of Fire Control Systems Pty Limited, either current or to be raised in the foreseeable future.

(b) Electro Optic Systems Pty Limited has engaged in Research and Development syndications during the period from 1992 through to 1996. The taxation treatment undertaken was in accordance with specific and general taxation rulings issued by the Australian Taxation Office. However, Electro Optic Systems Pty Limited has a contingent liability under indemnities given to Research and Development Investors in the event that the Australian Taxation Office reverses its rulings.

On 12 November 2004, the parent company received a letter from the Australian Taxation Office regarding a claim for a deduction for core technology of $5.3m in the financial year ended 30 June 1995 by a subsidiary company, FCS Technology Holdings Pty Limited. The letter offered the Company a choice of settling the matter on a prescribed formula amounting to some $881,000 plus interest and possible penalties or satisfying the Australian Taxation Office that the deduction claimed was reasonable and at arms length.

The Directors are of the view that the circumstances of this investment were significantly different from the majority of other syndications and based on legal advice the Company formally advised the Australian Taxation Office on 12 May 2005 that it would not accept the proposed settlement offer and that the Company would defend the position in respect of the claim. Legal counsel has been retained by the Company in the matter. The latest correspondence from the Australian Taxation Office was a letter dated 13 December 2005 to our lawyers advising the matter was still under consideration.

(c) On 8 December 2003, the parent company and the subsidiary company Electro Optic Systems Pty Limited entered into a Deed of Undertaking with the Industry Research and Development Board on behalf of the Commonwealth of Australia. The undertaking from the parent company was to ensure that the subsidiary company was able to contribute matching funding under the R & D Start Program for the Project.
The maximum liability is the amount received from the Commonwealth of Australia which was $5,559,652 as at 31 December 2005 although the directors are of the opinion that it is not possible to estimate any potential exposure, if any, to the consolidated entity under this undertaking.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

27. Contingent Liabilities (Cont)

(d) On 1 June 2005, Electro Optic Systems Pty Limited, a 100% owned subsidiary of Electro Optic Systems Holdings Limited, entered into a Joint Cooperation Agreement with the University of Applied Sciences, Fachhochschule Deggendorf of Bavaria, Germany ("FHD") for the formation of a new wholly owned subsidiary, EOS Optronics GmbH. Electro Optic Systems Pty Limited has agreed to contribute cash to fund the operations. FHD has agreed to contribute plant, facilities, offices and staff under the Joint Cooperation Agreement on a basis to be jointly agreed by the parties within 5 months after the end of the financial year (31 December). The parties have agreed that charges for services will commence from 1 January 2006. In future financial periods, once the value of these services have been determined, Electro Optic Systems Holdings Limited will issue fully paid ordinary shares to FHD for the agreed value of these services based on the closing market price of Electro Optic Systems Holdings Limited shares on the Valuation date.

28. Capital and Leasing Commitments

	Consolidated		The Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
(a) Finance leasing commitments				
Payable – minimum future lease payments				
not later than one year	910,565	446,717	-	-
later than one year and not later than five years	1,222,029	646,558	-	-
later than five years	-	-	-	-
Minimum lease payments	2,132,594	1,093,275	-	-
Less future finance charges	(342,021)	(150,400)	-	-
Total lease liability	1,790,573	942,875	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

28. Capital and Leasing Commitments (cont)

	Consolidated		The Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
(b) Finance leasing commitments				
Payable – Present value of minimum future lease payments				
not later than one year	735,747	354,186	-	-
later than one year and not later than five years	1,054,826	588,689	-	-
later than five years	-	-	-	-
Present value of minimum lease payments	1,790,573	942,875	-	-
Represented by:				
Current liability (Note 14)	735,747	354,186	-	-
Non-current liability (Note 14)	1,054,826	588,689	-	-
	1,790,573	942,875	-	-
(c) Operating lease commitments				
Non-cancellable operating leases contracted for but not recognised in the financial statements:				
Payable:				
not later than one year	1,017,463	717,460	-	-
later than one year and not later than five years	3,059,399	3,907,225	-	-
later than five years	-	-	-	-
	4,076,862	4,624,685	-	-

Operating Leases

Leasing arrangements
Operating leases relate to US premises at 325 West Grant Street, Tuscon, Arizona with a lease term of 10 years which expires on 15 March 2010. The consolidated entity has an option to renew for a further period of 5 years on expiry of the current lease. The rental is subject to annual reviews to CPI. There is no option to purchase the property.

28. **Capital and Leasing Commitments (cont)**

A new operating lease was entered into on 1 December 2004 for premises at 3160 East Transcon Way, Tuscon Arizona with a lease term of 5 years. There is no option to renew after 5 years and future lease payments are fixed under the contract. There is no option to purchase the property. A liability has been recognised relating to the lease incentive received upon signing of the lease.

On 1 January 2004 a subsidiary company entered into a renewal of a lease for the premises in Queanbeyan, Australia for a 5 year period with a 5 year option. The Company has the first right of refusal in respect of the purchase of the property.

On 31 December 2004 a subsidiary company entered into a new lease for premises at 111 Canberra Avenue, Griffith, ACT Australia for a 5 year period with a 5 year option. There is no option to purchase the property.

On 29 August 2005 a subsidiary company entered into a new lease for premises at Ulrichsberger Strasse 17, Deggendorf, Germany for an open ended term which can be cancelled by either party on six months notice. There is no option to purchase the property.

Finance Leases

Leasing arrangements

Finance leases relate to motor vehicles, computer and office equipment with lease terms of between one and three years. The consolidated entity has options to purchase the computer and office equipment for a nominal amount at the conclusion of the lease arrangements. The consolidated entity has options to purchase motor vehicles for agreed residual amounts at the conclusion of the lease arrangements.

29. **Subsequent Events**

The Directors are not aware of any significant subsequent events since the end of the financial period and up to the date of this report.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

30. **Financial Instruments**

(a) Interest Rate Risk

The consolidated 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 asset and financial liabilities, is as follows:

Cash assets totalling $21,434,803 (2004 - $3,686,742) attract variable interest at a weighted floating interest rate of 5.06% (2003 – 5.20%).

Finance leases totalling $1,790,573 (2004 - $942,875) incur fixed interest at a weighted average interest rate of 8.58% (2004- 9.32%)

Other receivables, investments, accounts payable, provisions and other financial items are non-interest bearing.

(b) Credit Risk

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date to recognised financial assets is the carrying amount of those assets, net of any provisions for doubtful debts of those assets, as disclosed in the statement of financial position and notes to the financial statements.

Credit risk for derivative financial instruments arises from the potential failure of counterparties to the contract to meet their obligations. The consolidated entity measures credit risk on a fair value basis.

The consolidated entity does not have significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

(c) Net Fair Values

The net fair value approximates their carrying value.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

30. **Financial Instruments (Cont)**

No financial assets and financial liabilities are readily traded on organised markets in standardised form.

The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the balance sheet or in the notes to the financial statements.

	Consolidated		Consolidated	
	December 2005 Carrying amount	December 2005 Net fair value	December 2004 Carrying amount	December 2004 Net fair value
Financial assets				
Cash	21,434,803	21,434,803	3,686,742	3,686,742
Receivables	13,799,654	13,799,654	4,192,238	4,192,238
Financial liabilities				
Accounts payable	5,808,846	5,808,846	2,092,819	2,092,819
Interest bearing liabilities	1,790,573	1,790,573	942,875	942,875

31. Segment Information

The consolidated entity operates in Australia, USA and Germany in the development, manufacture and sale of telescopes and dome enclosures, laser satellite tracking systems and the manufacture of electro-optic fire control systems for defence and investment. The Company also operates in the investment sector.

Product and Services within each Business Segment

Space Systems

EOS is a supplier of large optical systems. During the period the order intake in this sector continued to reflect the growing demand.

Space Surveillance

In the next 2 years the Company expects several billion dollars of space surveillance infrastructure, world-wide, to be upgraded.

EOS's laser-based space surveillance systems have been demonstrated in customer trials and EOS is now well-placed to be a major contributor to the next generation of space tracking capability.

In addition, EOS has substantial space resources in its own right, and will enter the market for space data provision from early 2006.

Defence

EOS develops, manufactures and markets advanced fire control, surveillance, and weapon systems to approved military customers. These products either replace or reduce the role of a human operator for a wide range of existing and future weapon systems in the US, Australia and other markets.

EOS is producing these CROWS units for the US Army from its Queanbeyan facility and its Tucson production facility.

Investment

The parent company had a commercial property in Dandenong, Victoria which was rented to independent tenants. The parent company sold the property in October 2004.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

31. **Segment Information (Cont)**

Segment Revenues

	12 Months ended 31 December 2005	12 Months ended 31 December 2004
Space systems and surveillance	23,487,897	12,048,090
Defence	15,481,464	1,656,037
Investment	-	79,101
Total of all segments	38,969,361	13,783,228
Unallocated	1,409,999	288,368
Consolidated	40,379,360	14,071,596
Reconciled to Note 2 as follows:		
Revenue	38,700,543	10,630,490
Other income	1,678,817	3,441,106
	40,379,360	14,071,596

Segment Results

Space systems and surveillance	(3,434,594)	(3,091,655)
Defence	(9,175,200)	(1,935,685)
Investment	-	72,824
Other	-	-
Total of all segments	(12,609,794)	(4,954,516)
Unallocated	(2,121,402)	(1,061,604)
(Loss) before income tax expense	(14,731,196)	(6,016,120)
Income tax expense	-	100,000
(Loss) for the period	(14,731,196)	(5,916,120)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

31. **Segment Information (cont)**

Segment Assets and Liabilities

	Assets		Liabilities	
	31 December 2005	31 December 2004	31 December 2005	31 December 2004
Space systems and surveillance	15,275,459	8,832,348	7,983,864	1,933,269
Defence	20,052,289	3,595,598	4,082,279	4,130,086
Total all segments	35,327,748	12,427,946	12,066,143	6,063,355
Unallocated	21,434,804	3,850,882	1,790,573	942,875
Consolidated	56,762,552	16,278,828	13,856,716	7,006,230

Other Segment Information

	Depreciation and amortisation of segment assets		Acquisition of segment assets	
	12 Months ended 31 December 2005	12 Months ended 31 December 2004	12 Months ended 31 December 2005	12 Months ended 31 December 2004
Space systems and surveillance	484,773	409,882	2,194,669	905,933
Defence	650,981	12,440	4,164,654	-
Total all segments	1,135,754	422,322	6,359,353	905,933
Unallocated	-	-	-	-
Consolidated	1,135,754	422,322	6,359,353	905,933

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

31. **Segment Information (cont)**

Information on Geographical Segments (secondary reporting format)

31 December 2005

Geographical Segments	Revenue from External Customers	Segment Assets	Acquisition of Segment Assets
Australia	5,516,075	43,285,428	4,365,412
North America	33,184,468	13,405,479	1,971,284
Germany	-	71,645	22,657
Total	38,700,543	56,762,552	6,359,353

31 December 2004

Geographical Segments	Revenue from External Customers	Segment Assets	Acquisition of Segment Assets
Australia	4,839,937	13,121,612	355,230
North America	5,790,553	3,157,216	550,703
Total	10,630,490	16,278,828	905,933

	Consolidated		Company	
	31 December 2005 $	31 December 2004 $	31 December 2005 $	31 December 2004 $
32. Construction Contracts				
Construction work in progress	49,968,444	36,230,928	-	-
Progress billings	(46,939,704)	(36,335,399)	-	-
	3,028,740	(104,471)	-	-
Recognised and included in the financial statements as amounts due:				
From customers under construction contracts:				
Current (note 6)	6,439,571	2,613,742	-	-
To customers under construction contracts:				
Current (note 13)	(3,410,831)	(2,718,213)	-	-
	3,028,740	(104,471)	-	-
Retentions included in progress billings	-	-	-	-

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards

The consolidated entity changed its accounting policies on 1 January 2005 to comply with Australian equivalents to International Financial Reporting Standards (A-IFRS). The transition to A-IFRS is accounted for in accordance with Accounting Standard AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards", with 1 January 2004 as the date of transition, except for financial instruments, including derivatives, where the date of transition is 1 January 2005.

An explanation of how the transition from superseded policies to A-IFRS has affected the consolidated entity's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the consolidated balance sheet as at 1 January 2004

	Note	Superseded policies * $	Effects of transition to A-IFRS $	A-IFRS $
Current Assets				
Cash assets		5,930,878	-	5,930,878
Receivables		5,437,566	-	5,437,566
Inventories		805,656	-	805,656
Other		19,842	-	19,842
Total Current Assets		12,193,942	-	12,193,942
Non-Current Assets				
Property, plant and equipment	(a)	6,860,729	(5,600,000)	1,260,729
Investment property	(b)	1,645,251	161,736	1,806,987
Goodwill	(c)	5,505,764	-	5,505,764
Total Non-Current Assets		14,011,744	(5,438,264)	8,573,480
Total Assets		26,205,686	(5,438,264)	20,767,422
Current Liabilities				
Payables		1,923,524	-	1,923,524
Interest-bearing liabilities		163,752	-	163,752
Provisions		1,010,367	-	1,010,367
Other		2,303,871	-	2,303,871
Total Current Liabilities		5,401,514	-	5,401,514
Non-Current Liabilities				
Interest-bearing liabilities		537,833	-	537,833
Provisions		80,235	-	80,235
Total Non-Current Liabilities		618,068	-	618,068
Total Liabilities		6,019,582	-	6,019,582
Net Assets		20,186,104	(5,438,264)	14,747,840
Equity				
Issued capital		22,630,548	-	22,630,548
Reserves	(d)	(101,256)	101,256	-
Accumulated losses		(2,343,188)	(5,539,520)	(7,882,708)
Total Equity		20,186,104	(5,438,264)	14,747,840

* Reported financial position for the year ended 31 December 2003

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the company balance sheet as at 1 January 2004

	Note	Super-seded policies * $	Effects of transition to A-IFRS $	A-IFRS $
Current Assets				
Cash assets		5,213,410	-	5,213,410
Receivables		5,396	-	5,396
Total Current Assets		5,218,806	-	5,218,806
Non-Current Assets				
Property, plant and equipment	(a)	1,046	-	1,046
Investment property	(b)	1,645,251	161,736	1,806,987
Investments		841,325	-	841,325
Total Non-Current Assets		2,487,622	161,736	2,649,358
Total Assets		7,706,428	161,736	7,868,164
Current Liabilities				
Payables		39,182	-	39,182
Total Current Liabilities		39,182	-	39,182
Total Liabilities		39,182	-	39,182
Net Assets		7,667,246	161,736	7,828,982
Equity				
Issued capital		22,630,548	-	22,630,548
Accumulated losses		(14,963,302)	161,736	(14,801,566)
Total Equity		7,667,246	161,736	7,828,982

* Reported financial position for the year ended 31 December 2003

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the consolidated income statement for the financial year ended 31 December 2004

	Note	Super-seded policies* $	Effect of transition to A-IFRS $	A-IFRS $
Revenue		10,630,490	-	10,630,490
Other income	(e)	5,248,093	(1,806,987)	3,441,106
Changes in inventories of finished goods and work in progress		260,329	-	260,329
Raw materials and consumables used		(7,882,369)		(7,882,369)
Employee benefits expense	(f)	(7,917,614)	(276,371)	(8,193,985)
Amortisation expense	(c)	(666,492)	666,492	
Administrative costs		(2,754,183)	-	(2,754,183)
Borrowing costs		(104,297)	-	(104,297)
Cost of property sold	(e)	(1,688,264)	1,688,264	-
Depreciation expense	(a)	(1,122,322)	700,000	(422,322)
Foreign exchange losses		(160,809)	-	(160,809)
Lease expenses		(36,682)	-	(36,682)
Occupancy costs		(626,207)	-	(626,207)
Other expenses from ordinary activities		(124,178)	(43,013)	(167,191)
Loss before income tax expense		(6,944,505)	928,385	(6,016,120)
Income tax expense		100,000	-	100,000
Loss for the period		(6,844,505)	928,385	(5,916,120)

* Reported financial results under previous Australian GAAP for the year ended 31 December 2004

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the company income statement for the financial year ended 31 December 2004

	Note	Super-seded policies* $	Effect of transition to A-IFRS $	A-IFRS $
Revenue		250,299		250,299
Other income	(e)	1,886,088	(1,806,987)	79,101
Employee benefits expense	(f)	(30,000)	(276,371)	(306,371)
Amortisation expense	(c)	-	-	-
Administrative costs		(206,442)	-	(206,442)
Cost of property sold	(e)	(1,688,264)	1,688,264	-
Depreciation expense	(a)	(418)	-	(418)
Occupancy costs		(39,952)	-	(39,952)
Provision for non-recovery of loan		(3,650,560)	-	(3,650,560)
Other expenses from ordinary activities		(55,493)	(43,013)	(98,506)
Loss before income tax expense		(3,534,742)	(438,107)	(3,972,849)
Income tax expense		-	-	-
Loss for the period		(3,534,742)	(438,107)	(3,972,849)

* Reported financial results under previous Australian GAAP for the year ended 31 December 2004

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the consolidated balance sheet as at 31 December 2004

	Note	Superseded policies * $	Effects of transition to A-IFRS $	A-IFRS $
Current Assets				
Cash assets		3,686,742	-	3,686,742
Receivables		4,192,238	-	4,192,238
Inventories		1,065,985	-	1,065,985
Other		170,979	-	170,979
Total Current Assets		9,115,944	-	9,115,944
Non-Current Assets				
Property, plant and equipment	(a)	6,557,120	(4,900,000)	1,657,120
Goodwill	(c)	4,839,272	666,492	5,505,764
Total Non-Current Assets		11,396,392	(4,233,508)	7,162,884
Total Assets		20,512,336	(4,233,508)	16,278,828
Current Liabilities				
Payables		2,092,819	-	2,092,819
Interest-bearing liabilities		354,186	-	354,186
Provisions		1,122,618	-	1,122,618
Other		2,748,453	-	2,748,453
Total Current Liabilities		6,318,076	-	6,318,076
Non-Current Liabilities				
Interest-bearing liabilities		588,689	-	588,689
Provisions		99,465	-	99,465
Total Non-Current Liabilities		688,154	-	688,154
Total Liabilities		7,006,230	-	7,006,230
Net Assets		13,506,106	(4,233,508)	9,272,598
Equity				
Issued capital		22,805,829	-	22,805,829
Reserves	(d),(f)	(112,030)	377,627	265,597
Accumulated losses		(9,187,693)	(4,611,135)	(13,798,828)
Total Equity		13,506,106	(4,233,508)	9,272,598

* Reported financial position under previous Australian GAAP as at 31 December 2004

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005 (cont)

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effect of A-IFRS on the company balance sheet as at 31 December 2004

	Note	Superseded policies * $	Effects of transition to A-IFRS $	A-IFRS $
Current Assets				
Cash assets		3,517,202	-	3,517,202
Receivables		9,477	-	9,477
Total Current Assets		3,526,679	-	3,526,679
Non-Current Assets				
Property, plant and equipment	(a)	628	-	628
Investments	(c)	841,325	-	841,325
Total Non-Current Assets		841,953	-	841,953
Total Assets		4,368,632	-	4,368,632
Current Liabilities				
Payables		60,847	-	60,847
Total Current Liabilities		60,847	-	60,847
Total Liabilities		60,847	-	60,847
Net Assets		4,307,785	-	4,307,785
Equity				
Issued capital		22,805,829	-	22,805,829
Reserves	(d),(f)	-	276,371	276,371
Accumulated losses		(18,498,044)	(276,371)	(18,774,415)
Total Equity		4,307,785	-	4,307,785

* Reported financial position under previous Australian GAAP as at 31 December 2004

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

Effects of A-IFRS on the cash flow statement for the financial year ended 31 December 2004

There are no material differences between the cash flow statement presented under A-IFRS and the cash flow statement presented under the superseded policies.

Notes to the reconciliations of income and equity

(a) Impairment of assets

The consolidated entity decided to write down the value of the Westpac satellite of $5,600,000 at the date of transition. The decision was taken on the basis that:

(i) there is no active market or basis for valuation to determine the fair value of the satellite less costs to sell;
(ii) The value in use based upon contracts on hand at transition date of 1 January 2004 was nil; and
(iii) the present value of expected future cash flows from the assets discounted back was not able to be determined as no reliable estimate of these can be formed at the transition date. The most significant cash flows are expected to occur after 5 years from transition date.
The effect of the transitional adjustment is that an annual depreciation charge will be reduced by $700,000 per annum.

(b) Investment property

The consolidated entity decided to revalue its investment property to fair value at the date of transition by increasing the value by $161,736 to $1,806,987. The adjustment was recognised as a transitional adjustment. The property was subsequently sold in October 2004 and the consolidated entity received net proceeds from the sale of $1,806,987.

33. Impacts of the adoption of Australian equivalents to International Financial Reporting Standards (cont)

(c) Goodwill

The consolidated entity has elected not to restate business combinations that occurred prior to the date of transition to A-IFRS, and accordingly, the carrying amount of goodwill at the date of transition has not changed.
However, goodwill, which was amortised under superseded policies, is not amortised under A-IFRS from the date of transition. The effect of this change is an increase in the carrying amount of goodwill by $333,492 and a reduction in the loss of $333,492 for the half-year ended 30 June 2004, and by $666,492 for the financial year ended 31 December 2004. There is no tax effect as deferred taxes are not recognised for temporary differences arising from goodwill for which amortisation is not deductible for tax purposes.

(d) Foreign Currency Translation Reserve

The consolidated entity decided to reset the foreign currency reserve to Nil as a transitional adjustment. The effect of the adjustment was a reduction in the reserve of $101,256 and a reduction in accumulated losses.

(e) Revenue

Under superseded policies, the consolidated entity recognised the gain or loss on disposal of property, plant and equipment on a gross basis by recognising the proceeds of sale as revenue, and the carrying amount of the property, plant and equipment disposed as an expense. Under A-IFRS, the gain or loss on disposal is recognised on a net basis, and is classified as income or expense. Accordingly, the gross amounts have been reclassified within the income statement for A-IFRS reporting purposes.

(f) Share-based payment

For the half-year ended 30 June 2004 and the financial year ended 31 December 2004, share based payments of $39,482 and $276,371 (included in employee benefit expenses) which were not recognised under the superseded policies were recognised under A-IFRS, with a corresponding increase in the employee equity settled benefits reserve.

34. Additional Company Information

Electro Optic Systems Holdings Limited is a listed public company in Australia, incorporated in Australia. The company and its subsidiaries operate in Australia, North America and Germany.

Registered Office

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75 Elizabeth Street
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Fax: 02 9232 3411

Principal Place of Business

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Australia
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Fax: 02 6299 7687

USA Operations

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94469 Deggendorf
Germany
Tel: +49 991 2910083
Fax: +49 991 2910399

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364
AND CONTROLLED ENTITIES

ASX ADDITIONAL INFORMATION

Additional information required by the Australian Stock Exchange Listing Rules and not disclosed elsewhere in this report.

HOME EXCHANGE

The Company's ordinary shares are quoted on the Australian Stock Exchange Limited under the trading symbol "EOS". The Home Exchange is Sydney.

SUBSTANTIAL SHAREHOLDERS

At 21 February 2006 the following substantial shareholders were registered:

	Ordinary Shares	Percentage of total Ordinary shares
Fred Bart Group	6,110,050	11.92%
Technology Investments Pty Limited	7,452,485	14.53%
Northrop Grumman Space and Mission Systems Corp.	5,000,000	9.75%
	18,562,535	36.20%

VOTING RIGHTS

At 21 February 2006 there were 1,423 holders of fully paid ordinary shares.

Rule 74 of the Company's Constitution stipulates the voting rights of members as follows:

"Subject to any rights or restrictions for the time being attached to any class or classes of shares and to this Constitution:

(a) on a show of hands every person present in the capacity of a Member or a proxy, attorney or representative (or in more than one of these capacities) has one vote; and

ASX ADDITIONAL INFORMATION (Cont)

(b) On a poll every person present who is a Member or proxy, attorney or Representative has member present has:

(i) For each fully paid share that the person holds or represents – one vote; and

(ii) For each share other than a fully paid share that the person holds or represents – that proportion of one vote that the amount paid (not credited) on the shares bears to the total amount paid and payable on the share (excluding amounts credited)."

OTHER INFORMATION

In accordance with Listing Rule 4.10.19, the Company has used the cash and assets in a form readily convertible to cash that it had at the time of admission in a way consistent with its business objectives.

DISTRIBUTION OF SHAREHOLDINGS

At 21 February 2006 the distribution of share and option holdings were:

Range	Ordinary Shareholders	Number of Shares
1-1,000	258	**178,526**
1,001 – 5,000	517	**1,542,512**
5,001 – 10,000	310	**2,667,982**
10,001 – 100,000	284	**8,622,381**
100,001 and over	54	**38,268,197**
	1,423	**51,279,598**

There were 17 ordinary shareholders with less than a marketable parcel.

There is no current on-market buy-back.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
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TWENTY LARGEST SHAREHOLDERS - QUOTED

TWENTY LARGEST ORDINARY SHAREHOLDERS - QUOTED

At 21 February 2006 the 20 largest ordinary shareholders held 61.72 % of the total issued fully paid quoted ordinary shares of 51,279,598.

Shareholder	Fully Paid Ordinary Shares	Percentage of Total
1. Citicorp Nominees Pty Limited	5,148,950	10.04%
2. Benny Allan Greene	4,563,925	8.90%
3. N & J Properties Pty Limited	4,090,000	7.98%
4. Technology Investments Pty Limited	2,888,560	5.63%
5. AWC Nominees Pty Limited	2,507,276	4.89%
6. ANZ Nominees Limited	2,406,569	4.69%
7. Link Traders (Aust) Pty Limited	1,600,000	3.12%
8. UBS Nominees Limited	1,279,000	2.49%
9. Invia Custodian Limited	1,021,000	1.99%
10. Innovation Investments Pty Limited	900,000	1.76%
11. National Nominees Limited	783,189	1.53%
12 AMP Life Limited	661,706	1.29%
13. F & B Investments Pty Limited	580,125	1.13%
14. Cogent Nominees Pty Limited	548,355	1.07%
15. Fodiro Pty Limited	510,000	0.99%
16. Capitol Enterprises Limited	500,000	0.98%
17. RBS Dexia Investor Services Australia Limited	489,879	0.96%
18. Citicorp Nominees Pty Limited <CFS A/C>	434,695	0.85%
19. Henry Herron	380,000	0.74%
20. Dr Joshua Ehrlich	356,447	0.69%
	31,649,676	61.72%

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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CORPORATE GOVERNANCE STATEMENT

Corporate Governance Statement

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

The Directors are committed to protecting stakeholders' interests and keeping investors fully informed about the performance of the Company, while meeting stakeholders' expectations of sound corporate governance practices. To ensure the best representation of Shareholder interests, the Board will regularly review its corporate governance practices.

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

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

Electro Optic Systems Holdings Limited's corporate governance practices were in place throughout the year ended 31 December 2005 and embrace the Council's best practice recommendations which are being put in place as appropriate.

The audit committee was formed on 28 April 2005 and consists of three non-executive directors. The members of the audit committee are Mr John Gordon (Chairman), Mr Ian Dennis and Ms Cheryl Bart. The majority of the audit committee are independent directors and the Chairman is an independent person.

The Company has in place informal policies and procedures for risk management and during the current year the Directors will document and adopt a formal risk assessment plan in order to comply with Principle 7.

CORPORATE GOVERNANCE STATEMENT (cont)

Additional information regarding the Company's corporate governance policies, its Directors, Insider Trading Policy and other relevant information can be found on the Company's website: www.eos-aus.com

Structure of the Board

The skills, experience and expertise relevant to the position of director held by each Director in office at the date of this Annual Report is included in the Directors' Report on pages 7 and 8. Directors of Electro Optic Systems Holdings Limited are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement.

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

In accordance with the definition of independence above, and the materiality thresholds set, the following Directors of Electro Optic Systems Holdings Limited are considered to be independent:

Name	Position
Mr. Ian Dennis	Non-Executive Director and Company Secretary
Mr John Gordon	Non-Executive Director

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

The term in office held by each Director in office at the date of this report is as follows:

Name	Position	Term in Office
Mr Fred Bart	Non-Executive Chairman	5 years 10 months
Dr Ben Greene	Executive Director	3 years 9 months
Mr. Ian Dennis	Non-Executive Director	5 years 10 months
Ms Cheryl Bart	Non-Executive Director	4 years 6 months
Mr John Gordon	Non-executive Director	1 year 4 months
Mr Mark Ureda	Non-executive Director	10 months

For additional details regarding board appointments, please refer to the Company's website.

Nomination Committee

The Board does not currently have a formal Nomination Committee. However, the Board continues to operate within the established guidelines, including when necessary, selecting candidates for the position of Director and, where appropriate, seeking the services of an independent consultant who is not a director of the Company to provide assistance in the recruitment of potential Directors. It is envisaged that a Nomination and Remuneration Committee will be established during the coming financial year.

Performance

The performance of the Board and key executives is reviewed regularly against both measurable and qualitative indicators. During the reporting period, an assessment of the performance of each Board member and key executive against specific and measurable qualitative and quantitative performance criteria was undertaken. The performance criteria against which directors and executives are assessed is aligned with the financial and non-financial objectives of Electro Optic Systems Holdings Limited. Directors whose performance is consistently unsatisfactory may be asked to retire.

Remuneration

One of the Company's key objectives is to provide maximum stakeholder benefits from the retention of a high quality Board and executive team by remunerating Directors and key executives fairly and appropriately with reference to relevant employment market conditions. Whilst the Company does not currently have a formal Remuneration Committee, the nature and amount of Executive Directors' and Officers' emoluments are linked to the Company's financial and operational performance. Further, it is envisaged that a Nomination and Remuneration Committee will be established during the coming financial year. The expected outcomes of the remuneration structure are:

- Retention and motivation of key executives;
- Attraction of quality management to the Company; and
- Performance incentives which allow executives to share the rewards of the success of Electro Optic Systems Holdings Limited.

For details regarding the amount of remuneration and all monetary and non-monetary components for Directors and executives, refer to Note 23 of the Notes to the Financial Statements. In relation to the payment of bonuses, options and other incentive payments, discretion is exercised by the Board, having regard to the overall performance of Electro Optic Systems Holdings Limited and the performance of the individual during the period.

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

The Board is responsible for determining and reviewing compensation arrangements for the Directors themselves, the Chief Executive Officer and the executive team.

CORPORATE GOVERNANCE STATEMENT (cont)

Safeguard integrity in financial reporting

The chief executive officer and the chief financial officer are required to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

Policy on Trading in Securities

Directors and employees of EOSH should not buy or sell securities in EOSH, when EOSH is in possession of price sensitive information that is not generally available to the market.

Subject to the insider trading provisions of the Corporations Act outlined in Section 2 and the notification requirements of the Company set out in the "Insider Trading Policy", the recommended time (in order to minimize suggestions of insider trading) for any Director or employee to deal in Securities is during the four week period commencing on the second business day after:

(a) EOSH's annual general meeting;

(b) The release of EOSH's half-yearly announcement to the ASX;

(c) The release of EOSH's preliminary final statement or full year announcement to ASX (whichever is earlier);

(d) The release of a disclosure document (eg. a prospectus) by EOSH.

(e) The release of the quarterly commitments test report known as Appendix 4C.

The Chairman of the Board, or the Chairman's delegate, (eg. the Company Secretary) may also notify Directors and employees of EOSH in writing of other ad hoc "trading windows".

The complete Insider Trading Policy of the Company is available on the Company's website at www.eos-aus.com