Advanced Engine Components Limited

ASX Code ACE

ANNOUNCEMENT TO THE AUSTRALIAN STOCK EXCHANGE

13 September 2005

Company Announcements Office
Australian Stock Exchange Limited
10th Floor, 20 Bond Street
SYDNEY NSW 2000

Dear Sir/Madam,

Re: Preliminary Final Report (Appendix 4E) for the year ended 30 June 2005

The Directors of Advanced Engines Components Limited (the "Company") are pleased to announce the unaudited results of the Company for the year ended 30 June 2005.

Yours faithfully,

Company Secretary

Appendix 4E

Preliminary final report

Name of entity

Advanced Engine Components Limited

ABN or equivalent company reference	Financial year ended ('current period')
67 009 081 770	**30 June 2005**

For announcement to the market ***$A'000's***

Revenues from ordinary activities	down	59 %	to	1,817
(Loss) from ordinary activities after tax attributable to members	down	20 %	to	(1,511)
(Loss) for the period attributable to members	down	20 %	to	(1,511)

Dividends	Amount per security	Franked amount per security
Final dividend proposed	Nil ¢	Nil ¢
Interim dividend	Nil ¢	Nil ¢

Results Commentary

During the year under review, Advanced Engine Components Limited (AEC) made substantial progress towards the further commercialisation of the patented AEC Natural Gas Vehicle System (NGVS). The company continues to develop strategic alliances with leading Original Equipment Manufacturers (OEM) of engines by which dedicated natural gas engines are developed for sale. Sales of the engines are promoted by co-marketing in the OEM's country and by AEC forming strategic marketing alliances with partners to market these low cost, low emission, high performance engines in target regions. AEC also continues to develop its own patented components within its NGVS to offer for sale as part of its system or as components to other system developers.

In France, AEC's involvement with the 600 Irisbus AEC NGVS Renault engined buses continues, with these buses having travelled over 45 million kilometres in route service since the first bus was commissioned in 2002.

AEC is currently retrofitting the Closed Loop (Lambda Sensor) System enhancement to these buses and continues under the contract to supply spare parts for 20 years.

AEC entered into a co-operation agreement in October 2003 with First Auto Works (FAW) of China to jointly design, develop, test and certify a natural gas engine incorporating a FAW base engine and AEC NGVS components.

A 6.6 litre 6 cylinder engine, the first engine produced under this agreement, recently completed the European Steady State Cycle exhaust emission procedure complying with Euro 3 standards. This standard is a generation ahead of the Euro 2 Standard currently applied by Chinese regulatory authorities.

The FAW/AEC co-operation agreement has proved very successful to date. AEC's preliminary design of the smaller FAW 3.2 litre, 4 cylinder natural gas engine is complete and discussions have commenced on a third FAW/AEC NG engine program on a 7.2 litre, 6 cylinder engine.

AEC entered into a product development agreement with Weifang Weichai Peterson Gas Engine Co (Weichai) in September 2004 to develop compressed natural gas (CNG,) liquefied natural gas (LNG) and liquefied petroleum gas (LPG) versions of a 9.7 litre 6 cylinder engine in a commercial arrangement under which Weichai would pay for the engine developments and ultimately purchase AEC NGVS components for these engines.

This agreement was amended in June 2005, substituting a 6.2L, 6 cylinder natural gas engine program for the LPG engine development part of the program. This substitution was made because Weichai believe that an additional natural gas engine product will be more saleable in the Chinese market than an LPG engine.

On the 29 June 2005, Weichai ordered 9.7L and 6.2L engine components, which will generate revenue for your company of the order of A$1.2 million.

AEC appointed Mr David Wang as General Manager of its Chinese operation, on 1 June 2005. Mr Wang is a Canadian-trained engineer, resident in Beijing. His role is to manage the engine development and components supply agreements with FAW and Weichai, manage the localised procurement and manufacture of AEC components in China, manage co-marketing with FAW and Weichai of NG products and seek out export opportunities for AEC/Chinese NG engines.

AEC continues to develop components for its NGVS. An AEC designed and patented natural gas injector to replace the imported product is nearing completion, with certification to the world standard ECE R110 expected before the end of 2005. Initial assembly will be done in Australia and assembly migrated to China early 2006.

A new and more powerful generation of AEC ECU 5 is well advanced for manufacture in China by mid-2006.

AEC is in the final stages of negotiating a minority shareholding in an Australian consortium, which will provide a natural gas refuelling, and vehicle package to Australian truck fleets.

The company has expanded its alliances in the Asian region with the signing of Memoranda of Understanding ("MOU") with Advanced Fuels Technology Pty Ltd and Automotive Corporation of Pakistan, which will enhance its marketing capacity in the Asia Pacific target region.

Financial Position

The net assets of the group have increased from a net deficiency of $9,835,877 as at 30 June 2004 to a net surplus of $203,405 in 2005. This increase has largely resulted from the following factors:

- The Mezzanine capital raising
- The Prospectus capital raising
- The conversion of debt to equity by significant lenders
- The conversion of debt to convertible notes by 698 Capital Asia Pacific Pty Ltd
- The appreciation of the group's plant and equipment with a net movement in the group's revaluation reserve of $750 000.

The group continued with it's many development programmes, and as a result of the anticipated decline in sales to our French customers during the year, there was a significant operating cash outflow. The 2004 financial year saw the conclusion of AEC's delivery of NGVS kits to Irisbus and CRMT in France which generated significant revenue for the company in the prior year. In addition, research and development was also capitalised in terms of our accounting policy with the investment funded out of working capital. The group's working capital, being current assets less current liabilities, has improved from a net deficiency of $9,909,647 at 30 June 2004 to a net surplus of $377,581 as at 30 June 2005.

Annual General Meeting

Wednesday the 23rd of November 2005.

Audit

The financial statements on which this report is based are in the process of being audited.

NTA backing		Current period	As shown in last Annual Report
11.1	Net tangible asset backing per +ordinary security	(0.006)	(0.058)

Control gained over entities having material effect

13.1	Name of entity (or group of entities)	N/A
13.2	Profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) since the date in the current period on which control was +acquired	
13.3	Date from which such profit (loss) has been calculated	
13.4	Profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) for the whole of the previous corresponding period	

Loss of control of entities having material effect

14.1	Name of entity (or group of entities)	N/A
14.2	Profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) for the current period to the date of loss of control	
14.3	Date to which the profit (loss) in item 14.2 has been calculated	
14.4	Profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) while controlled during the whole of the previous corresponding period	
14.5	Contribution to profit (loss) from ordinary activities and extraordinary items from sale of interest leading to loss of control	

Statements of Financial Performance
for the Financial Year Ended 30 June 2005

	Note	AEC Group		AEC Entity	
		2005 $	2004 $	2005 $	2004 $
Sales revenue	2	1,766,338	3,967,672	1,766,338	3,967,672
Cost of goods sold		(706,364)	(2,463,959)	(706,364)	(2,463,959)
Gross profit		1,059,974	1,503,713	1,059,974	1,503,713
Other revenue from ordinary activities	2	51,094	455,478	51,094	455,478
Distribution expenses		(22,347)	(109,131)	(22,347)	(109,131)
Marketing expenses		(17,402)	(45,449)	(17,402)	(45,449)
Occupancy expenses		(194,753)	(217,658)	(194,753)	(217,658)
Corporate and administration employment costs		(497,962)	(450,684)	(497,962)	(450,684)
Corporate and administration expenses		(832,646)	(751,454)	(832,646)	(750,395)
Research and development expenses	14	(684,306)	(1,521,503)	(684,306)	(1,521,503)
Borrowing costs		(367,839)	(460,339)	(367,839)	(460,339)
Other expenses from ordinary activities		-	(85,336)	-	(85,336)
Carrying value of net assets of discontinued operations sold		-	(216,371)	-	(216,371)
Loss From Ordinary Activities Before Income Tax Expense		(1,506,187)	(1,898,734)	(1,506,187)	(1,897,675)
Income tax expense relating to ordinary activities	4	(4,525)	-	(4,525)	-
Net Loss attributable to members of the parent entity	28	(1,510,712)	(1,898,734)	(1,510,712)	(1,897,675)
Total changes in equity other than those resulting from transactions with owners as owners	28	(1,510,712)	(1,898,734)	(1,510,712)	(1,897,675)
Basic Loss Per Share	5	($0.018)	($0.011)		

Statements of Financial Position
as at 30 June 2005

	Note	AEC Group		AEC Entity	
		2005 $	2004 $	2005 $	2004 $
Current Assets					
Cash assets	8	1,308,116	197,327	1,308,103	197,314
Receivables	9	479,299	1,045,782	479,299	1,045,782
Inventories	10	380,486	418,336	380,486	418,336
Other assets	11	300,248	256,668	300,248	256,668
Total Current Assets		2,468,149	1,918,113	2,468,136	1,918,100
Non-Current Assets					
Other financial assets	12	-	-	13	13
Plant and equipment	13	905,447	292,768	905,447	292,768
Intangibles	14	672,423	-	672,423	-
Total Non-Current Assets		1,577,870	292,768	1,577,883	292,781
Total Assets		4,046,019	2,210,881	4,046,019	2,210,881
Current Liabilities					
Payables	15	512,441	4,468,166	512,441	4,468,166
Interest-bearing liabilities	16	1,225,215	6,301,529	1,225,215	6,301,529
Provisions	17	352,899	1,058,052	352,899	1,058,052
Total Current Liabilities		2,090,555	11,827,747	2,090,555	11,827,747
Non-Current Liabilities					
Interest-bearing liabilities	18	1,734,001	204,083	1,734,001	204,083
Provisions	19	18,058	14,928	18,058	14,928
Total Non-Current Liabilities		1,752,059	219,011	1,752,059	219,011
Total Liabilities		3,842,614	12,046,758	3,842,614	12,046,758
Net Assets/(Liabilities)		203,405	(9,835,877)	203,405	(9,835,877)
Equity					
Contributed equity	22	9,476,993	25,809,199	9,476,993	25,809,199
Convertible Notes	24	1,323,000	-	1,323,000	-
Reserves	26	750,000	-	750,000	-
Accumulated losses	28	(11,346,588)	(35,645,076)	(11,346,588)	(35,645,076)
Total Equity/ (Deficiency of Equity)		203,405	(9,835,877)	203,405	(9,835,877)

Statements of Cash Flows
for the Financial Year Ended 30 June 2005

	Note	AEC Group Inflows (Outflows) 2005 $	AEC Group Inflows (Outflows) 2004 $	AEC Entity Inflows (Outflows) 2005 $	AEC Entity Inflows (Outflows) 2004 $
Cash Flows From Operating Activities					
Receipts from customers		2,250,649	3,133,575	2,250,649	3,133,575
Government grants received		-	253,105	-	253,105
Payments to suppliers and employees		(4,124,407)	(6,668,305)	(4,124,407)	(6,667,242)
Interest received		26,722	4,727	26,722	4,727
Interest and other costs of finance paid		(105,827)	(127,002)	(105,827)	(127,002)
Withholding taxes paid		(4,525)	-	(4,525)	-
Net cash (used in) operating activities	30(c)	(1,957,388)	(3,403,900)	(1,957,388)	(3,402,837)
Cash Flows From Investing Activities					
Payments for plant & equipment		(69,382)	(44,969)	(69,382)	(44,969)
Payment for capitalised research and development costs		(672,426)	-	(672,426)	-
Proceeds on sale of discontinued operations	36	-	233,000	-	233,000
Proceeds on sale of plant & equipment		14,519	22,044	14,519	22,044
Net cash from/(used in) investing activities		(727,289)	210,075	(727,289)	210,075
Cash Flows From Financing Activities					
Proceeds from issue of shares		4,350,000	-	4,350,000	-
Costs associated with issue of shares		(493,007)	-	(493,007)	-
Loan facility drawdown		210,000	2,366,567	210,000	2,366,567
Proceeds from term loans		336,453	778,829	336,453	778,829
Repayments of Term loans		(460,897)	(363,764)	(460,897)	(363,764)
Finance lease payments		(147,083)	(159,012)	(147,083)	(159,012)
Net cash provided by financing activities		3,795,466	2,622,620	3,795,466	2,622,620
Net Increase/ (Decrease) In Cash Held		1,110789	(571,205)	1,110789	(570,142)
Cash At The Beginning Of Financial Year		197,327	768,532	197,314	767,461
Cash At The End Of The Financial Year	30(a)	1,308,116	197,327	1,308,103	197,314

Notes to the Financial Statements
for the Financial Year Ended 30 June 2005

1. Statement of Significant Accounting Policies

Significant Accounting Policies

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.

Basis of Preparation

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

The financial report has been prepared on the basis of historical cost and except where stated, does not take into account changing money values or fair valuations of non-current assets.

The accounting policies have been consistently applied by each entity in the consolidated entity, and except where there is a change in accounting policy, are consistent with those of the previous year.

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

(a) *Going Concern*

The Company and consolidated entity incurred a net loss for the year of $1,510,712 (2004: $1,897,675 and $1,898,734 respectively).

At 30 June 2005 the Company and consolidated entity had cash assets of $1,308,103 (2004: $197,314) and $1,308,116 (2004: $197,327) and working capital of $377,581 (2004: deficiency of $9,909,647) and $377,594 (2004: deficiency of $9,909,634). At 30 June 2005 the Company and the consolidated entity had shareholders funds of $203,405 (2004: deficiency of $9,835,877).

Since 30 June 2005 the Company has expanded the number of engine development programs in progress; accelerated the establishment of its Chinese based infrastructure; committed $150,000 cash to the settlement of a royalty dispute contingent upon the impending Australian consortium; significantly increased accounts receivable and inventories as a result of the retrofit program in France and in preparation for imminent Chinese and Australian sales; and in acquisition of parts for its Company patented injectors and other spare parts in preparation for customer demand. These expanded activities have required and will continue to require additional cash input prior to further significant cash revenue being generated.

At 30 June 2005 the Company and consolidated entity had interest bearing liabilities of $741,673 (current) and $1,677,000 (non current) owing to 698 Capital Asia Pacific Limited. 698 Capital Asia Pacific Limited is a related party of the Company's majority shareholder 698 Capital International Limited. 698 Capital International Limited has resolved to provide financial support, in circumstances that will enable the Company to be able to meet its debts as and when they fall due, at least until one year from the signature of the Directors' Declaration. This support is subject to the Company raising additional working capital of a minimum $1,000,000 prior to 31 December 2005 and subject to 698 Capital International Limited remaining the majority shareholder of the Company.

Based on this support, and known potential to raise the additional working capital, the Directors consider it appropriate that the financial report be prepared on a going concern basis.

(b) *Acquisition of Assets*

All assets acquired including plant and equipment and intangibles other than goodwill are initially recorded at their cost of acquisition at the date of acquisition, being the fair value of the consideration provided plus incidental costs directly associated with the acquisition. When equity instruments are issued as consideration, their market price at the date of acquisition is used as fair value, except where the notional price at which they could be placed in the market is a better indication of fair value.

Where settlement of any part of cash consideration is deferred, the amounts payable are recorded at their present value, discounted at the rate applicable to the company if a similar borrowing were obtained from an independent financier under comparable terms and conditions.

The costs of assets constructed or internally generated by the consolidated entity, other than goodwill, include the cost of materials and direct labour.

Expenditure, including that on internally generated assets other than research and development costs, is only recognized as an asset when the entity controls future economic benefits as a result of the costs incurred, it is probable that those future economic benefits will eventuate, and the costs can be measured reliably. Costs attributable to feasibility and alternative approach assessments are expensed as incurred.

(c) *Revision of Accounting Estimates*

Revisions to accounting estimates are recognized prospectively in current and future periods only.

1. Summary Of Accounting Policies (continued)

(d) *Capital Raising Costs*

Costs that are directly attributable to a capital raising are offset against the proceeds of that capital raising. If the capital raising is unsuccessful or when the costs of the issue exceed the proceeds of the raising, the costs of the raising are expensed to the profit and loss account to the extent they exceed the proceeds of the capital raising.

(e) *Employee Entitlements*

Wages, Salaries and Annual Leave
The provision for employee entitlements to wages, salaries and annual leave, represents the amount which the Consolidated Entity has a present obligation to pay resulting from employees' services provided up to the balance date. The provision has been calculated at nominal amounts based on current wage and salary rates and includes related on-costs.

Long Service Leave
The liability for employee entitlements to long service leave represents the present value of the estimated future cash outflows to be made by the employer resulting from employees' services provided up to the balance date.

Liabilities for employee entitlements which are not expected to be settled within twelve months are discounted using the rates attaching to national government securities at the balance date that most closely match the terms of maturity of the related liabilities.

Superannuation Fund
The Company and other controlled entities contribute to an employee defined contribution superannuation fund in accordance with the superannuation guarantee charge. Contributions are charged against income as they are made.

(f) *Foreign Exchange*

Foreign currency transactions are translated to Australian currency at the rates of exchange ruling at the dates of the transactions. Amounts receivable and payable in foreign currencies at balance date are translated at the rates of exchange ruling on that date.

Exchange differences relating to amounts payable and receivable in foreign currencies are brought to account as exchange gains or losses in the statement of financial performance in the financial year in which the exchange rates change, except where they relate to the acquisition of qualifying assets (see Note 1(b))

(g) *Goods and Services Tax*

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

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

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

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

(h) *Research and Development*

Research and Development costs are charged to profit from ordinary activities before income tax as incurred or deferred where it is expected beyond reasonable doubt that sufficient future benefits will be derived so as to recover those deferred costs.

Deferred research and development expenditure is amortised on a straight line basis over the period during which the related benefits are expected to be realized, once commercial production has commenced.

1. Summary Of Accounting Policies (continued)

(i) *Inventories*

Inventories, which include finished goods, raw materials and stores, and work in progress, are carried at the lower of cost and net realisable value. Costs include direct materials, direct labour, other direct variable costs, and allocated production overheads necessary to bring inventories to their present location and condition, based on normal operating capacity of the production facilities.

Manufacturing Activities

Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition and location.

(j) *Investments*

Investments in controlled entities are recorded at the lower of cost and recoverable amount.

(k) *Leased Plant and Equipment*

Leases of plant and equipment under which the Company or its controlled entities assume substantially all the risks and benefits of ownership are classified as finance leases. Other leases are classified as operating leases.

Finance leases are capitalised. A lease asset and a liability equal to the present value of the minimum lease payments are recorded at the inception of the lease. Contingent rentals are written off as an expense of the accounting period in which they are incurred. Capitalised lease assets are amortised on a straight-line basis over the term of the relevant lease, or where it is likely the Consolidated Entity will obtain ownership of the asset, the life of the asset. Lease liabilities are reduced by repayments of principal. The interest components of the lease payments are charged to the statements of financial performance.

Payments made under operating leases are charged against profits in equal installments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased property.

(l) *Payables*

Liabilities are recognised for amounts to be paid in the future for goods or services received. Trade accounts payable are normally settled within 120 days.

(m) *Depreciation and Amortisation*

The depreciation and amortisation rates used for each class of assets are as follows:

Plant and equipment	7.5% - 30%
Lease plant and equipment	20%
Leasehold Improvements	10%
Capitalised Research and development	33%

Assets are depreciated or amortised from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use, on a straight line basis.

(n) *Principles of Consolidation*

The consolidated financial statements expressed in Australian dollars comprise the financial statements of the Company being the parent entity and its controlled entities ("the consolidated entity"). A list of controlled entities appears in Note 27. The consolidated financial statements include the results of each controlled entity 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 intercompany balances and transactions and unrealised profits occurring within the Consolidated Entity are eliminated in full. Outside interests in the equity and results of the entities that are controlled by the Company are shown as a separate item in the consolidated accounts.

1. Summary Of Accounting Policies (continued)

(o) *Receivables*

The collectibility of debts is assessed at balance date and specific provision is made for any doubtful accounts. Trade debtors are normally settled within 120 days.

(p) *Recoverable Amount of Non-Current Assets valued on cost basis*

The carrying amounts of non-current assets valued on the cost basis, are reviewed to determine whether they are in excess of their recoverable amount at balance date. If the carrying amount of a non-current asset exceeds its recoverable amount, the asset is written down to the lower amount. The write-down is expensed in the reporting period in which it occurs.

Where a group of assets working together supports the generation of cash inflows, the recoverable amount is assessed in relation to that group of assets.

In assessing recoverable amounts of non-current assets the relevant cash flows have not been discounted to their present value.

(q) *Revenue Recognition*

Revenues are recognised at fair value of the consideration received net of the amount of GST.

i. *Sale of Goods*
Revenue from the sale of goods (net of returns, discounts and allowances) is recognised when control of the goods passes to the customer.

ii. *Interest Income*
Interest income is recognised as it accrues.

iii. *Asset Sales*
The gross proceeds of asset sales are included as revenue of the entity. The profit or loss on disposal of assets is brought to account at the date an unconditional contract of sale is signed.

(r) *Taxation*

The consolidated entity adopts the liability method of tax effect accounting. Income tax expense is calculated on the operating loss adjusted for permanent differences between taxable and accounting income. The tax effect of timing differences, which arise from items being brought to account in different periods for income tax and accounting purposes, is carried forward in the Statement of Financial Position as a future income tax benefit or a provision for deferred income tax.

Future income tax benefits are not brought to account unless realisation of the asset is assured beyond reasonable doubt. Future income tax benefits relating to tax losses are only brought to account when their realisation is virtually certain.

(s) Impacts of Adopting Australian Equivalents to International Financial Reporting Standards (IFRS)

The Australian Accounting Standards Board (AASB) is adopting the International Financial Reporting Standards (IFRS) for application to reporting periods beginning on or after 1 January 2005. The adoption of IFRS will be first reflected in the Group's financial statements for the half-year ending 31 December 2005 and year ending 30 June 2006.

The company's management, along with its auditors, are assessing the significance of these changes and preparing for their implementation. An IFRS Committee is in the process of being established to oversee and manage the company's transition to IFRS. The IFRS Committee will be chaired by the CFO and reports to the Audit Committee. We will seek to keep stakeholders informed as to the impact of these new standards as they are finalised.

The directors do not anticipate any major changes. Set out below is the likely impact of these new standards.

1. Summary Of Accounting Policies (continued)

(s) Impacts of Adopting Australian Equivalents to International Financial Reporting Standards (IFRS) (continued)

This financial report has been prepared in accordance with Australian accounting standards and other financial reporting requirements (Australian GAAP). The differences between Australian GAAP and IFRS identified to date and their likely impact on the economic's entity's financial performance and financial position are set out below. This summary should not be taken as an exhaustive list of all the differences between Australian GAAP and IFRS. No attempt has been made to identify all disclosure, presentation or classification differences that would affect the manner in which transactions or events are presented.

i. Research and Development Expenditure

Under AASB 138: Intangible Assets, costs associated with the research phase of the development of an asset must be expensed. Costs associated with the development phase can only be capitalised when they meet all of the recognition criteria under AASB 138. This will result in a change in the current accounting policy, which capitalises research costs and development costs to the statement of financial position where it is expected beyond any reasonable doubt that sufficient future benefits will be derived so as to recover these deferred costs.

On transition, the financial effect of this impact is assessed as nil, as no research or development costs were capitalised at 1 July 2004. During the year, development costs were capitalised which meet the recognition criteria of AASB 138. Therefore, the financial effect of this impact at 30 June 2005 has been assessed as nil.

ii. Impairment of Assets

The Group currently determines the recoverable amount of an asset on the basis of undiscounted cash flows that will be received from the assets use and subsequent disposal. In terms of AASB 136: Impairment of Assets, the recoverable amount of an asset will be determined as the higher of fair value less cost to sell and value in use. In determining value in use, projected future cash flows are discounted using a risk adjusted pre-tax discount rate and impairment is assessed for the individual asset or at the cash generating unit level. It is likely that this change in accounting policy will lead to impairments being recognised more often than under the existing policy.

The Group has reassessed its impairment testing policy and tested all assets for impairment. During the current year, an independent valuation of plant and equipment has resulted in a revaluation of $750,000. The financial effects of the impact on opening retained earnings at 1 July 2004 and at 30 June 2005 have been assessed as nil.

iii. Financial Instruments

AASB 139: Financial Instruments: Recognition and Measurement, determines the accounting treatment for financial assets and financial liabilities. The financial assets and financial liabilities of the Group include cash, receivables, payables, loans and convertible notes.

Under AASB 139 all financial instruments must be measured at their fair value with movements in the fair value taken to the profit and loss.

AASB 1 provides an election whereby the requirements of AASB 139 dealing with financial instruments are not required to be applied to the first IFRS comparative year, and the first time adoption of the standard will apply from 1 July 2005. The Group has decided that it will adopt this election and will not restate comparative information for the 30 June 2005 financial year.

Under both the existing policy and under IFRS, the convertible notes are compound financial instruments with a debt component and an equity component, and there is no difference in the measurement of the debt and of the equity component.

The likely financial effect on financial instruments for the year 2006 has been assessed as nil.

Notes to the Financial Statements
for the Financial Year Ended 30 June 2005

1. Summary Of Accounting Policies (continued)

(s) Impacts of Adopting Australian Equivalents to International Financial Reporting Standards (IFRS) (continued)

iv. Share based payments

Under the existing policy, share based payments are not reflected in the profit and loss. AASB 2: Share Based Payments requires an entity to reflect in its profit or loss the effects of share-based payment transactions in which share options are issued to employees, with a corresponding increase in equity.

The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the options. The fair value at grant date is independently determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

Upon the exercise of options, the balance of the share-based payments reserve relating to those options is transferred to share capital.

At 1 July 2004 there had been no share options issued to employees as equity compensation for remuneration, and therefore no adjustment required to opening retained earnings. During the year ended 30 June 2005, 1,250,000 options at an exercise price of $0.20 were issued as part-payment for corporate advisory services provided. The impact of IFRS at 30 June 2005, based on the Black-Scholes options pricing model will be an increase in expenses of $98,018 with a corresponding decrease in equity.

v. Income Tax

Currently, the Group adopts the liability method of tax-effect accounting whereby the income tax expense is based on the accounting profit adjusted for any permanent differences. Timing differences are currently brought to account as either a provision for deferred income tax or future income tax benefit.

Under AASB 112: Income Tax, the company will be required to adopt a balance sheet approach under which temporary differences are identified for each asset and liability rather than the effects of the timing and permanent differences between taxable income and accounting profit. The financial effect of this impact is assessed as nil.

(t) Interest Bearing Liabilities

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

Convertible notes are brought to account on issue at the value of the net proceeds received. The Convertible Notes are compound financial instruments where interest is paid annually in arrears. The present value of the interest and principle payable on conversion are discounted at the market rate of interest at issue date and are brought to account as borrowings. The difference between the net proceeds received and the borrowing component is brought to account as equity.

(u) Service Warranties

Provision is made for the estimated liability on all products still under warranty at balance date. The amount of the provision is the present value of the estimated cash flows expected to be required to settle the warranty obligations, having regard to the service warranty experience over the last two years and the risks of the warranty obligations. The provision is not discounted to its present value, as the effect of discounting is not material.

1.	Summary of Accounting Policies (continued)

(v) Borrowing Costs

Borrowing costs are recognised as expenses in the period in which they are incurred, except where they are included in the costs of qualifying assets.

The capitalisation rate used to determine the amount of borrowing costs to be capitalised is the weighted average interest rate applicable to the entity's outstanding borrowings during the year.

Borrowing costs include:

- Interest on bank overdrafts and short-term and long-term borrowings, including amounts paid or received on interest rate swaps
- Finance lease charges

(w) Cash

For purposes of the statement of cash flows, cash includes deposits at call with financial institutions and other highly liquid investments with short periods to maturity, which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value, net of outstanding bank overdrafts.

(x) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

Notes to the Financial Statements
for the Financial Year Ended 30 June 2005

	AEC Group		AEC Entity	
	2005	2004	2005	2004
	$	$	$	$
2. Revenue				
(a) Revenue from operating activities				
Sales revenue:				
Sales of goods	1,766,338	3,150,743	1,766,338	3,150,743
Grant revenue from commercialisation contracts	-	816,929	-	816,929
	1,766,338	3,967,672	1,766,338	3,967,672
Other revenues from ordinary activities				
Interest revenue	26,722	4,727	26,722	4,727
Foreign Exchange Gain	6,070	68,769	6,070	68,769
Other income	15,208	19,938	15,208	19,938
	48,000	93,434	48,000	93,434
	1,814,338	4,061,106	1,814,338	4,061,106
(b) Revenue from outside operating activities				
Proceeds from the sale of assets:				
Proceeds on sale of Bullet and Sprintex divisions	-	340,000	-	340,000
Plant and equipment	3,094	22,044	3,094	22,044
Total revenue	**1,817,432**	**4,423,150**	**1,817,432**	**4,423,150**

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
3. Loss from Ordinary Activities				
(a) Borrowing Costs				
Interest:				
Director related entities				
698 Capital Asia Pacific Limited	295,960	281,906	295,960	281,906
LIM Asia Arbitrage Inc	-	51,573	-	51,573
Other	-	25,304	-	25,304
Other entities	71,879	101,556	71,879	101,556
	367,839	460,339	367,839	460,339
(b) Other disclosure items in respect of the loss from Ordinary Activities				
Net bad and doubtful debts arising from:				
Other entities	71,945	204,894	71,945	204,894
Depreciation and Amortisation				
Depreciation of plant and equipment	127,354	107,158	127,354	107,158
Amortisation of Leased plant and equipment	49,753	83,097	49,753	83,097
Amortisation of Leasehold Improvements	18,173	23,966	18,173	23,966
Foreign exchange loss	31,505	-	31,505	-
Net transfers to/(from) provisions:				
Revaluation decrement on inventory	-	20,453	-	20,453
Provisions for warranties	(717,153)	325,000	(717,153)	325,000
Employee entitlements	15,129	(18,267)	15,129	(18,267)
Operating lease rental expenses				
Minimum lease payments	125,717	131,463	125,717	131,463
Sales of assets in the ordinary course of business have given rise to the following profits and losses:				
Net Gains				
Profit on sale of discontinuing operations	-	123,640	-	123,640
Profit on sale of plant and equipment	3,094	11	3,094	11

	AEC Group		AEC Entity	
	2005	2004	2005	2004
	$	$	$	$

4. Income Tax

(a) Income Tax Expense

Prima facie income tax (benefit) calculated at 30% on operating loss	(451,856)	(569,303)	(451,856)	(569,303)
Increase in income tax expense due to:				
patents non deductible	6,389	9,022	6,389	9,022
other permanent differences	2,939	9,002	2,939	9,002
Tax losses of the Company and controlled entities not carried forward as future income tax benefits	717,119	701,804	717,119	701,804
Timing differences not brought to account as future income tax benefits	(274,591)	(150,525)	(274,591)	(150,525)
Withholding tax paid	4,525		4,525	
Income tax expense/(benefit) attributable to operating loss	4,525	-	4,525	-

The potential future income tax benefit arising from tax losses at 30 June 2005 and timing differences has not been recognised as an asset because recovery of these is not virtually certain and recovery of timing differences is not assured beyond a reasonable doubt. At 30 June 2005, if the Company meets the conditions for deductibility imposed by Division 165 of the Income Tax Assessment Act (1997), gross unutilized tax losses of $16.336 million (2004: $13.945 million), consolidated entity: $16.336 million (2004: : $13.945 million) may be available for future utilization.

The potential future income tax benefit will only be obtained if:

a) assessable income is derived of a nature and of amount sufficient to enable the benefit from the deductions to be realised or the benefit can be utilised by the Company and/or the consolidated entity in accordance with Division 170 of the Income Tax Assessment Act 1997;

b) conditions for deductibility imposed by the law are complied with; and

c) no changes in tax legislation adversely affect the realisation of the benefit from the deductions.

Tax Consolidation

For the purposes of income taxation, Advanced Engine Components have not elected to form a tax consolidated group. It is not expected the group will elect to form a consolidated tax group, as there does not appear to be any benefit in doing so. There will be no consequences to the deferred tax assets, deferred tax liability unutilized tax losses by not joining the consolidated tax regime.

5. Loss Per Share

	AEC Group	
	2005 $	2004 $
Basic loss per share	($0.018)	($0.011)
Weighted average loss per share	($0.038)	($0.112)

During the year a consolidation of existing shares on a 1 for 10 basis was effected. There was a mezzanine capital raising and a further prospectus offer where additional capital was raised. In conjunction with both offers, debt was converted to equity by existing shareholders. The 2004 comparatives take into account the 1 for 10 consolidation in respect of the weighted average loss per share and the weighted average number of ordinary shares on issue calculations.

	2005 No.	2004 No.
The weighted average number of ordinary shares on issue during the financial year used in the calculation of basic loss per share	47,871,205	16,934,204

Reconciliation of loss used in the calculation of loss per share

	2005 $	2004 $
Net Loss	(1,510,712)	(1,898,734)
Operating loss used in the calculation of basic loss per share	(1,510,712)	(1,898,734)

6. Employee Share Option Plan

The employee share option plan was not in operation during the year ended 30 June 2005. The Board however has agreed on the awards to be made to employees and will be allotting them before the end of the second quarter of the 2006 financial year.

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
7. Remuneration of Auditors				
Auditors of the Company – Horwath				
Audit and review of the financial report				
- Current Year	40,017	29,425	40,017	29,425
- Prior Year	8,500	-	8,500	-
Other assurance services	43,057	15,681	43,057	15,681
	91,573	45,106	91,573	45,106
8. Cash				
Cash at bank	1,308,116	197,327	1,308,103	197,314
	1,308,116	197,327	1,308,103	197,314
9. Current Receivables				
Trade receivables	776,882	1,320,772	776,882	1,320,772
Provision for doubtful debts	(319,312)	(275,010)	(319,312)	(275,010)
	457,570	1,045,762	457,570	1,045,762
GST recoverable	21,729	20	21,729	20
New Tel Limited	400,000	400,000	400,000	400,000
Provision for doubtful debts	(400,000)	(400,000)	(400,000)	(400,000)
	479,299	1,045,782	479,299	1,045,782
10. Current Inventories				
Raw materials and stocks – at cost	235,777	160,222	235,777	160,222
Work in progress – at cost	26,136	60,464	26,136	60,464
Finished goods – at cost	118,573	218,104	118,573	218,104
	380,486	438,790	380,486	438,790
Provision for Net realizable value of inventory	-	(20,454)	-	(20,454)
	380,486	418,336	380,486	418,336

	AEC Group		AEC Entity	
	2005	2004	2005	2004
	$	$	$	$
11. Other Assets – Current				
Prepayments	297,702	250,667	297,702	250,667
Deposit on rental vehicle/property	2,546	6,001	2,546	6,001
	300,248	256,668	300,248	256,668
12. Other Financial Assets – Non-Current				
Investment in controlled entities	-	-	156,013	156,013
Less: Provision for diminution	-	-	(156,000)	(156,000)
	-	-	13	13

13. Plant and Equipment – Consolidated

	Plant and Equipment	Leased Plant and Equipment	Leasehold Improvements	Total
	$	$	$	$
Gross Carrying Amount				
Balance at 30 June 2004	1,716,791	758,246	162,280	2,637,317
Additions	34,774	-	34,608	69,382
Disposals	(175,500)	(20,705)	-	(196,205)
Revaluation during the year note (i)	750,000	-	-	750,000
Balance at 30 June 2005	2,326,065	737,541	196,888	3,260,494
Accumulated Depreciation/Amortisation				
Balance at 30 June 2004	(1,618,222)	(705,999)	(20,328)	(2,344,549)
Disposals	165,388	19,394	-	184,782
Depreciation expense	(127,354)	(49,753)	(18,173)	(195,280)
Balance at 30 June 2005	(1,580,188)	(736,358)	(38,501)	(2,355,047)
Net Book Value				
As at 30 June 2004	98,569	52,247	141,952	292,768
As at 30 June 2005	745,877	1,183	158,387	905,447

Notes to the Financial Statements
for the Financial Year Ended 30 June 2005

13. Plant and Equipment – Company

	Plant and Equipment	Leased Plant and Equipment	Leasehold Improvements	Total
	$	$	$	$
Gross Carrying Amount				
Balance at 30 June 2004	1,716,791	758,246	162,280	2,637,317
Additions	34,774	-	34,608	69,382
Disposals	(175,500)	(20,705)	-	(196,205)
Revaluation during the year note (i)	750,000	-	-	750,000
Balance at 30 June 2005	2,326,065	737,541	196,888	3,260,494
Accumulated Depreciation/Amortisation				
Balance at 30 June 2004	(1,618,222)	(705,999)	(20,328)	(2,344,549)
Disposals	165,388	19,394	-	184,782
Depreciation expense	(127,354)	(49,753)	(18,173)	(195,280)
Balance at 30 June 2005	(1,580,188)	(736,358)	(38,501)	(2,355,047)
Net Book Value				
As at 30 June 2004	98,569	52,247	141,952	292,768
As at 30 June 2005	745,877	1,183	158,387	905,447

(i) An independent valuation of plant and equipment was undertaken by Garside and Webb (Specialist Auctioneers and Valuers) on 13 April 2005. The valuation was based upon an in situ and going concern basis.

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
14. Intangibles				
Intellectual Property Rights – at cost	-	508,366	-	508,366
Accumulated amortisation	-	(508,366)	-	(508,366)
Capitalised research and development costs	672,423	-	672,423	-
	672,423	-	672,423	-

During the year total research and development costs incurred was $1,356,729. Of this $684,306 was expensed whilst $672,423 was capitalised.

	AEC Group		AEC Entity	
	2005	2004	2005	2004
	$	$	$	$
15. Current Payables				
Trade creditors	265,740	935,434	265,740	935,434
Loans by Directors (note 32)	-	68,418	-	68,418
Loan from 698 Capital International Ltd (i)	-	3,318,924	-	3,318,924
Other creditors and accruals	246,701	145,390	246,701	145,390
	512,441	4,468,166	512,441	4,468,166

(i) Unsecured loan

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
16. Current Interest-Bearing Liabilities				
Unsecured:				
Loan from LIM Asia Arbitrage (note 32)	-	653,249	-	653,249
Loans by Directors (note 32)	-	250,000	-	250,000
Loan from 698 Capital Asia Pacific Limited (note 32)	-	606,255	-	606,255
Insurance Premiums Finance	336,454	241,001	336,454	241,001
Loan from Share Trust Account (iii)	-	217,500	-	217,500
Secured:				
Lease liabilities (i) (note 25 (b))	147,088	147,088	147,088	147,088
Loan from 698 Capital Asia Pacific Limited (ii) (note 32)	741,673	4,186,436	741,673	4,186,436
	1,225,215	6,301,529	1,225,215	6,301,529

(i) Secured over the individual assets leased.

(ii) Secured by a fixed and floating charge over the assets of the company

(iii) Funds advanced by investors in terms of the further placement of shares and options

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
17. Current Provisions				
Employee entitlements (note 20)	266,052	254,052	266,052	254,052
Warranty provision	86,847	804,000	86,847	804,000
	352,899	1,058,052	352,899	1,058,052

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $

18. Non-Current Interest-Bearing Liabilities

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
Secured:				
Convertible note from 698 Capital Asia Pacific Limited (i) (note 32, note 24)	1,677,000	-	1,677,000	-
Lease liabilities (ii) (note 25(b))	57,001	204,083	57,001	204,083
	1,734,001	204,083	1,734,001	204,083

(i) Secured by a fixed and floating charge over the assets of the Company.

(ii) Secured over the individual assets leased.

19. Non-Current Provisions

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
Employee entitlements (note 20)	18,058	14,928	18,058	14,928

20. Employee Entitlements

The aggregate employee entitlement liability recognized and included in the financial statements is as follows:

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
Provision for employee entitlements:				
Current (note 17)	266,052	254,052	266,052	254,052
Non-current (note 19)	18,058	14,928	18,058	14,928
	284,110	268,980	284,110	268,980

	2005 No.	2004 No.	2005 No.	2004 No.
Number of employees at end of financial year	30	26	30	26

21. Non-Hedged Foreign Currency Balances

The Australian dollar equivalent of foreign currency balances included in the financial statements which are not effectively hedged are as follows:

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
US Dollars				
Payables - Current	(9,291)	(1,101)	(9,291)	(1,101)
Euro				
Receivables - Current	759,963	1,208,666	759,963	1,208,666
Payables - Current	(1,457)	(890)	(1,457)	(890)

22. Contributed Equity

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
82,534,266 fully paid ordinary shares (2004: 169,342,036)	9,476,993	25,809,199	9,476,993	25,809,199
Movement in ordinary shares				
Balance at the beginning of year	25,809,199	25,809,199	25,809,199	25,809,199
Share Capital Reduction				
• Accumulated losses considered permanently lost. This also involved a 1 for 10 capital consolidation of the shares held at 15 September 2004	(25,809,199)	-	(25,809,199)	-
Shares issued				
• Issue of 8,500,000 ordinary shares @ $0.10 – mezzanine offer	850,000	-	850,000	-
• Conversion of A Middleton and G Keys debt to equity 1,500,000 ordinary shares @$0.10.	150,000	-	150,000	-
• Issue of 17,500,000 ordinary shares @ $0.20 under a public offer pursuant to a prospectus.	3,500,000	-	3,500,000	-
• Conversion of LIM Asia Arbitrage Fund Inc debt to equity 6,500,000 ordinary shares @$0.10.	650,000	-	650,000	-
• Conversion of 698 Capital Asia Pacific Limited debt to equity 15,000,000 ordinary shares @$0.10.	1,500,000	-	1,500,000	-
• Conversion of 698 Capital Asia Pacific Limited debt to equity16,600,000 ordinary shares @$0.20.	3,320,000	-	3,320,000	-
• Share Issue Costs	(493,007)	-	(493,007)	-
Balance at end of year	9,476,993	25,809,199	9,476,993	25,809,199

Terms and conditions

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders meetings.

In the event of winding up of the Company, ordinary shareholders rank after all other shareholders and creditors, and are fully entitled to any proceeds of liquidation.

23. Options on issue

			AEC Group 2005 Number of Options	AEC Group 2004 Number of Options	AEC Entity 2005 Number of Options	AEC Entity 2004 Number of Options
Opening balance			-	-	-	-
Add: New Options issued						
Grant Date	Expiry Date	Exercise Price $				
13/09/2004	12/09/2005	0.20	5,000,000	-	5,000,000	-
08/09/2004	30/06/2008	0.20	5,625,000	-	5,625,000	-
05/04/2005	15/06/2008	0.20	20,000,000	-	20,000,000	-
Less: Exercised during the year			-	-	-	-
Less: Expired during the year			-	-	-	-
Closing balance			30,625,000	-	30,625,000	-

The Company entered into a product development agreement dated the 13th of September 2004 with Weifang Weichai Peterson Gas Engine Co. Ltd where by Weifang Weichai Peterson Gas Engine Co. Ltd was granted an option to subscribe for up to 5,000,000 fully paid ordinary shares in AEC at a price of 20 cent each, within twelve months of the date of the Agreement subject to the Corporations Act and the ASX Listing Rules. These options were not exercised by the 13th of September 2005 and have lapsed.

5,625 000 new options were issued by the Company in terms of resolutions passed at the General meeting of shareholders held on 8 September 2004. These options are exercisable at 20 cents each on or before 30 June 2008.

20,000,000 new options were issued by the Company in terms of resolutions passed at the General meeting of shareholders held on 5 April 2005. These options are only exercisable when AEC shares have a 30-day volume weighted average price on the ASX of at least $0.50. The exercise price of the options is 20 cents each on or before 15 June 2008.

In addition approval was granted at the Annual General Meeting on 25 November 2004 of the Advanced Engine Components Limited Director and Employee Share Option Plan (ESOP).

An offer of options under the ESOP may not be made if the total of:

-the number of shares which would be issued if all the options offered were exercised;

-the number of shares which would be issued if all outstanding options were exercised;

-number of shares issued during the previous five years under the ESOP or any other employee share scheme or pursuant to the exercise of any options under the ESOP or any other employee share scheme of AEC;

would exceed 5% of the total number of issued shares of AEC at the time of the offer.

To date no options have been issued under this plan.

24. Convertible Notes

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
Option reserve				
Convertible notes – 698 Capital Asia Pacific Limited	3,000,000	-	3,000,000	-
Less: Classified as Non Current Interest Bearing (Note 18)	(1,677,000)	-	(1,677,000)	-
Equity Component	1,323,000	-	1,323,000	-

On 6 April 2005, Advanced Engine Components limited issued 3,000,000 Convertible Notes at $1.00 each to 698 Capital Asia Pacific Limited. The notes can be converted into fully paid ordinary shares at 40 cents per share at any time on or before 31 December 2009. The notes are secured by a first fixed and floating charge over all present and future assets and undertakings of AEC and it's subsidiaries. Interest is paid annually in arrears at a rate of 7.57%.

25. Commitments For Expenditure

(a) Contractual Commitments

- ***Capital equipment and Commitments to Consultants***

Not later than 1 year	40,160	10,000	40,160	10,000
Later than 1 year and not later than 5 years	-	-	-	-
	40,160	10,000	40,160	10,000

(b) Finance Leases

Leasing arrangements

The Consolidated Entity leases plant and equipment under finance leases expiring from 1 to 5 years. At the end of the lease term the Consolidated Entity has the option to purchase the plant and equipment at a price deemed to be a bargain purchase option.

Finance lease liabilities				
No later than 1 year	134,219	164,987	134,219	164,987
Later than 1 year and not later than 5 years	77,843	215,067	77,843	215,067
Minimum finance lease payments	212,062	380,054	212,062	380,054
Less future finance charges	(7,973)	(28,882)	(7,973)	(28,882)
Finance lease liabilities	204,089	351,171	204,089	351,171
Included in the financial statements as:				
Current interest bearing liabilities (note 16)	147,088	147,088	147,088	147,088
Non-current interest bearing liabilities (note 18)	57,001	204,083	57,001	204,083
	204,089	351,171	204,089	351,171

Operating leases				
Not later than 1 year	134,342	121,156	134,342	121,156
Later than 1 year and not later than 5 years	540,643	828,000	540,643	828,000
	674,985	949,156	674,985	949,156

The consolidated entity leases property and equipment under non-cancellable and cancelable operating leases expiring within the next eight years. Leases generally provide the consolidated entity with a right of renewal at which time all terms are re-negotiated.

26. Reserves

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
Asset Revaluation Reserve				
Movements During the year				
Opening balance	-	-	-	-
Revaluation increment on plant and equipment	750,000	-	750,000	-
Closing balance	750,000	-	750,000	-

The asset revaluation reserve records revaluations of non-current assets (Note 13 (i))

27. Controlled Entities

(a) Particulars in relation to Controlled Entities

Name of Entity	Country of Incorporation	Ownership Interest 2005 %	Ownership Interest 2004 %
Parent Entity			
Advanced Engine Components Limited	Australia		
Controlled Entities			
Transcom NGVS Research Pty Ltd	Australia	100	100
AEC Vehicle Technology Pty Ltd	Australia	100	100
NGVS (No.1) Pty Ltd*	Australia	-	100
NGVS (No.2) Pty Ltd*	Australia	-	100
NGVS (No.3) Pty Ltd*	Australia	-	100
NGVS (No.4) Pty Ltd*	Australia	-	100
NGVS (No.5) Pty Ltd*	Australia	-	100
NGVS (No.6) Pty Ltd*	Australia	-	100
NGVS (No.7) Pty Ltd*	Australia	-	100
NGVS (No.8) Pty Ltd*	Australia	-	100
NGVS (No.9) Pty Ltd*	Australia	-	100
NGVS (No.10) Pty Ltd*	Australia	-	100
NGVS (No.11) Pty Ltd*	Australia	-	100
NGVS (No.12) Pty Ltd*	Australia	-	100
NGVS (No.13) Pty Ltd*	Australia	-	100
NGVS (No.14) Pty Ltd*	Australia	-	100
NGVS (No.15) Pty Ltd*	Australia	-	100
NGVS (No.16) Pty Ltd*	Australia	-	100
NGVS (No.17) Pty Ltd*	Australia	-	100
NGVS (No.18) Pty Ltd*	Australia	-	100
NGVS (No.19) Pty Ltd*	Australia	-	100

* These companies were deregistered during the 2005 financial year

28. Accumulated Losses

	AEC Group		AEC Entity	
	2005	2004	2005	2004
	$	$	$	$
Accumulated losses at the beginning of the year	(35,645,076)	(33,746,342)	(35,645,076)	(33,747,401)
Net loss after income tax	(1,510,711)	(1,898,734)	(1,510,711)	(1,897,675)
Share Capital Reduction – permanently lost	25,809,199	-	25,809,199	-
Accumulated losses at the end of the year	(11,346,588)	(35,645,076)	(11,346,588)	(35,645,076)

29. Segment Reporting

Inter-segment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise of interest bearing loans, borrowings and expenses.

Business Segments.

The consolidated entity comprises the following main business segments:

The Natural Gas Vehicle Systems (NGVS) segment operated in the public transport area of the industry. Predominantly, NGVS is responsible for the Company's contracts to supply its patented Natural Gas combustion technology. The segment's operations are based at the Company's Head Office in Malaga, Western Australia with a Branch office having recently been set up in Beijing, China.

The Sprintex Superchargers and Bullet Supercar segments operated in the passenger car and retail of sports cars areas of the industry. Both these businesses were disposed of during the early part of the 2004 financial year.

Geographical Segments

The geographical segments of the Consolidated Entity are Australia, China and France.

Primary Reporting - Business Segments	NGVS (Natural Gas Vehicle Systems)		Discontinuing Operations Sprintex Superchargers and Bullet Supercars		Unallocated		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
	$	$	$	$	$	$	$	$
Revenue								
Total Revenue	1,817,432	3,903,504	-	519,646	-	-	1,817,432	4,423,150
Result								
Segment Result	(1,216,093)	(1,042,299)	-	(18,634)	(294,618)	(837,801)	(1,510,711)	(1,898,734)
Depreciation of Fixed Assets and Amortisation of Leased Assets	195,281	75,135	-	139 085	-	-	195,281	214,220

Notes to the Financial Statements
for the Financial Year Ended 30 June 2005

29.

Primary Reporting - Business Segments	NGVS (Natural Gas Vehicle Systems)		Discontinuing Operations Sprintex Superchargers and Bullet Supercars		Unallocated		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
	$	$	$	$	$	$	$	$
Other non-cash items:								
Amounts set aside to provisions								
Doubtful debts	44,302	260,629	-	-	-	-	44,302	260,629
Employee Entitlements	15,129	(18,267)	-	-	-	-	15,129	(18,267)
Provision for warranties	(717,153)	325,000	-	-	-	-	(717,153)	325,000
Inventory diminution	-	-	-	20,453	-	-	-	20,453
Assets								
Segment Assets	4,046,019	2,049,625	-	161,256	-	-	4,046,019	2,210,881
Liabilities								
Segment Liabilities	(1,228,892)	(2,191,373)	-	(345,794)	(2,613,722)	(9,509,591)	(3,842,614)	(12,046,758)
Acquisition of Non-Current Assets	69,382	26,788	-	18,181	-	-	69,382	44,969

Secondary Reporting – Geographical Segments	France		Australia		China		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004
Segment Revenue by location of customers	1,354,933	2,444,751	417,449	1,978,399	45,050	-	1,817,432	4,423,150
Segment Assets by location of assets	452,652	963,892	1,246,989	1,246,989	-	-	4,046,019	2,210,881
Acquisition of Non-Current Assets	-	11,645	69,382	33,324	-	-	69,382	44,969

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $

30. Notes To The Statement Of Cash Flows

(a) *Reconciliation of Cash*

For the purposes of the statement of cash flows, cash includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the Statement of Financial Position as follows:

	AEC Group 2005 $	AEC Group 2004 $	AEC Entity 2005 $	AEC Entity 2004 $
Cash (Note 8)	1,308,116	197,327	1,308,103	197,314
	1,308,116	197,327	1,308,103	197,314

(b) *Non-Cash Financing and Investing Activities*

During the year ended 30 June 2005 there were several non-cash financing transactions:

Conversion of A Middleton debt to equity @$0.10.	$100,000
Conversion of G Keys debt to equity @$0.10.	$50,000
Conversion of LIM Asia Arbitrage Fund Inc debt to equity @$0.10.	$650,000
Conversion of 698 Capital Asia Pacific Limited debt to equity @$0.10.	$1,500,000
Conversion of 698 Capital Asia Pacific Limited debt to equity @$0.20.	$3,320,000
Total	$5,620,000

30. *Notes To The Statement Of Cash Flows (continued)*

	AEC Group		AEC Entity	
	2005 $	2004 $	2005 $	2004 $
(c) *Reconciliation of Loss From Ordinary Activities After Income Tax to Net Cash Flows used in Operating Activities*				
Loss from ordinary activities after income tax	(1,510,712)	(1,898,734)	(1,510,712)	(1,897,675)
(Less) items classified as investing activities:				
(Profit)/loss on sale of discontinuing operations	-	(123,640)	-	(123,640)
(Profit)/loss on sale of non-current assets	(3,094)	(11)	(3,094)	(11)
Add non-cash items				
Depreciation and amortisation of non-current assets	195,279	214, 221	195,279	214, 221
Doubtful debts provision	44,302	204,894	44,302	204,894
Diminution in inventory	-	20,454	-	20,454
Unrealised foreign exchange (gain)/loss	13,201	(68,769)	13,201	(68,769)
Amounts set aside for provisions	(702,024)	367,303	(702,024)	367,303
Net Cash (used in) operating activities before changes in net assets and liabilities	(1,962,948)	(1,284,282)	(1,962,948)	(1,283,223)
Changes in net assets and liabilities:				
(Increase)/decrease in assets:				
Current receivables	508,880	(119,167)	508,880	(119,167)
Current inventories	37,850	2,258	37,850	2,258
Other current assets	(30,224)	(74,037)	(30,224)	(74,033)
Other financial assets	-	-	-	-
Increase/(decrease) in liabilities:				
Current payables	(772,968)	(1,637,579)	(772,968)	(1,637,579)
Current interest bearing liabilities	262,022	333,337	262,022	333,337
Other current liabilities	-	(624,430)	-	(624,430)
Non-current interest bearing liabilities	-	-	-	-
Net cash (used in) operating activities	(1,957,388)	(3,403,900)	(1,957,388)	(3,402,837)

31. Financial Instruments

(a) *Significant Accounting Policies*

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which revenues and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1 to the financial statements.

(b) *Interest Rate Risk*

The following table details the consolidated entity's exposure to interest rate risk as at the 30 June 2005:

			Fixed Interest Rate Maturity				
2005	Average Interest Rate %	Variable Interest Rate $	Less than 1 Year $	1 to 5 Years $	More than 5 Years $	Non-Interest Bearing $	Total $
Financial Assets							
Cash	4.23%	1,306,103	-	-	-	2,000	1,308,103
Receivables	-	-	-	-	-	479,299	479,299
		1,306,103	-	-	-	481,299	1,787,402
Financial Liabilities							
Payables - current	-	-	-	-	-	512,441	512,441
Insurance Finance	4.53%	-	336,454	-	-	-	336,454
Convertible Note	7.57%	-	-	1,677,000	-	-	1,677,000
Loan facilities	8.41%	-	741,673	-	-	-	741,673
Finance lease liabilities	9.02%	-	147,088	57,001	-	-	204,089
		-	1,225,215	1,734,001	-	512,441	3,471,657

The following table details the economic entity's exposure to interest rate risk as at the 30 June 2004:

			Fixed Interest Rate Maturity				
2004	Average Interest Rate %	Variable Interest Rate $	Less than 1 Year $	1 to 5 Years $	More than 5 Years $	Non-iterest Bearin $	Total $
Financial Assets							
Cash	3.8%	195,314	-	-	-	2,000	197,314
Receivables	-	-	-	-	-	1,045,782	1,045,782
		195,314	-	-	-	1,047,782	1,243,096
Financial Liabilities							
Payables - current	-	-	-	-	-	1,149,242	1,149,242
Insurance Finance	4.01%	-	241,003	-	-	-	241,003
Loan facilities	8.41%	-	5,913,438	-	-	3,318,924	9,232,362
Finance lease liabilities	9.55%	-	147,088	204,083	-	-	351,171
		-	6,301,529	204,083	-	4,468,166	10,973,778

(c) *Foreign Exchange Risk*

The consolidated entity does not currently enter into forward exchange rate contracts to hedge purchase or sale commitments. The Directors are of the view that its Irisbus contract is yet to establish a trend from which to hedge. The consolidated entity continually reviews its foreign exchange risk and minimises its exposure by sourcing non-core components in the same currency.

31. Financial Instruments (continued)

(d) Credit Risk

Credit risk refers to the risk that a counter-party will default on its contractual obligations resulting in financial loss to the consolidated entity. The consolidated entity has adopted the policy of only dealing with creditworthy counter-parties and obtaining sufficient collateral or other security where appropriate, as a means of mitigating the risk of financial loss from defaults. The consolidated entity measures credit risk on a fair value basis.

The credit risk on financial assets, excluding investments, of the consolidated entity which have been recognized on the statement of financial position, is the carrying amount, net of any provision for doubtful debts. As at 30 June 2005, 94% (2004: 96%) of the consolidated entity's trade debtors were owed by two customers in the NGVS business segment. These debtors comprise of large multinational vehicle and component manufacturers and therefore the credit risk associated with these parties is considered to be minimal.

(e) Net Fair Value

The carrying amount of financial assets and financial liabilities recorded in the financial statements approximates their respective net fair values, determined in accordance with the accounting policies disclosed in note 1 to the financial statements.

32. Related Party Disclosures

Transactions of Directors and Directors-related entities

Mr Middleton made a loan to the company amounting to $168,418 during the previous financial year. $100,000 of this loan was converted to equity following the approval by shareholders in general meeting on the 8th September 2004. The remaining loan was repaid during April 2005. Interest at 15% per annum on the above loan, amounting to $7,192 was paid during the year to Mr Middleton and related entities.

Mr Keys is a Director and majority shareholder of Norvest Corporate Pty Limited, which provides various corporate and secretarial services to the company at normal commercial rates. During the year Norvest Corporate Pty Limited supplied company corporate and secretarial services to the company to the value of $356,443. Of this amount $300,518 was in respect of work performed in the raising of equity. At a shareholders meeting held on the 8th of September 2004, it was agreed to issue Norvest Corporate Pty Ltd with 1,250,000 free options over the shares in the company, exercisable at $0.20 each as part payment for corporate advisory services. These options were valued at $98,018 using Black-Scholes. As at 30 June 2005, the Company owed Norvest Corporate Pty Ltd $114,774, this amount is reflected in payables and does not attract any interest.

Sebu Pty Limited, a company of which Mr Keys is a Director of, has made a loan to the Company of $150 000, $50,000 of this loan was converted to equity following the approval by shareholders in general meeting on the 8th September 2004. The remaining loan was repaid during April 2005. Interest at 15% per annum on the above loan, amounting to $18,185 was paid during the year to Sebu Pty Limited.

At a shareholders meeting held on 5 April 2005 shareholders approved the application by Mr Middleton and/or his related parties and Mr Keys and/or his related parties applying for 500,000 shares and 1,000,000 shares in the Company, respectively, pursuant to the AEC Prospectus Offer. Mr Middleton and Mr Keys, and/or their related parties, subscribed $100,000 and $200,000 respectively to the AEC Prospectus Offer and were issued with 500,000 and 1,000,000 shares respectively in April 2005.

During the year the Company entered into a number of transactions with LIM Asia Arbitrage Fund Inc (LIM). Mr Long, a Director of the Company until 19 October 2004 is a Director and major shareholder of LIM. During the year LIM made no further advances to the Company. LIM charged interest on this advance at an interest rate of 8.41%. During the year LIM converted $650,000 of it's debt to equity and the remaining accrued interest was fully repaid. LIM was paid an amount of $50,000 in respect of commission on their application for and issue of 5,000,000 shares at a subscription price of $1,000,000 pursuant to the AEC Prospectus Offer.

During the year 698 Capital Asia Pacific Limited advanced the Company a further $210,000 and charged interest on this advance at an interest rate of 8.41%. This loan is secured by way of fixed and floating charge over the assets of the Company. During the year $1.5 million of this loan was converted to equity following the approval by shareholders in general meeting on the 8th September 2004 and a further $3,000,000 was converted to a convertible note following the approval by shareholders in general meeting on the 5th of April 2005. At year-end the 698 Capital Asia Pacific Limited loan stood at $741,673. 698 Capital Asia Pacific Limited is a related entity. The repayment date of the full facility has been extended to 30 September 2006.

698 Capital International Limited entered into a shortfall agreement with the Company in October 2004 whereby it would subscribe for an amount of up to $1,000,000 for up to 5,000,000 shares in the AEC Prospectus Offer. 698 Capital International Limited subsequently applied for and were issued with 5,000,000 shares pursuant to the AEC Prospectus Offer. 698 Capital International Limited was paid a commitment fee of $15,000 in respect of the issue of shares through the AEC Prospectus Offer.

698 Capital International Limited has resolved to provide financial support, in circumstances that will enable the Company to be able to meet its debts as and when they fall due, at least until one year from the signature of the Directors' Declaration. This support is subject to the Company raising additional working capital of a minimum $1,000,000 prior to 31 December 2005 and subject to 698 Capital International Limited remaining the majority shareholder of the Company.

Mr Liu and Mr Lee are Directors of 698 Capital International Limited and 698 Capital Asia Pacific Limited. Details of other transaction with these entities are set out elsewhere in the notes of the financial statements.

33. Economic Dependency

39% of the Company's forecast sales revenue over the next twelve months is expected to be derived from its contract for the supply of NGVS kits, spare parts and services to Irisbus and Iveco. Both of these customers are based in France. It will only be in the second half of the 2006 financial year that anticipated contracts in China and Australia would dilute the current dependency on these two French customers.

34. Contingencies

The Company entered into an arrangement with two of it's French customers, CRMT and Irisbus, pursuant to which CRMT installs NGVS and other parts into the GNV EURO 3 gas engine for use by Irisbus in the manufacture of gas powered buses.

CRMT commenced litigation against Irisbus on 8 July 2004 in the Commercial Court of Lyon and Irisbus have counterclaimed against CRMT requesting an expert evaluation of the facts in relation to the dispute between the two parties. CRMT has joined AEC to the action in relation to the counterclaim by Irisbus against CRMT.

The expert evaluation was expected to be completed by 31 July 2005 but has been extended by six months to 31 January 2006. It requires legal and technical input from the Company, Irisbus and CRMT.

After completion of the expert valuation the parties can continue to bring actions against each other on the merits of the case. Any such action could last 12 to 24 months. Apart from the €1,508,217.56 claimed against Irisbus by CRMT, Irisbus has alleged that the costs of the operational problems amount to €10,000,000 but no quantum of loss has been officially claimed by Irisbus against AEC or CRMT.

After the expert has delivered it's finding, any party may amend or bring a fresh claim including their estimate as to the loss they have suffered. It will only be at this time that AEC will have an understanding of the quantum of claim (if any) that it is exposed to. Currently neither Irisbus nor CRMT is claiming any specific quantum of loss from AEC.

AEC will vigorously defend any claim made against it after the expert has concluded its evaluation, and will pursue all of its legal remedies against CRMT for any loss that CRMT may have occasioned to AEC.

AEC has instructed Delsol & Associes in Lyon, France to represent it in relation to the expert valuation, and in relation to any action commenced against or by AEC on the merits of the matter.

The Directors have no reason to believe that the provision made for warranty in the accounts is insufficient.

35. After Balance Date Events

The Company announced on the 8th July 2005 that it had settled its dispute with Gas Torque Engines Pty Ltd in respect of royalties on intellectual property purchased from AEC. In terms of the agreement AEC would purchase 100% of Gas Torque Engines Pty Ltd, including the disputed contract. The consideration payable would be the transfer of some minor plant and equipment, the payment of $150,000 in cash and the allotment of $150,000 in AEC shares. Settlement of the GTE acquisition only occurs when AEC executes the formal contract for participation in an Australian consortium. AEC is in the final stages of negotiating a minority shareholding in that Australian consortium, which will provide a natural gas refuelling, and vehicle package to Australian truck fleets.

36. Discontinuing operation

On 1 September 2003 the company announced that it had entered into an agreement to sell its Bullet division with effect from the 28 August 2003 and is reported in this financial year report as a discontinuing operation.

On 26 February 2004 the company announced that due to a technical breach of the agreement that the company had accepted a cancellation of the agreement. However on 30 June 2004 the parties agreed to re-instate the original agreement with minor amendments being agreed to, to take into account the "technical breach".

On 17 October 2003 the company announced it had entered into an agreement to sell its Sprintex division with effect from 3 December 2003 and is reported in this financial report as a discontinuing operation.

Financial information relating to these discontinuing operations for the periods up to the dates of disposal is set out below. Further information is set out in Note 30 Segment Reporting.

	AEC Group 2005 $	AEC Group 2004 $
Financial Performance Information for the five months ended 3 December 2003		
Revenue from ordinary activities, excluding the sale of the divisions	-	179,646
Revenue from sale of divisions	-	340,000
Total revenue from ordinary activities	-	519,646
Expenses from ordinary activities, excluding the carrying amount of assets of the divisions sold	-	321,909
Carrying amount of net assets of the divisions sold	-	216,371
Total expenses from ordinary activities	-	538,280
Profit from ordinary activities before related income tax	-	(18,634)
Income tax expense	-	-
Net profit	-	(18,634)
Carrying amounts of assets and liabilities		
Property, plant and equipment	-	76,371
Prepayments	-	-
Inventories	-	140,000
Total assets	-	216,371
Trade creditors	-	-
Accruals and other	-	-
Insurance premium finance	-	-
Lease liabilities	-	-
Provisions for employee benefits	-	-
Total liabilities	-	-
Net assets	-	216,371

36. Discontinuing operation (continued)

	AEC Group 2005 $	AEC Group 2004 $
Cash Flow Information		
Net cash inflow/ (outflow) from ordinary activities	-	(535,693)
Net cash inflow from investing activities (2004 includes an inflow of $283 000 from the sale of divisions)	-	233,000
Net cash/ (outflow) from financing activities	-	(217,044)
Net increase/ (decrease) in cash generated by these divisions	-	(535,693)
Details of the sale of the divisions is as follows		
Consideration received or receivable:		
Cash	-	233,000
Present value of amount due on 1 July 2004	-	50,000
Present value of amount due on 1 September 2004	-	45,000
Present value of amount due on 30 September 2004	-	12,000
	-	340,000
Carrying amount of net assets sold	-	216,371
Gain/ (loss) on sale before related income tax	-	123,629
Income tax expense	-	-
Gain on sale after related income tax expense	-	123,629

Certain assets of the company are leased to the purchasers of these divisions for periods, which align with the company's own leases over this equipment. On termination of the leases the purchasers have the option to purchase the assets at the residual values reflected in the lease agreements or return the assets to the company. Leasing income is shown in the accounts as other income.

37. Company Details

The registered office of the company is:

Advanced Engine Components Limited

14 Energy Street

Malaga WA