



ADVANCED ENGINE COMPONENTS LIMITED

ABN 67 009 081 770

**ANNUAL REPORT
2010**

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Corporate Information

This annual report covers the consolidated entity comprising Advanced Engine Components Limited and its subsidiaries (the “Group”). The Group’s functional and presentation currency is AUD (\$).

A description of the Group’s operations and principal activities is included in the review of operations and activities in the directors’ report on pages 3 to 16.

Directors

Mr. G Keys (Chairman)

Mr. A Middleton (Managing Director)

Mr. A Pun (Non-Executive Director)

Mr. V Nathan (Non-Executive Director)

Mr. M Gathani (Non-Executive Director)

Company Secretary

Ms. A Mitton

Registered and Principal Office

14 Energy Street

Malaga WA 6090

Tel: (08) 9209 6900

Email: shares@advancedengine.com

Share Registrar

Computershare Investor Services Pty Limited

Level 2, 45 St Georges Terrace

Perth WA 6000

Tel: 1300 85 05 051

Bankers

St George Bank

152-158 St Georges Terrace

Perth WA 6000

Auditors

BDO Audit (WA) Pty Ltd

38 Station Street

Subiaco WA 6008

Website

www.advancedengine.com

ASX Code

ACE

Directors' Report

The Directors submit their report on the consolidated entity constituting Advanced Engine Components Limited and the entities it controlled at the end of or during the year ended 30 June 2010.

DIRECTORS

The names and details of the Company's Directors in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

Mr. Graham Keys
BEc (Monash) ACA FFin
MAICD(Dip)
(Non-executive Chairman)

Mr. Keys is a former corporate finance partner of Ernst & Young. He has experience as Executive Director, and subsequently Managing Director, of a publicly listed company, as non-executive Chairman of publicly listed companies and as the executive officer of two large private companies. He formed Norvest Corporate Pty Ltd, a specialist corporate advisory firm, in April 2000 and is the current Executive Chairman of that company. He was appointed a Non-executive Director of AEC on 9 May 2003 and Chairman on 19 October 2004. During the past three years, Mr. Keys has also served as a director of Brand New Vintage Ltd, Cape Range Wireless Ltd and Sterling Biofuels International Ltd.

Mr. Antony Middleton
BE MBA FIE (Aust) FCILT
(Managing Director)

Mr. Middleton holds a Bachelor of Engineering and Master of Business Administration from the University of Western Australia, and a Company Directors' Diploma from the University of New England. Mr. Middleton has held senior management positions with government agencies including Chairman and Chief Executive Officer of Transperth and also on various international engineering projects. He is past National Chairman and a Fellow of the Chartered Institute of Logistics and Transport in Australia, and a Fellow of the Institution of Engineers (Australia). Mr. Middleton is currently the President of Natural Gas Vehicles for Australia (NGVA) the body representing all sectors of the natural gas vehicle industry in Australia. Mr. Middleton was appointed a Director of AEC in March 1997 and Chairman in December 2002. He retired as Chairman and was appointed Managing Director in August 2003. During the past three years Mr. Middleton has not served as a director for any other Australian listed companies.

Mr. Kin Wa Pun (Albert)
MSC BSocSc
(Non-Executive Director)

Mr Pun has significant international investment experience. Mr Pun is the Managing Director and founder of Cherry Capital Management Limited ("Cherry"), a Hong Kong based financial advisory company, providing strategic and financial advice to its clients. He is currently appointed as the Chief Advisor of KGI Asia Limited, a Hong Kong based regional investment bank. Prior to joining Cherry, Mr Pun was the Chief Financial Officer and a member of the board of Directors of KG Investment Holdings Limited, a regional financial services group in Hong Kong. Both KGI Asia Limited and KG Investment Holdings Limited are part of the Koos Group which is one of the largest business groups in Taiwan. Mr Pun also previously worked at Morgan Stanley Asia Limited as Vice President. Mr Pun has a Master of Sciences and Bachelor of Social Sciences degree from the University of Hong Kong. Mr. Pun was appointed a Non-executive Director of AEC on 28 November 2006. During the past three years Mr. Pun has not served as a director for any other Australian listed companies.

Directors' Report

Mr. Ming Fai (Arnold) Chan
BSocSc
(Non-Executive Director)
(Resigned 24 September
2010)

Mr Chan has significant international investment experience. He is currently the Chief Executive Officer of Full Seas Technology Limited which is a technology provider for an intelligent management system used in electric power network in some Chinese cities. Prior to that, he was the President of Dandelion Capital Group ("Dandelion"), a company focusing on special situation investment opportunities in China. Mr Chan has over twenty years experience in investment advisory and asset management. He established Dandelion, in 2006, and co-founded the KGI Group, a pan-Asian investment bank, in 1997. He has also worked with HSBC and Jardine Fleming, based in Hong Kong, with responsibilities throughout Asia. Mr Chan is an independent non-executive Director of China LotSynergy Holdings Limited a company listed on the Hong Kong stock exchange. Mr Chan has a Bachelor of Social Sciences degree from the University of Hong Kong with a major in Economics. Mr. Chan was appointed a Non-executive Director of AEC on 28 May 2009. During the past three years Mr. Chan has not served as a director for any other Australian listed companies.

Mr. Vivekananthan MV
Nathan
(Non-Executive Director)
(Appointed 18 February
2010)

Mr Nathan is the Deputy Chairman of Deleum Berhad ("Deleum") a Malaysian based public listed company. Deleum was incorporated in November 2005 and is the holding company of Delcom Services Sdn Bhd (DSSB). DSSB has been supplying a diverse range of supporting specialised products and services to the oil and gas industry for over 25 years. Mr Nathan is a co-founder of DSSB. He joined ESSO Malaysia in 1962 in the Instrumentation and Electrical Engineering Services Department and undertook assignments at ESSO refineries in Malaysia and Thailand. He then worked for Mobil Refinery, Singapore and subsequently as Project Engineer with Avery Laurence (S) Pte Ltd on various projects in Brunei, Thailand and Indonesia and also attended training in Japan with Yokogawa Electric Works. He later joined Teledyne Inc. and was based in the USA for training in management before being posted as its Marketing Director of the Far East Operations. In 1982, together with his founding partners he spearheaded DSSB's venture into the oil and gas industry and was appointed as its Managing Director and later re-designated as President. He was appointed the Deputy Executive Chairman of Deleum in 2006 and re-designated to his current position in June 2010. Mr Nathan is a Council Member of the Malaysian Gas Association and sits on the boards of World Gas Conference (WGC) 2012, Malaysia Deepwater Production Contractors Sdn Bhd and Malaysia Deepwater Floating Terminal (Kikeh) Ltd.

Mr. Manharlal Bhaichand
Gathani Jain
(Non-Executive Director)
(Appointed 18 February
2010)

Mr Gathani is a Director of PKF Tax Services Sdn Bhd in Malaysia and a Fellow of the Malaysian Institute of Taxation. He joined the Inland Revenue Board of Malaysia (IRB) soon after completing his Bachelor of Arts at the University of Malaya. His long service culminated in the Directorship of the East Malaysian IRB office of Sabah in 1975. He was awarded the "Ahli Darjah Setia Kinabalu" (ADSK) title by the Yang Di Pertua Sabah in 1978. He has successfully integrated his long civil service career with a successful professional practice since his departure from the IRB. Mr Gathani's experience and interpretation of the tax laws have gained him wide recognition in the business community. He has acted as an advisor to a number of corporations for all kinds of strategic tax and business related matters. He has also served in the publication committee of the Malaysian Institute of Taxation.

Directors' Report

Company Secretary

Ms Alicia Mitton BA (Intnl Stud), BBus (Intnl bus), MBus (Acc)

Ms. Mitton was appointed in place of Ms. Susan Hunter who resigned as Company Secretary effective 21 May 2010.

Ms. Mitton has several years experience in project management and corporate advisory roles with public, private, state and federal government organisations with projects in Australia and various Asian countries. Her experience includes organisational strategic reviews, feasibility studies, financial consulting, business valuations, project management, business performance and improvement projects. Ms. Mitton holds a Bachelor of Business (International Business), a Bachelor of Arts (International Studies) and a Masters of Business (Accountancy) from the University of South Australia.

DIRECTORS' INTERESTS

As at the date of this report, the interests of the Directors in the shares and options of Advanced Engine Components Limited were:

Director	Number of Ordinary Shares	Number of Options over Ordinary Shares
Mr. G Keys (ii)	4,933,334	4,392,000
Mr. A Middleton (ii)	5,013,264	768,000
Mr. A Pun (i)(ii)	333,334	18,875,000
Mr V Nathan	30,590,910	-
Mr M Gathani	-	-

(i) Mr. Pun, through his directorship of 698 Capital International Ltd, has an interest in 84,423,731 AEC shares and 18,875,000 options held by that company.

(ii) The table below sets out details of the options over ordinary shares held by the Directors:

Details of Options over Ordinary Shares					
Mr Keys	Mr Middleton	Mr Pun (i) above	Exercise Price	Expiry Date	Notes
275,000			\$0.20	31 Dec 2010	Approved 2008 AGM
		5,000,000	\$0.20	31 Dec 2010	Approved 2008 AGM
	400,000		\$0.18	31 Dec 2010	2007 Employee Share Option Plan
315,000	30,000	375,000	\$0.043	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	375,000	\$0.044	30 Nov 2011	Approved 3 July 2009 General Meeting
967,000	68,000	2,125,000	\$0.047	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	1,375,000	\$0.036	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	1,375,000	\$0.037	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	1,375,000	\$0.071	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	1,375,000	\$0.062	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	375,000	\$0.059	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	375,000	\$0.054	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	375,000	\$0.053	30 Nov 2011	Approved 3 July 2009 General Meeting
315,000	30,000	375,000	\$0.050	30 Nov 2011	Approved 3 July 2009 General Meeting
		1,000,000	\$0.0565	30 Nov 2011	Approved 2009 AGM
		3,000,000	\$0.055	30 Nov 2011	Approved 11 May 2010 General Meeting
4,392,000	768,000	18,875,000			

Directors' Report

PRINCIPAL ACTIVITIES

The Company's principal activities in the course of the financial year were the sale of AEC patented Natural Gas Vehicle Systems ("NGVS"), natural gas engines incorporating AEC's NGVS and associated components and spare parts.

OPERATING RESULTS

The consolidated loss after tax for the year attributable to the members of Advanced Engine Components Limited was \$3,795,896 (2009: \$2,840,527).

DIVIDENDS

No dividends have been declared or paid to shareholders at the date of this report.

REVIEW OF OPERATIONS

Overview

The global financial crisis continued to impact AEC throughout the 2010 financial year. Sales for the year were the lowest annual sales AEC has recorded this decade.

Recurring sales of spares and services generated 57% of the revenue, while sales of engines generated 31% and sales of NGVS kits and components generated 12%. This split demonstrates the status of the global economy throughout the year and AEC's market in particular. The majority of sales were for spares and service which relate to existing vehicles rather than sales of engines and NGVS kits for new vehicles.

Although AEC's sales and sales revenue were disappointing there were a number of developments throughout the 12 month period that will benefit AEC in future periods.

Global economy

The price and availability of oil is a key determining factor in the likely demand for natural gas vehicles. The price of oil fell from US\$136 per barrel in mid 2008 to US\$48 per barrel by the end of 2008. Through FY2010 oil traded in a range of US\$60 to US\$84 per barrel with an average for the period of US\$73.

Growth in developed economies slowed significantly as a result of the global financial crisis. Emerging economies such as China, India, South East Asia, the Middle East and South America continued to grow with increasing demand for energy.

China is now reported to have overtaken the United States as the world's largest energy consumer. As developing economies, China and the other emerging countries will be less energy efficient than the western world with an increasing demand for oil per capita. Changes will be required in these emerging countries to overcome the prohibitive financial and environmental costs of increasing demand for the traditional energy sources of oil and coal.

The requirement for new discoveries is forcing oil exploration into deeper water and more hazardous environments. Recent, unfortunate incidents, in Australia and overseas have highlighted the potential high cost of extraction and environmental risks of such discoveries.

With increased energy demand and diminishing supply, over the next decade and beyond the likely outcome is higher energy prices. The higher the cost of energy, the greater the incentive for governments and corporations to look at cleaner and cheaper alternatives.

Natural gas, as a cleaner technology emitting significantly less carbon than oil or coal, is steadily becoming a more important part of the energy mix. Demand for natural gas vehicles will benefit as refuelling infrastructure expands combined with an increasing price and reduced security for the supply of oil.

The global financial crisis has highlighted the changing demographics of the world. The demand for energy is increasingly coming from the emerging markets. It is in these markets that AEC has concentrated its marketing efforts over the last decade.

Directors' Report

AEC developments

AEC had a number of significant developments throughout FY2010. These include:

- (a) Development of the Tata Motors Limited (TML) natural gas engines commenced and progressed to commissioning of the first production series vehicles. AEC production sales to TML commenced in June 2010.
- (b) TML commissioning AEC to assist in their development of a hybrid NG engine.
- (c) AEC and SHIGAN Quantum Technologies Pvt Ltd (SQT) of India signing a Technical Assistance Agreement and Development & Supply Agreement. This relationship facilitates AEC's development of the TML engines; future production in India; in country procurement, testing, commissioning and after sale service; and introduction of AEC's NGVS to other leading Indian heavy duty vehicle manufacturers.
- (d) Sale of 25 LNG engines to Hangzhou Public Transport Company (HPT) in China. HPT now has 36 LNG buses using the AEC NGVS.
- (e) Sale of 20 CNG engines to PT Arimba Jaya (AJA) in Indonesia. In total, AJA has purchased 85 CNG engines from AEC for AJA's operations in Indonesia.
- (f) Signing of a co-operation agreement with Norinco Equipment Co Ltd (Norinco) in June 2010 whereby AEC will receive a royalty based on Norinco's future gross sales revenue from natural gas vehicles, engines, components, etc arising from the joint co-operation of AEC and Norinco.
- (g) Negotiations, in conjunction with Norinco, for large bus contracts in Thailand and Egypt. Norinco and AEC are involved in a number of other proposals, in various countries, where the negotiations are not as advanced as those in Thailand and Egypt.
- (h) Commenced development of a Huachai Deutz 12 litre engine for Norinco; a Cummins 5.9 litre engine for Xiangyang Shengtian Industrial Trade Corp; and a Dong Feng 4 cylinder engine for Lixun Automotive Electronics.
- (i) Development, in conjunction with Deutz Dalian Engine Co (DDE), of a hybrid CNG electric engine. DDE sold 100 hybrid CNG electric engines in FY2010 using NGVS kits purchased from AEC in prior periods.
- (j) Completing development of the DDE Deutz 1013 7.1 litre LNG and CNG engines.
- (k) Successful conversion of an Isuzu 295hp diesel vehicle to LNG for an Australian customer. Further orders were expected but to date have not been received.
- (l) Completing development and commencing commercial sales of AEC's fifth generation electronic control unit (ECU). This fifth generation ECU has significant cost and performance benefits over AEC's fourth generation ECU and competitor products.
- (m) Favourable settlement of long outstanding and disputed amounts due from Centre de Recherche en Machines Thermiques (CRMT) in France and Weifang Weichai Peterson Gas Engine Co Ltd in China.

Throughout the financial year AEC has conducted more than 10 separate road trials in China with different end users and different vehicles/engines using the AEC NGVS. Despite success of the trials, both in competitive and non-competitive tender situations, the negotiations and trials have all continued well past the agreed closure dates. Some of these trials date back a number of years and demonstrate the patience required for doing business in China.

Directors' Report

Financial review

As stated above, sales for the year were the lowest annual sales AEC has recorded this decade.

Sales revenue was down by 66% compared to the previous year. AEC Australia's revenue from external customers decreased by 55% and AEC China's sales to external customers decreased by 70%.

The \$3.8 million loss for the financial year was 34% higher than the \$2.8 million loss in 2009.

The loss is after charging \$2.0 million in non-cash expenses for depreciation, amortisation and impairment of capitalised development expenditure, unrealised foreign exchange losses, share based payments and accrued interest on the major shareholder loans.

Gross margins by product were generally in line with prior years. Margins on sales to India were lower than other regions as sale prices are based on high volume sales that did not commence until July 2010. The total margin for FY2010 was negative due to a different product mix from prior periods, \$190,000 write down of obsolete inventory and \$300,000 worth of stock returns in relation to the Weichai settlement.

General overhead costs charged before arriving at \$3.1 million Earnings Before Interest Taxation Depreciation and Amortisation (EBITDA) were \$700,000 less than FY2009. However, foreign exchange losses, write off of capitalised expenditure and bad debt write offs were \$1.3 million higher than FY2009.

As at 30 June 2010 AEC's working capital had improved by \$2.2 million over 30 June 2009. The improved working capital is the result of the \$1.2 million share placement, the \$1.8 million rights issue and restructuring of the major shareholders loan facility.

AEC's net asset position deteriorated by \$800,000 due to the \$3.8 million loss.

At 30 June 2010, other than premium funding of insurance, all interest bearing secured borrowings are from AEC related entities.

Summary

The 2010 Financial Year was disappointing in terms of the lack of sales achieved and the loss incurred.

Technically and commercially AEC's products remain very competitive. As a result, FY2010 saw AEC firmly established in India in addition to its existing markets in China, France, Thailand and Australia.

Despite on-going concerns for the global economy, AEC's key business drivers of:

- the price of oil;
- concern for the security of energy supply;
- environmental concerns; and
- emerging economies growing demand for alternative energy,

remain positive.

These business drivers, strong business relationships with SQT in India and Norinco in China and the quality of AEC's technical management are expected to deliver a much improved result for FY2011. However, a key focus in the short term will remain cash flow and funding to ensure AEC's true potential is achieved.

Directors' Report

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

The Company placed 21,818,182 shares at \$0.055 per share to raise \$1,200,000.

A non-renounceable rights issue offer was made to all eligible shareholders, on the basis of one new share for every three shares held as at 3 March 2010, at \$0.055 per share. Shareholders subscribed for 32,806,611 shares to raise \$1,804,363 including the \$1,100,000 subscribed by 698 Capital International Limited and offset against accrued interest on the expired convertible note.

698 Capital Asia Pacific Ltd ("698"), a party related to AEC's major shareholder, extended repayment of the \$3,000,000 due under the convertible note which expired on 31 December 2009 to 31 December 2011. 698 also consolidated their \$750,000 short term loan and the \$3,000,000 sales financing facility, together with all outstanding interest on those loans, into a single loan repayable at call.

AFTER BALANCE DATE EVENTS

There are no matters or circumstances that have arisen since 30 June 2010 that have or may significantly affect the operations, results, or state of affairs of the Group in the future financial years.

FUTURE DEVELOPMENTS, PROSPECTS AND BUSINESS STRATEGIES

Refer to the Review of Operations included in this report of the Directors.

ENVIRONMENTAL ISSUES

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

MEETINGS OF DIRECTORS

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

Directors	Board of Directors	
	Held	Attended
Mr. G Keys (Chairman)	7	7
Mr. A Middleton	7	7
Mr. A Pun	7	7
Mr. A Chan (resigned 24 September 2010)	7	7
Mr. V Nathan (appointed 18 February 2010)	3	1
Mr. M Gathani (appointed 18 February 2010)	3	3

MEETINGS OF AUDIT COMMITTEE

The Company's Audit Committee comprised of two non-executive Directors, Mr. G Keys and Mr. A Pun. During the financial year, two Audit Committee meetings were held, which were attended by BDO Audit (WA) Pty Ltd, the Company's auditors.

Members	Audit Committee	
	Held	Attended
Mr. G Keys (Chairman)	2	2
Mr. A Pun	2	1

Directors' Report

SHARES UNDER OPTION

The following were unissued ordinary shares under option as at the date of this report:

- 1,180,000 options - exercisable at 18.0 cents per share on or before 31 December 2010.
- 5,505,000 options - exercisable at 20.0 cents per share on or before 31 December 2010.
- 2,500,000 options - exercisable at 6.0 cents per share on or before 30 November 2011.
- 4,250,000 options - exercisable at 5.5 cents per share on or before 30 November 2011.
- 2,000,000 options - exercisable at 5.0 cents per share on or before 30 November 2011.
- 3,220,000 options - exercisable at 4.7 cents per share on or before 30 November 2011.
- 750,000 options - exercisable at 4.4 cents per share on or before 30 November 2011.
- 750,000 options - exercisable at 4.3 cents per share on or before 30 November 2011.
- 1,750,000 options - exercisable at 3.6 cents per share on or before 30 November 2011.
- 1,750,000 options - exercisable at 3.7 cents per share on or before 30 November 2011.
- 1,750,000 options - exercisable at 7.1 cents per share on or before 30 November 2011.
- 1,750,000 options - exercisable at 6.2 cents per share on or before 30 November 2011.
- 750,000 options - exercisable at 5.9 cents per share on or before 30 November 2011.
- 1,000,000 options - exercisable at 5.65 cents per share on or before 30 November 2011.
- 750,000 options - exercisable at 5.4 cents per share on or before 30 November 2011.
- 750,000 options - exercisable at 5.3 cents per share on or before 30 November 2011.

The holders of these options do not have any rights under the options to participate in any share issue of the company or of any other entity.

REMUNERATION REPORT (AUDITED)

This report details the nature and amount of remuneration for each Director of AEC and for the key management personnel receiving the highest remuneration.

(a) Remuneration Policy

The objective of the Company's key management personnel reward framework is to ensure reward for performance is competitive and appropriate for the results delivered. The Board reviewed all staff's remuneration, including the Managing Director and key management, at meetings held on 19 February 2009 and 26 March 2009. It was agreed the approach to be taken over the following 12 months would have regard to the impact of the financial global crisis on the financial position of the Group. As a result no salary increases were granted to the Managing Director or key management. All Australian staff were placed on a four day working week. Key China staff remained on a five day week with their salary reduced by 20%. The approach has been regularly reviewed throughout FY2010. In May 2010 Australian key management returned to a five day working week.

AEC's remuneration policy is designed to align Director and key management personnel objectives with shareholder and business objectives by providing a fixed remuneration component and offering specific short and long-term incentives. There is no direct relationship between performance and Non-Executive Directors and key management personnel remuneration. In assessing individual remuneration levels consideration is given to the employee's service to reward the achievement of corporate goals and strategic objectives. The Board of AEC believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best key management personnel and Directors to run and manage the Company to create goal congruence between Directors, key management personnel and shareholders, and to remunerate these key management personnel and Directors on normal commercial terms commensurate with their experience and responsibilities. For the 2010 financial year the policy was varied having regard to the financial circumstances of the Company.

Directors' Report

During the year ended 30 June 2010 AEC did not have a separately established remuneration committee. The duties and responsibilities typically delegated to such a committee is included in the responsibilities of the full Board.

The Board's policy for determining the nature and amount of remuneration for Board members and senior executives is as follows:

The remuneration policy, setting the terms and conditions for the Executive Director and key management personnel, is approved by the non-executive Directors on the Board. All key management personnel receive a base salary (based on factors such as length of service and experience), superannuation, fringe benefits, options and performance incentives. The Board reviews key management personnel packages annually by reference to the economic entity's performance, key management personnel performance and comparable information from industry sectors and other listed companies in similar industries.

The Managing Director and key management receive a superannuation guarantee contribution required by the government, which is currently 9%, and do not receive any other retirement benefits. Some individuals, however, have chosen to sacrifice part of their salary to increase payments towards superannuation.

All remuneration paid to Directors and key management personnel is valued at the cost to the company and expensed. Options are valued at the time of issue using the Black-Scholes methodology.

The Board policy is to remunerate Non-Executive Directors at market rates for comparable companies for time, commitment and responsibilities but which also takes into consideration the financial state of the company. The Board determines payments to the Non-Executive Directors and reviews their remuneration annually. The maximum aggregate amount of fees that can be paid to Non-Executive Directors is subject to approval by shareholders at the Annual General Meeting.

Other than as stated above, to 30 June 2010 there was no direct relationship between performance and Director and key management personnel remuneration. The tables below set out summary information about AEC consolidated earnings and share price movements for the five years to 30 June 2010:

	30 June 2010 \$	30 June 2009 \$	30 June 2008 \$	30 June 2007 \$	30 June 2006 \$
Revenue	1,647,506	4,826,837	4,672,220	3,076,717	2,570,712
Net loss before tax	(4,422,800)	(2,840,527)	(2,072,610)	(3,131,445)	(1,390,985)
Net loss after tax	(3,795,896)	(2,840,527)	(2,072,610)	(3,131,445)	(1,386,454)
Basic loss per share	(0.0235)	(0.0192)	(0.015)	(0.028)	(0.015)
Share price	0.035	0.04	0.18	0.20	0.09
Dividends	-	-	-	-	-

(b) Options Issued as Part of Remuneration for the Year Ended 30 June 2010

During the year the Company did not grant any options over ordinary shares to the Managing Director and key management personnel as part of their remuneration.

Directors' Report

(c) Directors' and Other Key Management Personnel Remuneration

Names and positions held of parent entity Directors and other key management personnel in office at any time during the financial year are:

Parent Entity Directors

Mr. G Keys	Chairman – Non-Executive
Mr. A Middleton	Managing Director – Executive
Mr. A Pun	Director - Non-Executive
Mr. A Chan	Director - Non-Executive (resigned 24 September 2010)
Mr. V Nathan	Director – Non-Executive (appointed 18 February 2010)
Mr. M Gathani	Director – Non-Executive (appointed 18 February 2010)

Other Key Management Personnel

Mr. B Neumann	Engine Development Manager
Mr. N McLaren	Electronics Division Manager
Mr. M McKay	Senior Mechanical Engineer
Mr. D Wang	General Manager - AEC China

The above persons are among the five highest paid executives as required to be disclosed under the Corporations Act 2001.

In addition, Ms. A Mitton has been included as a specified executive due to holding office as Company Secretary.



ADVANCED ENGINE COMPONENTS LIMITED

Directors' Report

Compensation of key management personnel (Group) for the year ended 30 June 2010:

30 June 2010	Short Term	Post Employment	Long Term	Share-based Payment	Total	% of Value of Remuneration that Consists of Options
	Salary & Fees	Superannuation	Long Service Leave Provision	Options		
	\$	\$	\$	\$	\$	
<i>Directors</i>						
Mr. G Keys	25,000	-	-	-	25,000	-
Mr. A Middleton	65,869	102,557	3,714	-	172,140	-
Mr. A Pun	-	-	-	-	-	-
Mr. A Chan (ii)	15,000	-	-	-	15,000	-
Mr. V Nathan (i)	-	-	-	-	-	-
Mr. M Gathani (i)	-	-	-	-	-	-
<i>Other Key Management</i>						
Mr. B Neumann	91,236	42,001	2,402	-	135,639	-
Mr. N McLaren	122,231	11,181	470	-	133,882	-
Mr. M McKay	122,231	11,001	-	-	133,232	-
Mr. D Wang	127,668	-	-	-	127,668	-
<i>Specified Executives</i>						
Ms. A Mitton (iii)	-	-	-	-	-	-
Total	569,235	166,740	6,586	-	742,561	

No proportion of the above remuneration is performance based.

(i) Messrs. Nathan and Gathani were appointed on 18 February 2010.

(ii) Mr. Chan resigned on 24 September 2010.

(iii) Ms. Mitton was appointed as Company Secretary on 21 May 2010 taking over from Ms. Hunter, who resigned on 21 May 2010. Both Ms. Mitton and Ms. Hunter are employees of Norvest Corporate Pty Ltd. The fees for company secretarial services are paid direct to Norvest Corporate Pty Ltd as referred to in Note 29. Ms. Mitton and Ms. Hunter received no direct personal compensation for company secretarial services performed.

Directors' Report

Compensation of key management personnel (Group) for the year ended 30 June 2009:

30 June 2009	Short Term	Post Employment	Long Term	Share-based Payment	Total	% of Value of Remuneration that Consists of Options
	Salary & Fees	Superannuation	Long Service Leave Provision	Options		
	\$	\$	\$	\$	\$	
<i>Directors</i>						
Mr. G Keys	25,000	-	6,321	8,718	40,039	26%
Mr. A Middleton	68,763	99,663	-	-	168,426	-
Mr. A Pun	-	-	-	-	-	-
Mr. A Chan (i)	-	-	-	-	-	-
Mr. T Liu (ii)	-	-	-	-	-	-
<i>Other Key Management</i>						
Mr. B Neumann	93,356	39,882	16,096	-	149,334	-
Mr. N McLaren	122,231	11,001	12,016	-	145,248	-
Mr. M McKay	122,231	11,001	-	-	133,232	-
Mr. D Wang	179,857	-	-	-	179,857	-
Total	611,438	161,547	34,433	8,718	816,136	

No proportion of the above remuneration is performance based.

(i) Mr. Chan was appointed on 28 May 2009.

(ii) Mr. Liu resigned on 28 May 2009.

The only cash bonuses, special incentive or share based payment bonuses paid to Directors or key management in either the 2009 or 2010 financial years were the Share based option payments as shown in the above tables.

(d) Share-based compensation

The Employee Share Option Plan is used to reward Directors and employees for their performance and to align their remuneration with the creation of shareholder wealth. There are no performance requirements to be met before exercise can take place. The Plan is designed to provide long-term incentives to deliver long-term shareholder returns. Participation in the Plan is at the discretion of the Board and no individual has a contractual right to participate in the plan or to receive any guaranteed benefits.

The issue of options is not linked to performance conditions because by setting the option price at a level above the current share price at the time the options are granted, provides incentive for management to improve the Company's performance.

No options were granted under the Plan during the 2010 financial year.

(e) Equity instruments issued on exercise of remuneration options

No shares were issued during the period to Directors or key management as a result of options exercised that had previously been granted as compensation.

Directors' Report

(f) Value of options to Directors and key management

There were no options granted, exercised or lapsed during the year to Directors and key management as part of their remuneration.

(g) Service contracts

Executive Service Contracts

Mr. Antony Middleton, Managing Director

Mr. Middleton joined AEC as an Executive Director in March 1997, became the Executive Chairman in December 2002 and was appointed Managing Director in August 2003. Mr. Middleton's remuneration package is reviewed annually as part of the annual appraisal scheme. For the 2010 financial year Mr. Middleton's salary was set at \$160,568 per annum effective 1 July 2009. Due to the impact of the global financial crisis all Australian based employees hours were reduced from February 2009. Mr Middleton's salary was pro-rata to the reduced hours worked. Mr Middleton returned to normal hours in May 2010. The Company or the employee may terminate the contract by providing one months notice of intention to terminate or by payment or forfeiture of salary in lieu. Where the employee is aged over 45 years and has completed at least two years continuous service an additional one weeks notice or payment in lieu will be given.

Mr. Barry Neumann, Engine Development Manager

Mr. Neumann joined AEC as Engine Development Manager in 1987. For the 2010 financial year, Mr. Neumann's remuneration package was set at \$130,000 per annum effective 1 July 2009. The remuneration package is reviewed annually as part of the annual appraisal scheme. Due to the impact of the global financial crisis all Australian based employees hours were reduced from February 2009. Mr Neumann's salary was pro-rata to the reduced hours worked. Mr Neumann returned to normal hours in May 2010. The Company or the employee may terminate the contract by providing one months notice of intention to terminate or by payment or forfeiture of salary in lieu. Where the employee is aged over 45 years and has completed at least two years continuous service an additional one weeks notice or payment in lieu will be given.

Mr. Nathon McLaren, Electronics Division Manager

Mr. McLaren joined AEC in 1999. He was appointed Electronics Division Manager in 2003. For the 2010 financial year, Mr. McLaren's remuneration package was set at \$130,000 per annum effective 1 July 2009. The remuneration package is reviewed annually as part of the annual appraisal scheme. Due to the impact of the global financial crisis all Australian based employees hours were reduced from February 2009. Mr McLaren's salary was pro-rata to the reduced hours worked. Mr McLaren returned to normal hours in May 2010. The Company or the employee may terminate the contract by providing one months notice of intention to terminate or by payment or forfeiture of salary in lieu. Where the employee is aged over 45 years and has completed at least two years continuous service an additional one weeks notice or payment in lieu will be given.

Mr. Mike McKay, Senior Mechanical Engineer

Mr. McKay joined AEC as Senior Mechanical Engineer in 2006. For the 2010 financial year, Mr. McKay's remuneration package was set at \$130,000 per annum effective 1 July 2009. The remuneration package is reviewed annually as part of the annual appraisal scheme. Due to the impact of the global financial crisis all Australian based employees hours were reduced from February 2009. Mr McKay's salary was pro-rata to the reduced hours worked. Mr McKay returned to normal hours in May 2010. The Company or the employee may terminate the contract by providing one months notice of intention to terminate or by payment or forfeiture of salary in lieu. Where the employee is aged over 45 years and has completed at least two years continuous service an additional one weeks notice or payment in lieu will be given.

Mr. David Wang, General Manager China

Mr. Wang joined AEC in June 2005 as General Manager China. Mr. Wang does not have a formal employment contract with the Company. For the 2010 financial year, Mr. Wang's remuneration package was set at RMB 930,000 (approximately A\$170,000) per annum. The remuneration package is reviewed annually as part of the annual appraisal scheme. Mr. Wang's salary will next be reviewed at 31 December 2010. In March 2009, due to the impact of the global financial crisis, all Chinese based executive employees had their salaries reduced by 20% until the financial position and future requirements of the Company become clear.

End of Remuneration Report (audited)

Directors' Report

INDEMNIFYING OFFICERS

Every officer of the consolidated entity is indemnified by the consolidated entity against any liability incurred by him in his capacity as officer in defending any proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or in connection with any application in relation to any such proceedings in which relief is under the Law granted to him by the Court.

The Directors have not included details of the nature of the liabilities covered or the amount of the premium paid in respect of the Company's insurance contracts, as such disclosure is prohibited under the terms of the contract.

NON-AUDIT SERVICES

The Board of Directors, in accordance with advice from the audit committee, is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- All non-audit services are reviewed and approved by the audit committee prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- The nature of the services provided do not compromise the general principles relating to auditor independence as set out in the Institute of Chartered Accountants in Australia and CPA Australia's APES 110 Code of Ethics for Professional Accountants.

There were no amounts paid or payable to the auditor for non audit services provided during this year or the prior year.

PROCEEDINGS ON BEHALF OF THE COMPANY

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

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

AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration for the year ended 30 June 2010 has been received and can be found on page 26.

Signed in accordance with a resolution of the Board of Directors.



A MIDDLETON
Managing Director
PERTH, WESTERN AUSTRALIA

Dated 30 September 2010

Corporate Governance Statement

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed.

The Board of Directors of Advanced Engine Components Limited ("AEC" or "the Company") is responsible for its corporate governance and the Board has adopted a manual of corporate governance policies and procedures based on control systems and accountability. A summary of the Company's corporate governance policies and procedures is included in this Statement.

The Company's corporate governance policies and procedures are in line with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations 2nd Edition ("the ASX Principles & Recommendations"). The Company has followed the Principles & Recommendations where the Board has considered the recommendation to be an appropriate benchmark for its corporate governance practices. Where, after due consideration by the Board, the Company's corporate governance practices depart from the Principles & Recommendations, the Board has fully disclosed the departure and the reason for the adoption of its own practice, in compliance with the "if not, why not" exception reporting regime.

Further information about the Company's corporate governance practices including the information on the Company's charters, code of conduct and other policies and procedures is set out on the Company's website at www.advancedengine.com.au.

Role of the Board and Management

The Board is responsible for promoting the success of the Company in a way which ensures that the interests of shareholders and stakeholders are promoted and protected. The Board may delegate some powers and functions to the Managing Director for the day-to-day management of the Company. Powers and functions not delegated remain with the Board.

Specific responsibilities of the Board include:

- to develop, review and monitor the Group's long-term business strategies and provide strategic direction to management;
- to ensure policies and procedures are in place to safeguard the Group's assets and business and to enable the Group to act ethically and prudently;
- to develop and promote a system of corporate governance which ensures the Group is properly managed and controlled;
- to identify the Group's principal risks and ensure that it has in place appropriate systems of risk management, internal control, reporting and compliance;
- to monitor management's performance and the Group's financial results on a regular basis;
- to ensure the Group has in place appropriate systems to comply with relevant legal and regulatory requirements that impact on its operations;
- to determine the appropriate capital management for the Group;
- to manage the fair and responsible remuneration of the Company's executives based on their own performances; and
- to provide relevant support and advice to the Managing Director and executive management as required.

The Board carries out its responsibilities according to the following principles:

- The Board should possess a broad range of skills, qualifications and experience.
- All available information in connection with items to be discussed at a meeting of the Board shall be provided to each Director prior to that meeting.

Corporate Governance Statement

- If a vacancy exists, through whatever reason, or where it is considered that the Board would benefit from the services of a new Director with particular skills, a candidate with appropriate expertise and experience is chosen.
- A Director (other than the Managing Director) may not retain office for more than three years without submitting for re-election.

The Board has delegated responsibilities and authorities to management to enable management to conduct the Company's day to day activities and progress the strategic direction provided by the Board in accordance with the delegated authorities for expenditure levels and materiality thresholds in place. Matters which are not covered by these delegations require Board approval. The separation of responsibilities between the Board and management is clearly understood and respected within the business.

The Managing Director is responsible for overseeing the daily operations, management and development of the Group by providing leadership and identifying strategic opportunities.

The role of senior management in the Company is to progress the strategic direction provided by the Board. The Group's senior management is responsible for supporting the Executive Directors in implementing the running of the general operations and financial business of the Group in accordance with the delegated authorities for expenditure levels and materiality thresholds in place. At this stage of the development of the Company, AEC has only informal procedures in place for performance evaluation of the Board, its committees and individual Directors. Senior executives undertake annual performance and remuneration reviews conducted by the Managing Director. Senior executives are reviewed against a number of qualitative and quantitative factors relevant to their role and position. Further to this, the Company has undertaken a 12 month action plan including a formal survey for employees on the performance of the Company, senior executives and leadership. At the end of financial year 2010, the survey was being implemented across the organisation.

The Board has not developed a specific diversity policy, however strictly adheres to its equal opportunity and anti-discrimination commitments in the Company's Code of Conduct. Given the present size of the Company and the historical hiring rate, the Board believes no greater diversity or other benefits could be gained by establishing a diversity policy. The Board will re-consider establishing a diversity policy as the Company's operations and employee numbers grow. If an existing position becomes available within the Company, diversity within the organisation will be considered when reviewing candidates for the position. AEC encourages women to apply for positions that become available, currently 20% of the AEC Group employees are female.

A summary of the Board Charter, a statement of matters reserved for the Board and senior management is available on the Company's website.

Composition of the Board

The Company has adopted a *Policy on Assessing the Independence of Directors* which is consistent with the guidelines detailed in the ASX Principles & Recommendations.

The Company's Board Charter includes guidelines for assessing the materiality of matters which are summarised below:

- Balance sheet items are material if they have a value of more than 5% of pro-forma net asset.
- Profit and loss items are material if they will have an impact on the current year operating result of 5% or more.
- Items are also material if (i) they impact on the reputation of the Company, (ii) they involve a breach of legislation or may potentially breach legislation, (iii) they are outside the ordinary course of business, (iv) they could affect the Company's rights to its assets, (v) if accumulated they would trigger the quantitative tests above, (vi) they involve a contingent liability that would have a probable effect of 5% or more on balance sheet or profit and loss items or (vii) they will have an effect on operations which is likely to result in an increase or decrease in net income or dividend distribution of more than 5%.

Corporate Governance Statement

- Contracts will be considered material if (i) they are outside the ordinary course of business, (ii) they contain exceptionally onerous provisions, (iii) they impact on income or distribution in excess of the quantitative tests above, (iv) any default, should it occur may trigger any of the quantitative or qualitative tests above, (v) they are essential to the activities of the Company and cannot be replaced, or cannot be replaced without an increase in cost of such a quantum, triggering any of the quantitative tests above, (vi) they contain or trigger change of control provisions, (vii) they are between or for the benefit of related parties or (viii) they otherwise trigger the quantitative tests above.

The current Board consists of a non-executive Chairman (Mr Graham Keys), three non-executive Directors (Mr Albert Pun, Mr Vivekananthan Nathan and Mr Manharlal Gathani) and one executive Director (Mr Antony Middleton), who also performs the role of Managing Director. A profile of each Director containing their date of appointment, skills, experience and expertise is set out in the Directors' Report.

The Board considers Mr Keys and Mr Gathani to be independent based on the criteria for independence included in the Company's *Policy on Assessing the Independence of Directors* and the ASX Principles & Recommendations. When applying the Company's Policy on Assessing the Independence of Directors and the ASX Principles & Recommendations Mr Pun is not considered an independent Director due to his direct association with the major shareholder of the Company and Mr. Nathan is not considered an independent Director due to his significant shareholding.

As only two of the five Directors are independent, there is not a majority of independent Directors on the Board. The Board believes that given the size and scale of the Company, it is not practical to have a majority of independent Directors. The Board will continue to reassess its composition on a regular basis to ensure it has the necessary skill set and decision making capabilities to best serve all shareholders.

A minimum of three Directors is required under the Company's Constitution. Any changes to the composition of the Board will be determined by the Board, subject to any applicable laws and the resolutions of Shareholders. The Board seeks to nominate persons for appointment to the Board who have the qualifications, experience and skills to augment the capabilities of the Board. All Directors (except the Managing Director) are required by the Constitution of the Company to submit themselves for re-election at regular intervals and at least every three years.

New Directors are provided with a letter of appointment which sets out the key terms and conditions of their appointment and undergo an induction program.

A summary of the Company's policy for re-election of Directors and selection and appointment of new Directors is available on the Company's website.

Conflicts of Interest

In accordance with the Corporations Act, Directors must keep the Board advised, on an ongoing basis, of any interest that could potentially conflict with those of the Company. Where the Board believes that a significant conflict exists, the Director concerned does not receive the relevant Board papers and is not present at the meeting whilst the item is considered.

Statement Concerning Availability of Independent Professional Advice

The Board considers that to assist Directors with independent judgement a Director may consider it necessary to obtain independent professional advice to properly discharge the responsibility of their office as a Director. Provided the Director first obtains approval for incurring such expense from the Chairman, the Company will pay the reasonable expenses associated with obtaining such advice.

Nomination Committee

Given the present size of the Company, the whole Board acts as the Nomination Committee, if required. The Board believes no efficiencies or other benefits could be gained by establishing a separate Nomination Committee. To assist the Board to fulfil its function as the Nomination Committee, the Board has adopted a Nomination Committee Charter. A summary of the Nomination Committee Charter is available on the Company's website.

Corporate Governance Statement

Remuneration Committee

Given the present size of the Company, the whole Board acts as the Remuneration Committee, if required. The Board believes no efficiencies or other benefits could be gained by establishing a separate Remuneration Committee. To assist the Board to fulfil its function as the Remuneration Committee, the Board has adopted a Remuneration Committee Charter. All matters of remuneration are determined by the Board pursuant to the Corporations Act and the ASX Listing Rule requirements, especially in respect of related party transactions. That is, no Directors participated in any deliberation regarding his own remuneration or related issues.

The Company has a Remuneration Policy adopted by the Board. Remuneration of Directors and senior management is determined with regard to payments made by other companies of similar size and industry and in accordance with the skills and experience of the particular person. Details of remuneration of Directors and Key Management Personnel are disclosed in the Remuneration Report.

There are no termination or retirement benefits for non-executive Directors (other than for superannuation).

Pursuant to the Remuneration Policy, executives are prohibited from entering into transactions or arrangements which limit the economic risk of participating in unvested entitlements.

A summary of the Remuneration Committee Charter and the Remuneration Policy are available on the Company's website.

Audit Committee

To assist in the execution of its responsibilities, the Board has established an Audit Committee.

The primary role of the Audit Committee is to monitor and review, on behalf of the Board, the effectiveness of the control environment of the Group in the areas of operational and balance sheet risk, legal/regulatory compliance and financial reporting. The overriding objective of the Committee is to provide an independent and objective review of financial and other information prepared by management, in particular that to be provided to members and/or filed with regulators. The Committee meets and receives regular reports from its external auditors concerning matters that arise in connection with their audit. The Committee is also responsible for review of performance of the external auditors.

The Committee is comprised of Mr Graham Keys (Chairman) and Mr Albert Pun both of whom are non-executive Directors. Mr Graham Keys is considered independent. Details of the Directors' attendance at the Audit Committee meetings are set out in the Directors' Report.

The Audit Committee provides recommendations to the Board in relation to the initial appointment of the external auditor and the appointment of a new external auditor should a vacancy arise. Any appointment of a new external auditor made by the Board must be ratified by shareholders at the next annual general meeting.

Proposed external auditors must be able to demonstrate complete independence from the Group and an ability to maintain independence through the engagement period. In addition, the successful candidate for external auditor must have arrangements in place for the rotation of the audit engagement partner on a regular basis. Other than these mandatory criteria, the Board may select an external auditor based on other criteria relevant to the Company such as references, cost and any other matters deemed relevant by the Board.

A formal Audit Committee Charter has been adopted, a copy of which is available on the Company's website.

The Company Secretary provides secretarial services for the audit committee, whilst the Managing Director and Finance Manager are invited to audit committee meetings in attendance only.

Corporate Governance Statement

Integrity of Financial Reporting

The Company's Managing Director and Finance Manager have provided a declaration to the Board in writing pursuant to section 295A of the Corporations Act and the ASX Listing Rules that:

- the consolidated financial statements of the Company and its controlled entities for each half and full year present a true and fair view, in all material aspects, of the Company's financial condition and operational results and are in accordance with accounting standards;
- the above statement is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and
- the Company's risk management and internal compliance and control framework is operating efficiently and effectively in all material respects.

Risk Management

The operation of internal controls and the measurement of risk are important in the creation and preservation of shareholder value and is a high priority for the Board and management. A summary of the Company's Risk Management Policy is available on the Company's website. Responsibility for control and risk management is delegated to the appropriate level of management with the Managing Director having ultimate responsibility to the Board for the risk management and control framework. The Audit Committee assists the Board in monitoring this role.

The Company is committed to the identification, monitoring and management of risks associated with its business activities and has established various financial and operational reporting procedures and other internal control and compliance systems in this regard. These include the following:

- the Managing Director is required to report on the management of risk as a standing agenda item at each Board meeting. This involves that tabling of a Risk Register which is actively monitored and updated by management;
- delegated authority limits exist in respect of financial expenditure and other business activities;
- a comprehensive insurance programme is undertaken;
- internal controls exist to safeguard the Company's assets and ensure the integrity of business processes and reporting systems;
- annual budgeting and monthly reporting systems for business operations is undertaken which enable the monitoring of progress against performance targets and the evaluation of trends;
- appropriate due diligence procedures are undertaken for acquisitions and divestments; and
- disaster recovery procedures and crisis management systems exist.

The Company's Managing Director and the Finance Manager have provided a declaration 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. Additionally, the Managing Director and Finance Manager have stated that this declaration is based on a sound system for risk management and internal compliance and control which implements the policies adopted by the Board and the Company's risk management and internal compliance and control framework is operating efficiently and effectively in all material respects.

The Board also requires management to report to it confirming that those risks are being managed effectively. The Board has received assurance from the Managing Director that the Company's management of its material business risks are effective.

Corporate Governance Statement

Continuous Disclosure

The Company is a “disclosing entity” for the purposes of Part 1.2A of the Corporations Act. As such, the Company has an Information Policy. The purpose of this Information Policy is to set out the procedure for:

- protecting confidential information from unauthorised disclosure;
- identifying material price sensitive information and reporting it to the Managing Director and Company Secretary for review;
- ensuring the Company achieves best practice in complying with its continuous disclosure obligations under the Corporations Act and ASX Listing Rules; and
- ensuring the Company and individual officers do not contravene the Corporations Act or ASX Listing Rules.

The Company has obligations under the Corporations Act and ASX Listing Rules to keep the market fully informed of information which may have a material effect on the price or value of the Company's securities and to correct any material mistake or misinformation in the market. The Company discharges these obligations by releasing information to the ASX in the form of an ASX release or disclosure in other relevant documents, for example, the Annual Report.

The Company recognises that the maintenance of confidentiality is also of paramount importance to the Company both to protect its trade secrets and to prevent any false market for the Company's shares from developing.

All relevant information provided to ASX in compliance with the continuous disclosure requirements of the Corporations Act and ASX Listing Rules is promptly posted on the Company's web site.

A summary of the Information Policy is available on the Company's website.

Communication to Shareholders

The Company has a Shareholder Communications Policy that promotes effective communication with shareholders and encourages presentation of information to shareholders in a clear, concise and effective manner. The Board aims to ensure that Shareholders are informed of all major developments affecting the Company's state of affairs. Information will be communicated to Shareholders through its annual report, annual general meeting, half-yearly results and quarterly activities and cash flow announcements, ASX announcements and the Company's website.

The Company considers general meetings to be an effective means to communicate with shareholders and encourages shareholders to attend the meeting. Information included in the notice of meeting sent to shareholders is presented in a clear, concise and effective manner.

A summary of the Shareholder Communications Policy is available on the Company's website.

Code of Conduct

The Company has adopted a Code of Conduct that outlines how the Company expects its Directors and employees to behave and conduct business in the workplace on a range of issues. The Company is committed to the highest level of integrity and ethical standards in all business practices. The objective of the Code is to:

- provide a benchmark for professional behaviour;
- support the Company's business reputation and corporate image; and
- make Directors and employees aware of the consequences if they breach the code.

The Code records the Company's commitment and responsibilities with respect to various stakeholders, in particular, employees, clients, shareholders, governments and surrounding communities.

It sets out the Company's expectations of its Directors and employees with respect to a range of issues including compliance with the law, fair dealing, discrimination, financial inducements, occupational health and safety, confidentiality of information, conflicts of interest, use of Company assets and outside employment.

A breach of the code is subject to disciplinary action which may include termination of employment.

A summary of the Code of Conduct is available on the Company's website.

Corporate Governance Statement

Ethical Standards

The Board considers that the success of the Company will be enhanced by a strong ethical culture within the Group. Accordingly, the Board is committed to the highest level of integrity and ethical standards in all business practices. Employees must conduct themselves in a manner consistent with current community and corporate standards and in compliance with all legislation.

Guidelines for Dealing in Securities

The Guidelines for Dealing in Securities Policy adopted by the Board prohibits trading in shares by a Director, officer or employee during certain blackout periods (in particular, prior to release of interim or annual results) except in exceptional circumstances and subject to procedures set out in the Guidelines.

Outside of these blackout periods, a Director, officer or employee must first obtain clearance in accordance with the Guidelines before trading in shares. For example:

- a Director must receive clearance from the Chairman before he may buy or sell shares;
- if the Chairman wishes to buy or sell shares he must first obtain clearance from the Managing Director; and
- other officers and employees must receive clearance from the Managing Director before they may buy or sell shares.

Directors must advise the Company Secretary of any transactions conducted by them in securities of the Company as soon as reasonably possible after the date of the change and in any event no later than three business days after the date of the change.

Directors, officers and employees must observe their obligations under the Corporations Act not to buy or sell shares if in possession of price sensitive non-public information and that they do not communicate price sensitive non-public information to any person who is likely to buy or sell shares or communicate such information to another party.

A summary of the Guidelines for Dealing in Securities Policy is available on the Company's website.

ASX Listing Rule Disclosure – Exception Reporting

As required by ASX Listing Rules, the following table discloses the extent to which the Company has not followed the best practice recommendations set by the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (2nd Edition).

Principle No	Best Practice Recommendation	Compliance	Reasons for Non-compliance
2.1	A majority of the Board should be independent Directors.	Currently, the Company has two independent Directors and three Directors that are not considered to be independent.	The Board considers that its structure has been, and continues to be, appropriate in the context of the Company's recent history and the scope and scale of the Company's operations. Persons have been selected as Directors to bring specific skills and industry experience relevant to the Company. The Board will continue to reassess its composition on a regular basis to ensure it has the necessary skill set and decision making capabilities to best serve all shareholders.

Corporate Governance Statement

Principle No	Best Practice Recommendation	Compliance	Reasons for Non-compliance
2.4	The Board should establish a nomination committee.	The Board has not established a separate nomination committee, however, the responsibilities of a nomination committee are carried out by the full Board.	Given the present size of the Company, the whole Board acts as a nomination committee, if required. The Board believes no efficiencies or other benefits could be gained by establishing a separate Nomination Committee. However, it is noted the Board has adopted a Nomination Committee Charter. The Board will re-consider establishing a separate Nomination Committee as the Company's operations grow.
2.5	Companies should disclose the process for evaluating the performance of the Board, its committees and individual Directors.	The Company has in place informal procedures for evaluating the performance of the Board, its committees and individual Directors.	At this stage of the development of the Company, only informal procedures are in place for performance evaluation of the Board, its committees and individual Directors against qualitative indicators. During the financial year 2010 the Company undertook steps to roll out an employee survey as part of a 12 month action plan. The survey will evaluate the performance of senior executives and the Board. The completion of the employee survey is expected to be in the months following the end of financial year.
3.2	Companies should establish a policy concerning diversity including measurable objectives for achieving gender diversity.	The Board has not developed a specific diversity policy, however strictly adheres to its equal opportunity and anti-discrimination commitments in the Company's Code of Conduct.	Given the present size of the Company and the historical hiring rate, the Board believes no greater diversity or other benefits could be gained by establishing a diversity policy. The Board will re-consider establishing a diversity policy as the Company's operations and employee numbers grow. If an existing position becomes available within the Company, diversity within the organisation will be considered when reviewing candidates for the position.
4.2	The Audit Committee should consist of a majority of independent Directors, be chaired by an independent Director who is not Chair of the Board and have at least 3 members.	Currently, the Audit Committee has one independent Director and one Director who is not considered to be independent. There are only two members of the Audit Committee and the Committee is chaired by the Chairman of the Board.	The Board considers that the structure of the Audit Committee has been, and continues to be, appropriate in the context of the Company's recent history and the scope and scale of the Company's operations and given the size of the Board. The members of the Committee have specific skills and experience relevant to the efficient operation of the Committee. The Board will continue to reassess its composition of the Audit Committee on a regular basis to ensure it has the necessary skill set and experience to best serve the Board and all shareholders. It is noted the Chairman of the Committee, whilst Chair of the Board, is an independent Director that possesses skills and experience suitable for leading the Audit Committee.

Corporate Governance Statement

Principle No	Best Practice Recommendation	Compliance	Reasons for Non-compliance
8.1	The Board should establish a remuneration committee.	The Board has not established a separate remuneration committee however, the responsibilities of a remuneration committee are carried out by the full Board.	Given the present size of the Company, the whole Board acts as a remuneration committee, if required. The Board believes no efficiencies or other benefits could be gained by establishing a separate remuneration committee. All matters of remuneration are determined by the Board in accordance with Corporations Act requirements, particularly in respect of related party transactions. No director participates in any discussion or decision regarding his own remuneration or related issues. The Board has adopted a Remuneration Committee Charter and Remuneration Policy.

30 September 2010

Board of Directors
Advanced Engine Components Limited
11 Energy Street
MALAGA WA 6090

DECLARATION OF INDEPENDENCE BY PETER TOLL TO THE DIRECTORS OF ADVANCED ENGINE COMPONENTS LIMITED

As lead auditor of Advanced Engine Components Limited for the year ended 30 June 2010, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

- the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Advanced Engine Components Limited and the entities it controlled during the period.



Peter Toll
Director



BDO Audit (WA) Pty Ltd
Perth, Western Australia

Consolidated Statement of Comprehensive Income

For the Financial Year Ended 30 June 2010

	Notes	2010 \$	2009 \$
Revenue	9	1,647,506	4,826,837
Cost of sales		(1,767,932)	(3,283,492)
Gross profit / (loss)		(120,426)	1,543,345
Other income	9	260,675	810,953
Distribution expenses		(58,140)	(118,123)
Marketing expenses		(28,356)	(269,011)
Occupancy expenses		(265,805)	(300,580)
Corporate costs		(411,598)	(571,646)
Administration expenses		(1,929,629)	(1,692,723)
Development expenses		(1,019,669)	(1,440,584)
Results from operating activities		(3,572,948)	(2,038,369)
Finance costs	9	(849,852)	(802,158)
Loss before income tax benefit		(4,422,800)	(2,840,527)
Income tax benefit	10	626,904	-
Net loss attributable to the owners of Advanced Engine Components Limited		(3,795,896)	(2,840,527)
Other comprehensive income			
Foreign currency translation differences for foreign operations		17,518	(7,488)
Other comprehensive income for the year		17,518	(7,488)
Total comprehensive income for the year attributable to the owners of Advanced Engine Components Limited		(3,778,378)	(2,848,015)
Basic loss per share	11	(\$0.0235)	(\$0.0192)
Diluted loss per share	11	(\$0.0235)	(\$0.0192)

The above Consolidated Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

Consolidated Statement of Financial Position

As at 30 June 2010

	Notes	2010 \$	2009 \$
Current Assets			
Cash and cash equivalents	13	828,891	279,955
Trade and other receivables	14	1,955,560	4,199,320
Inventories	15	1,704,617	1,604,622
Total Current Assets		4,489,068	6,083,897
Non-Current Assets			
Investment accounted for using the equity method	16	40,317	40,317
Plant and equipment	17	275,300	418,926
Intangible assets	18	4,557,337	4,232,970
Total Non-Current Assets		4,872,954	4,692,213
Total Assets		9,362,022	10,776,110
Current Liabilities			
Trade and other payables	19	1,420,887	2,734,467
Borrowings	20	6,323,935	8,821,580
Provisions	21	324,613	324,254
Total Current Liabilities		8,069,435	11,880,301
Non-Current Liabilities			
Borrowings	22	3,120,082	-
Provisions	21	119,119	-
Total Non-Current Liabilities		3,239,201	-
Total Liabilities		11,308,636	11,880,301
Net Liabilities		(1,946,614)	(1,104,191)
Equity			
Contributed equity	23	21,193,635	18,366,020
Reserves	23	1,433,271	1,307,413
Accumulated losses	24	(24,573,520)	(20,777,624)
Total Equity/(Deficiency in Equity)		(1,946,614)	(1,104,191)

The above Consolidated Statement of Financial Position should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes in Equity

For the Financial Year Ended 30 June 2010

2009-10	Issued Capital	Convertible Notes	Asset Revaluation Reserve	Share Based Payments Reserve	Foreign Exchange Translation Reserve	Accumulated Losses	Total Equity/(Deficiency in Equity)
	\$	\$	\$	\$	\$	\$	\$
Opening balance as at 1 July 2009	18,208,020	158,000	750,000	494,940	62,473	(20,777,624)	(1,104,191)
Net loss for the year	-	-	-	-	-	(3,795,896)	(3,795,896)
<i>Comprehensive income for the year</i>							
Foreign currency translation differences	-	-	-	-	17,518	-	17,518
Total comprehensive income for the year	-	-	-	-	17,518	(3,795,896)	(3,778,378)
<i>Transactions with owners, recorded directly in equity</i>							
Contributions by and distributions to owners	3,004,425	(158,000)	-	-	-	-	2,846,425
Transaction costs	(18,810)	-	-	-	-	-	(18,810)
Share based payments	-	-	-	108,340	-	-	108,340
Total contributions by and distributions to owners	2,985,615	(158,000)	750,000	108,340	-	-	2,935,955
Closing balance as at 30 June 2010	21,193,635	-	750,000	603,280	79,991	(24,573,520)	(1,946,614)

2008-09	Issued Capital	Convertible Notes	Asset Revaluation Reserve	Share Based Payments Reserve	Foreign Exchange Translation Reserve	Accumulated Losses	Total Equity/(Deficiency in Equity)
	\$	\$	\$	\$	\$	\$	\$
Opening balance as at 1 July 2008	17,324,203	158,000	750,000	329,166	69,961	(17,937,097)	694,233
Net loss for the year	-	-	-	-	-	(2,840,527)	(2,840,527)
<i>Comprehensive income for the year</i>							
Foreign currency translation differences	-	-	-	-	(7,488)	-	(7,488)
Total comprehensive income for the year	-	-	-	-	(7,488)	(2,840,527)	(2,848,015)
<i>Transactions with owners, recorded directly in equity :</i>							
Contributions by and distributions to owners	944,906	-	-	-	-	-	944,906
Exercise of options	826	-	-	-	-	-	826
Transaction costs	(61,915)	-	-	-	-	-	(61,915)
Share based payments	-	-	-	165,774	-	-	165,774
Total contributions by and distributions to owners	883,817	-	-	165,774	-	-	1,049,591
Closing balance as at 30 June 2009	18,208,020	158,000	750,000	494,940	62,473	(20,777,624)	(1,104,191)

The above Consolidated Statement of Changes in Equity should be read in conjunction with the accompanying notes.

Consolidated Statement of Cash Flows

For the Financial Year Ended 30 June 2010

	Note	2010	2009
		\$	\$
Cash Flows From Operating Activities			
Receipts from customers		3,398,324	4,661,250
Payments to suppliers and employees		(4,027,766)	(6,395,269)
Interest received		5,254	3,732
Interest and other costs of finance paid		(121,730)	(651,833)
Net cash used in operating activities	13	(745,918)	(2,382,120)
Cash Flows From Investing Activities			
Payments for plant and equipment		(43,887)	(6,957)
Payment for capitalised development costs		(1,011,312)	(1,153,578)
Net cash used in investing activities		(1,055,199)	(1,160,535)
Cash Flows From Financing Activities			
Proceeds from issue of shares		1,904,425	945,732
Transaction costs associated with issue of shares		(18,810)	(61,915)
Proceeds from borrowings		1,046,703	4,272,940
Repayments of borrowings		(582,265)	(1,503,623)
Net cash from financing activities		2,350,053	3,653,134
Net increase in cash and cash equivalents		548,936	110,479
Cash and cash equivalents at beginning of year		279,955	169,476
Cash and cash equivalents at end of year	13	828,891	279,955

The above Consolidated Statement of Cash Flows should be read in conjunction with the accompanying notes.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

1. Reporting Entity

Advanced Engine Components Limited (the "Company" or "AEC") is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange. The Company's registered office is 14 Energy Street Malaga WA 6090.

The consolidated financial statements of the Company as at and for the year ended 30 June 2010 comprise the Company and its subsidiaries (together referred to as the "Group"). The nature of the operations and principal activities of the Group are described in the Directors' Report.

2. Basis of Preparation

(a) Statement of compliance

The consolidated financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Interpretations) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The financial report of the Group also complies with International Financial Reporting Standards (IFRSs) and interpretations adopted by the International Accounting Standards Board. The parent company financial report is not included in this financial report in accordance with the requirements of the Corporations Amendment (Corporate Reporting Reform) Act 2010, instead certain financial information of the parent is disclosed by way of note 6.

The consolidated financial statements were approved by the Board of Directors on 30 September 2010.

(b) Basis of measurement

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

(c) Financial statement presentation

AEC applies revised AASB 101 Presentation of Financial Statements (2007), which became effective as of 1 July 2009. As a result, AEC presents in the consolidated statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the consolidated statement of comprehensive income. This presentation has been applied in these consolidated financial statements as of and for the year ended 30 June 2010.

Comparative information has been represented so that it also is in conformity with the revised standard. Since the change in accounting policy only impacts presentation aspects, there is no impact on earnings per share.

(d) Functional and presentation currency

These consolidated financial statements are presented in Australian dollars, which is the Company's functional currency and the functional currency of the majority of the Group.

3. Critical Accounting Judgements and Key Sources of Estimation Uncertainty

In the application of the Group's accounting policies, 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 other factors that are considered to be relevant. 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. Refer to note 18 for a discussion of critical judgements in applying the entity's accounting policies, and key sources of estimation uncertainty.

4. Adoption of New and Revised Accounting Standards

In the current year, the Company has adopted all of the applicable new and revised Standards and Interpretations issued by the Australian Accounting Standards Board that are relevant to its operations and effective for the current annual reporting period. Details of the impact of the adoption of these new accounting standards are set out in the individual accounting policy notes set out below.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

4. Adoption of New and Revised Accounting Standards (continued)

AASB 8 Operating Segments

- This standard requires a management approach to be used for segment reporting and replaces the requirement to determine the primary and secondary segments. The adoption of this standard did not have any impact on the Group.

AASB 7 Financial instruments: Disclosures

- The amended standard requires additional disclosures about fair value measurement and liquidity risk. Fair value measurements related to all financial instruments recognised and measured at fair value are to be disclosed by source of inputs using a three level fair value hierarchy, by class. In addition, reconciliation between the beginning and ending balance is required for level three fair value, as well as significant transfers between levels of hierarchy of fair value.

AASB 3 Business Combinations (Revised) and AASB 127 Consolidated and Separate Financial Statements

- The standard has been applied prospectively to business combinations for which the acquisition date is on or after 1 July 2009. The standard allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests either at fair value or at the non-controlling interests share of the fair value of the identifiable net assets of the acquirer. The standard changes the recognition and subsequent accounting requirements for contingent consideration. The standard requires the acquisition-related costs be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred.

5. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities.

(a) Basis of consolidation

Subsidiaries are entities controlled by the Group. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

The financial statements of subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Intra-group balances, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

There is no non-controlling interest in any subsidiary of the Group.

(b) Investment in joint venture

Joint ventures are those entities over whose activities the consolidated entity has joint control. Joint ventures are accounted for using equity method (equity accounted investees). The consolidated financial statements include the Group's share of the income and expenses of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest (including any long-term investments) is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payment on behalf of the investee.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(c) Segment reporting

As of 1 July 2009 AEC determines and presents operating segments based on the information that internally is provided to the Board of Directors who make key operating decisions. This change in accounting policy is due to the adoption of AASB 8 Operating Segments. Previously operating segments were determined and presented in accordance with AASB 114 Segment Reporting. The new accounting policy in respect of segment operating disclosures is presented as follows.

Comparative segment information has been represented in conformity with the transitional requirement of AASB 8. Since the change in accounting policy only impacts presentation and disclosure aspects, there is no impact on earnings per share.

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of AEC's other components. An operating segment's operating results are reviewed regularly by the Board of Directors to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the Board of Directors include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets (primarily the capitalised research and development), head office expenses, and income tax assets and liabilities.

(d) Foreign currency transaction and balances

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

All exchange differences in the consolidated financial statements are taken to the consolidated statement of comprehensive income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

The functional currency of the overseas subsidiaries AEC China Holdings Limited is Hong Kong Dollar and AEC China Limited is the Chinese Yuan.

As at the reporting date the assets and liabilities of these overseas subsidiaries are translated into the presentation currency of Advanced Engine Components Limited at the rate of exchange ruling at the balance sheet date and the consolidated statement of comprehensive income are transferred at the weighted average rates for the year.

The exchange differences arising on the retranslation are taken directly to a separate component of equity.

(e) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

Sale of goods

Revenue is recognised when the significant risks and rewards of the goods have passed to the buyer and can be measured reliably and is probable future economic benefits will flow to the entity. Risks and rewards are considered passed to the buyer at the time of delivery of the goods to the customer.

Interest

Revenue is recognised as the interest accrues (using the effective interest method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(f) Income tax

Deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

- except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred tax assets and deferred tax liabilities shall be offset only if:

- (a) there is a legally enforceable right to set-off current tax assets against current tax liabilities; and
- (b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
 - (i) the same taxable entity; or
 - (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The Group has not implemented the tax consolidation legislation.

(g) Other taxes

Revenues, expenses and assets are recognised net of the amount of GST except:

- (a) Where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- (b) Receivables and payables are stated with amounts of GST included.

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

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(g) Other taxes (continued)

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

Commitments or contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

In case of AEC China Limited, revenue is recognised net of value added tax of the People Republic of China and expenses and assets are recognised inclusive of value added tax where the right to claim the credit of tax paid is yet to be established.

(h) Leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership.

Operating Leases

The minimum lease payments made under operating leases are charged against profits in equal instalments over the accounting periods covered by the lease term where the lessor effectively retains substantially all of the risks and benefits of ownership of the leased item.

The cost of improvements to or on leasehold property is capitalised, disclosed as leasehold improvements and amortised.

(i) Impairment of assets with indefinite useful life

At each reporting date, management assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, management makes a formal estimate of recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

Recoverable amount is the greater of fair value less cost to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

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.

(j) Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purposes of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(k) Investments and other financial assets

All investments are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment.

Loans and non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has a positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification.

Amortised cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity.

Investments are recognised and derecognised on trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss which are initially measured at fair value.

Subsequent to initial recognition, investments in subsidiaries are measured at cost in the company financial statements.

Other financial assets are classified into 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(k) Investments and other financial assets (continued)

Effective interest method

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 (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest rate basis for debt instruments.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method less impairment.

Interest income is recognised by applying the effective interest rate.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that as a result of one or more events that occurred after the initial recognition of the financial asset the estimated future cash flows of the investment have been impacted.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of financial assets including uncollectible trade receivables is reduced by the impairment loss through the use of an allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or it transfers the financial asset and subsequently all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

(l) Inventories

Inventories are valued at the lower of cost or net realisable value.

Costs incurred in bringing each product to its present location and conditions are accounted for as follows:

Raw Materials – purchase cost on a first in, first out basis.

Finished goods and work in progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and estimated costs necessary to make the sale.

(m) Derivative financial instruments and hedging

The Group has adopted the policy of keeping the exposure open and accordingly no foreign exchange risk exposure of the Group has been hedged.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(n) Plant and equipment

Plant and equipment and leasehold improvements are carried at cost, less accumulated depreciation and any impairment in value.

(i) Depreciation & Amortisation

Depreciation is calculated on a straight –line basis over the estimated useful life of the asset as follows:

- Plant and equipment – over 3 to 13 years
- Leasehold improvements – 10 years

The assets' residual values, useful lives and amortisation method are reviewed, and adjusted if appropriate, at each financial year end.

(ii) Impairment

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

If any such indication exists and where the carrying value exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The impairment losses are recognised in the consolidated statement of comprehensive income.

The recoverable amount of plant and equipment is the greater 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.

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated statement of comprehensive income in the year the item is derecognised.

(iii) Revaluations

Following initial recognition at cost, plant and equipment are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and any subsequent impairment losses. An independent expert valuer determined the fair value by reference to the market-based evidence, which is the amount, which the asset could be exchanged between knowledgeable parties at an arm's length transactions.

(o) Intangible assets

Research and development costs

Current expenditure on research activities, undertaken with the prospect of obtaining new scientific or technical understanding is recognised in the consolidated statement of comprehensive income as an expense when it is incurred.

Expenditure on development activities, being the application of research findings or other knowledge to a plan or design for the production of new or substantially improved products before the start of commercial production or use is capitalised if the products are technically and commercially feasible and adequate resources are available to complete development.

Expenditure on equipment used in research and development activities is capitalised in plant and equipment and depreciated over its estimated useful life.

Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight line basis over its usual life which is currently 5 years.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(p) Trade and other payables

These amounts represent liabilities for goods and services provided to the Group prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 60 days of recognition.

(q) Interest-bearing loans and borrowings

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.

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in profit or loss when the liabilities are derecognised.

Compound instruments

The component parts of compound instruments are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or upon the instruments reaching maturity. The equity component initially brought to account is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognised and included in equity, net of income tax effects and is not subsequently remeasured.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

(r) Borrowing costs

Borrowing costs are recognised as an expense when incurred, except where they are directly attributable to the acquisition or construction of qualifying assets, in which case they are capitalised as part of the cost of that asset.

(s) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(t) Employee leave benefits

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

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

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(t) Employee leave benefits (continued)

(ii) Long service leave

The liability for long service leave is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market value at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

(u) Pension and employment benefits

The Group contributes to various superannuation plans in accordance with and at rates set down by law. Some employees contribute to these plans at differing percentages of their salaries.

The Group contribution plan and costs are charged as an expense as incurred.

(v) Governments grants

Government grants are assistance by the government in the form of transfers of resources to the Group in relation to the current development programme.

Government grants are not recognised until there is reasonable assurance that the grants will be received.

Government grants are presented in the statement of financial position by deducting the grant in arriving at the carrying amount of the assets.

(w) Share-based payment transactions

The Group operates an Employee Share Option Plan (ESOP), which provides benefits to employees (including Directors) of the Group in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ("equity-settled transactions").

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. An external valuer using an option-pricing model determines the fair value.

From 1 July 2004, options granted as part of employee remuneration have been valued using an option pricing model which takes into account the factors including the option exercise price, the current level and volatility of the underlying share price, the risk-free interest rate, expected dividends on the underlying share, current market price of the underlying share, the expected life of the option, and any barriers associated with vesting.

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

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date reflects:

- (i) The extent to which the vesting period has expired, and
- (ii) The number of options that, in the opinion of the Directors of the Group, will ultimately vest. This opinion is formed based on the best available information at balance date. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

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

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

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

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

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(x) Contributed equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(y) Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing:

- the profit attributable to owners of the Company, excluding any costs of servicing equity other than ordinary shares; and
- by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year and excluding treasury shares.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per shares 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 additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

(z) New standards and interpretation not yet adopted

Certain new accounting standards have been published that are not mandatory for 30 June 2010 reporting periods. The Group has not applied any of the following in preparing this financial report:

Affected Standard	Title of Affected Standard	Nature of Change	Application Date *	Impact on Initial Application
AASB 2009-5 (issued May 2009)	Further Amendments to Australian Accounting Standards arising from the Annual Improvements Process	Not urgent, but necessary changes to AIFRS as a result of the IASB's 2008 annual improvement process.	1 January 2010	
AASB 107	Statement of Cash flows	Clarifies that only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as cash flows from investing activities.	1 January 2010	Initial adoption of this amendment will have no impact as the entity only recognises cash flows from investing activities for expenditures that result in a recognised asset in the statement of financial position.
AASB 5	Non-Current Assets Held for Sale and Discontinued Operations	Clarifies that disclosures required for non-current assets classified as held for sale are limited to those required by AASB 5 unless disclosures are specifically required for these assets by other AASB's.	1 January 2010	There will be no impact as these requirements are only required to be applied prospectively to disclosures for non-current assets classified as held for sale.
AASB 2009-8 (issued July 2009)	Amendments to Australian Accounting Standards-Group Cash-Settled Share based Payment transactions	Clarifies the scope and accounting for group cash-settled share-based payment transactions in the individual financial statements of an entity receiving goods/services when that entity has no obligation to settle the share-based payment transaction. Supersedes Interpretation 8 <i>Scope of AASB 2 and Interpretation 11 AASB 2 Group and Treasury Share Transactions.</i>	1 January 2010	No impact as there are no share-based payment transactions where the entity receives goods or services with no corresponding obligation to settle the share-based payment transaction.
AASB 2009-10	Amendments to Australian Accounting Standards-Classification of Rights Issues [AASB 132]	Clarifies that such transaction where an issue of rights or options to a fixed number of shares for a fixed amount in a different currency to the functional currency must be treated as equity.	1 February 2010	There will be no impact as the entity does not issue rights or options to a fixed numbers of shares for a fixed amount in a different currency to the functional currency.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

5. Significant Accounting Policies (continued)

(z) New standards and interpretation not yet adopted (continued)

Affected Standard	Title of Affected Standard	Nature of Change	Application Date *	Impact on Initial Application
AASB 9 (issued December 2009)	Financial Instruments	Amends the requirements for classification and measurement of financial assets.	1 January 2013	Due to the recent release of these amendments and that adoption is only mandatory for the 30 June 2014 year end, the entity has not yet made an assessment of the impact of these amendments.
AASB 124 (issued December 2009)	Related Party Disclosures	Clarifies the definition of a related party.	1 January 2011	As this a disclosure standard only, there will be no impact on amounts recognised in the financial statements.
AASB Interpretation 19 (issued December 2009)	Extinguishing Financial Liabilities with Equity Instruments	Equity instruments issued to a creditor to extinguish all or part of a financial liability are 'consideration paid' to be recognised at the fair value of the equity instruments issued, unless their fair value cannot be measured reliably, in which case they are measured at the fair value of the debt extinguished. Any difference between the carrying amount of the financial liability extinguished and the 'consideration paid' is recognised in profit or loss.	1 July 2010	The interpretation is applied retrospectively from the beginning of the earliest period presented (1 July 2009). It is not expected to have any impact on the group.
IFRS 7	Financial Instruments Disclosures	Deletes various disclosures relating to credit risk, renegotiated loans and receivables and the fair value of collateral held.	1 January 2011	There will be no impact on initial adoption to amounts recognised in the financial statement as the amendments result in fewer disclosures.

* - periods commencing on or after this date

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

6. Parent Entity Information

The following detailed information related to the parent entity, Advanced Engine Components Limited, at 30 June 2010. The information presented here has been prepared using consistent accounting policies as presented in note 5.

	2010	2009
	\$	\$
Current assets	5,161,514	5,504,402
Non-current assets	4,888,987	4,703,384
Total assets	10,050,501	10,207,786
Current liabilities	7,729,788	11,592,103
Non-current liabilities	3,358,962	-
Total liabilities	11,088,750	11,592,103
Contributed equity	21,193,635	18,366,020
Accumulated losses	(23,585,164)	(20,995,277)
Reserves	1,353,280	1,244,940
Total equity	(1,038,249)	(1,384,317)
Loss for the year	(2,589,902)	(2,895,715)
Other comprehensive income for the year	-	-
Total comprehensive income for the year	(2,589,902)	(2,895,715)

The Company has no guarantee and contingent liability as at 30 June 2010.

Included in commitments in note 25 are commitments incurred by the parent entity relating to the lease agreement for an amount of \$352,680 (2009: \$467,052).

7. Going Concern

The consolidated entity incurred a loss after income tax from continuing operations for the year of \$3,795,896 (2009: \$2,840,527). At 30 June 2010 the consolidated entity had cash assets of \$828,891 (30 June 2009: \$279,955), negative working capital of \$3,580,367 (30 June 2009: negative \$5,796,404) and liabilities exceeded total assets by \$1,946,614 (30 June 2009: \$1,104,191).

The Directors are confident with sales to India commencing in July 2010, commercial release of the fifth generation ECU, current negotiations, existing key relationships and the co-operation agreement with Norinco that sales, cash flow and overall financial position will improve in the 2011 financial year. However, timing delays in receiving future sales orders or in collecting sales receivables owing, unforeseen costs or need to repay debt, may require additional cash input from future debt or equity raisings.

The consolidated entity has interest bearing liabilities of \$4,435,284 (current) and \$3,120,082 (non-current) owing to 698. In addition, \$375,000 of the Syndicate Loan, shown as a secured current borrowing, is owed to 698 with the balance of this loan owed to other related parties. 698 is a related party of the Company's major 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. The financial support, of 698 and 698 Capital International Limited, is subject to 698 Capital International Limited remaining the major shareholder of the Company holding not less than 35% of the ordinary issued shares in the Company.

Based on 698 Capital International Limited's support and the expectation of increased sales revenue over the next twelve months, the Directors consider it appropriate that the financial report be prepared on a going concern basis.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

8. Segment Information

Management has determined the operating segments based on the reports reviewed by the Board in making strategic decisions. The Board considers the business from a geographic and product perspective. There are two key geographic segments, Australia and China, which produce, procure and sell AEC products to their own and other geographic regions. AEC Australia supplies product to Australia, China, France and India. AEC China Ltd supplies product to China, Australia and South East Asia. AEC has four product segments. Namely, sale of spares and services, sale of NGVS kits and components, sale of completed engines purchased from original equipment manufacturers incorporating AEC NGVS and research and development of new products. The Australian segment is responsible for research and development.

The Board considers the performance of the two key geographic segments in making strategic decisions. All geographic segments for the three product segments, other than research and development, are considered both jointly and separately for revenue and direct costs as there is considerable integration of all segments. Research and development does not have revenue of its own as it contributes and assists all segments.

In the strategic decision making process, assets and liabilities are only considered by the two key geographical segments.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

8. Segment Information (continued)

(a) Segment information provided to the Board

The segment information provided to the Board for the reportable segments for the 12 months ended 30 June 2010 was as follows:

Reporting segments	Australia	China	Total
	\$	\$	\$
Revenue			
Total segment revenue	790,116	953,324	1,743,440
Inter-segment revenue	(59,612)	(36,322)	(95,934)
Revenue from external customers	730,504	917,002	1,647,506
Adjusted EBITDA	(919,697)	(1,361,008)	(2,280,705)
Depreciation	(181,332)	(6,180)	(187,512)
Investments accounted for using the equity method	40,317	-	40,317
Additions to non-current assets	1,054,818	-	1,054,818
Total segment assets	9,284,501	1,670,499	10,955,000
Total segment liabilities	(1,644,734)	(3,799,744)	(5,444,478)

The segment information provided to the Board for the reportable segments for the 12 months ended 30 June 2009 was as follows:

Reporting segments	Australia	China	Total
	\$	\$	\$
Revenue			
Total segment revenue	3,499,630	3,259,498	6,759,128
Inter-segment revenue	(1,866,695)	(65,596)	(1,932,291)
Revenue from external customers	1,632,935	3,193,902	4,826,837
Adjusted EBITDA	(2,552,959)	360,539	(2,192,420)
Depreciation	(185,219)	(6,499)	(191,718)
Investments accounted for using the equity method	40,317	-	40,317
Additions to non-current assets	1,149,977	10,558	1,160,535
Total segment assets	9,872,332	3,391,155	13,263,487
Total segment liabilities	(2,770,507)	(3,805,322)	(6,575,829)

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

8. Segment Information (continued)

(b) Other segment information - Adjusted EBITDA

The Board assesses the performance of the operating segments on a measure of adjusted EBITDA. The measurement basis excludes other income, corporate costs, financing costs, unrealised foreign exchange movements, depreciation, amortisation and intangible asset impairment expenses. A reconciliation of adjusted EBITDA to operating profit before income tax is provided as follows:

	2010	2009
	\$	\$
Adjusted EBITDA	(2,280,705)	(2,192,420)
Other income	260,675	810,953
Corporate costs	(411,598)	(571,646)
Finance costs	(849,852)	(802,158)
Unrealised foreign exchange movements	(279,073)	497,803
Depreciation	(187,132)	(191,718)
Amortisation	(310,906)	(340,541)
Impairment expenses	(364,209)	(50,800)
Loss before income tax	(4,422,800)	(2,840,527)

(i) Segment revenue

	2010	2009
	\$	\$
Total segment revenue	1,647,506	4,826,837
Interest revenue – parent entity	5,608	3,373
Other revenue	255,067	807,580
Total revenue from continuing operations	1,908,181	5,637,790

Revenues of \$504,233 (2009: \$1,443,689) were derived from Iveco France SA in Australia as external customers sale of spare parts.

(ii) Segment assets

The amounts provided to the Board with respect to total assets are measured in a manner consistent with that of the financial statements. These assets are allocated based on the operations of the segment and the physical location of the asset.

Reportable segments' assets are reconciled to total assets as follows:

	2010	2009
	\$	\$
Segment assets	10,955,000	13,263,487
Intersegment eliminations	(2,462,186)	(2,807,649)
Unallocated:		
Cash and cash equivalents	828,891	279,955
Investments accounted for using the equity method	40,317	40,317
Total assets as per the consolidated statement of financial position	9,362,022	10,776,110

The total of non-current assets located in Australia is \$4,859,602 (2009: \$4,673,997), and the total of these non-current assets located in other countries is \$13,352 (2009: \$18,216). Segment assets are allocated to countries based on where the assets are located.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

8. Segment Information (continued)

(b) Other segment information - *Adjusted EBITDA* (continued)

(iii) Segment liabilities

The amounts provided to the Board with respect to total liabilities are measured in a manner consistent with that of the financial statements. These liabilities are allocated based on the operations of the segment.

The Group's borrowings are not considered to be segment liabilities but rather managed by the treasury function.

	2010	2009
	\$	\$
Segment liabilities	(5,444,478)	(6,575,829)
Intersegment eliminations	3,579,859	3,517,108
Unallocated:		
Current borrowings	(6,323,935)	(8,821,580)
Non-current borrowings	(3,120,082)	-
Total liabilities as per the consolidated statement of financial position	(11,308,636)	(11,880,301)

9. Revenue and Expenses

	2010	2009
	\$	\$
(a) Revenue from continuing operations		
Sales revenue:		
Sales of goods	1,647,506	4,826,837
Total sales revenue	1,647,506	4,826,837
(b) Other income		
Interest revenue	5,649	3,732
Foreign exchange gain	42,830	589,556
Government grant	140,193	215,811
Other income	72,003	1,854
Total other revenue	260,675	810,953
Total revenue and other income	1,908,181	5,637,790
(c) Cost of inventories		
Included in cost of sales:		
Cost of inventories	1,179,399	2,563,079
(d) Employee benefits expense		
Wages and salaries	1,975,903	2,335,511
Superannuation expenses	147,811	143,936
Annual leave	114,486	124,811
Long service leave	139,900	59,926
Share based payments expenses	-	1,976
Total	2,378,100	2,666,160

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

9. Revenue and Expenses (continued)

	2010	2009
	\$	\$
(e) Finance costs		
Interest:		
Director related entities-		
698 Capital Asia Pacific Limited	672,808	348,089
Norvest Corporate Pty Ltd	1,001	8,436
Seibu Pty Ltd	47,250	11,780
Jildane Pty Ltd	4,500	1,122
Other financial loans	124,293	432,731
	<u>849,852</u>	<u>802,158</u>

The above finance costs included share based payments in lieu of changes in the base interest rate (refer to note 26(b) for details).

(f) Lease payments

Operating lease rental expenses		
Minimum lease payments	<u>172,455</u>	<u>222,789</u>

(g) Other disclosure items in respect of the loss before income tax benefit

Depreciation of plant and equipment	86,216	172,500
Amortisation of leasehold improvements	101,296	19,218
Amortisation of intangible assets	310,906	340,541
Foreign exchange net loss	279,073	-
<i>Net transfer to / (from) provisions:</i>		
Provision for warranties	2,388	28,853
Employee entitlements	175,714	262,942
Provision for doubtful debts written back	-	(12,000)
Impairment of intangible assets	364,209	50,800
Inventory written off	584,628	-
Bad debts written off	656,064	-
Insurance recovery for bad debts written off	<u>(465,000)</u>	<u>-</u>

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

10. Taxation

	2010	2009
	\$	\$
The reconciliation between tax expense and the product of accounting loss before tax multiplied by the Group's applicable income tax rate is as follows:		
Loss before income tax	(4,422,800)	(2,840,527)
Income tax benefit @ 30%	(1,326,840)	(852,158)
Tax effect of amounts which are not deductible in calculating taxable income:		
Research and development allowance	626,904	-
Share based payments	29,016	67,012
Sundry items not deductible	181,159	19,349
Temporary differences not recognised	(93,769)	(28,378)
Deferred tax assets relating to tax losses not recognised	1,171,227	782,491
Adjustment due to the difference of tax rates between China and Australia	39,207	11,684
Total income tax benefit	626,904	-
The franking account balance at year end was \$Nil (2009: \$Nil)		
Deferred tax assets and liabilities not recognised relate to the following:		
Deferred tax assets:		
Tax losses	9,895,958	10,236,476
Other temporary differences	391,158	679,032
	10,287,116	10,915,508
Deferred tax liabilities	(1,384,595)	(1,294,489)
Net deferred tax assets	8,902,521	9,621,019

The deferred tax assets arising from these balances have not been recognised as an asset because non-recovery of tax losses is not probable at this point in time.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

11. Loss Per Share

	<u>2010</u>	<u>2009</u>
	\$	\$
Net loss attributable to ordinary equity holders of Advanced Components Engine Limited	(3,795,896)	(2,840,527)
Weighted average number of ordinary shares for basic loss per share	161,802,414	148,139,591
Weighted average number of ordinary shares adjusted for the effect of dilution	161,802,414	-
Loss per share		
- Basic loss per share	(\$0.0235)	(\$0.0192)
- Diluted loss per share	(\$0.0235)	(\$0.0192)

12. Remuneration of Auditors

	<u>2010</u>	<u>2009</u>
	\$	\$
Auditors of the Group - BDO Audit (WA) Pty Ltd: audit and review of the financial report		
- Current year	36,447	51,966
Auditors of subsidiary – BDO China		
- Current year	6,860	15,984
	<u>43,307</u>	<u>67,950</u>

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

13. Cash and Cash Equivalents

	2010	2009
	\$	\$
For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise the following at 30 June		
Cash at bank and in hand	828,891	279,955
(a) Reconciliation to cash at the end of the year		
Balance as above	828,891	279,955
Bank overdraft	-	-
Balance per consolidated statement of cash flows	828,891	279,955
Note: Including in the cash and cash equivalents, \$318,000 is restricted and the amount is at call and can be drawn down at any time.		
(b) Reconciliation of loss after income tax to net cash flows used in operations		
Loss after income tax	(3,795,896)	(2,840,527)
Government grant received and offset against capitalised development costs	11,830	116,140
Add non-cash items:		
Depreciation and amortisation of non-current assets	498,418	532,259
Impairment	364,209	50,800
Provision for doubtful debt written back	-	(12,000)
Costs of share based payment	108,340	165,774
Unrealised foreign exchange loss	17,518	(11,751)
Net cash used in operating activities before changes in net assets and liabilities	(2,795,581)	(1,999,305)
Changes in net assets and liabilities:		
(Increase)/decrease in assets:		
Current trade and other receivables	2,243,760	(1,114,871)
Current inventories	(99,995)	(105,365)
Increase/(decrease) in liabilities:		
Current trade and other payables	(213,580)	770,169
Current and non-current provisions	119,478	67,252
Net cash used in operating activities	(745,918)	(2,382,120)

Non-cash financing and investing activities

During the year ended 30 June 2010 there were the following non-cash financing and investing transactions:

- (i) Insurance premiums with a fair value of \$186,726 (2009: \$134,922) were financed.
- (ii) The Company's 1 for 3 rights issue closed on 30 April 2010. \$1,804,000 was raised including \$1,100,000 subscribed by 698 Capital International Ltd by offset against accrued interest on the convertible notes which expired on 31 December 2009.
- (iii) 698 Capital Asia Pacific Ltd's ("698") \$750,000 short term loan and \$3,000,000 sales financing facility, together with all outstanding interest, were consolidated as one loan repayable at call. The additional \$3,000,000 due to 698 under the convertible notes that expired on 31 December 2009 was restructured as a non-current loan and extended to 31 December 2011.

Refer to note 28 for more information on the risk exposure.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

14. Trade and Other Receivables

	2010	2009
	\$	\$
Trade receivables (i)	785,392	3,218,630
Provision for doubtful debts	(15,793)	(172,728)
	769,599	3,045,902
Loan to Monika AEC Limited (ii)	915,558	1,010,393
Other receivables:		
Prepayments	197,452	143,025
Deposits and GST receivable	72,951	-
	<u>1,955,560</u>	<u>4,199,320</u>
Non-hedging foreign currency receivable above (iii)	<u>712,454</u>	<u>3,137,519</u>

- (i) Trade receivables are non-interest bearing and are generally on 30 to 90 day terms. An allowance for doubtful debts is made when there is objective evidence that a trade receivable is impaired.
- (ii) The Company facilitated a US\$700,000 (AUD1,010,393) loan from an unrelated company, CCM Global Limited, to the Thailand joint venture company, Monika AEC Limited for the year ended 30 June 2009. The loan was delivered directly to Monika AEC Limited and did not involve cash flow through the Company. The Company has recorded an asset and a liability of US\$700,000 (AUD1,010,393) in the consolidated accounts for the year ended 30 June 2009. Monika AEC Limited repaid USD85,000 (AUD94,835) during the year ended 30 June 2010. For facilitating the loan the Company is entitled to a margin on interest payable. The loan is unsecured.
- (iii) Non hedging foreign currency receivable represents the net receivable from foreign customers (refer note 14(e)).
- (iv) The average credit period on sales of goods is 90 days with no credit period applied to sales of spare parts. No interest is charged on the trade receivables. The normal credit term applied to established customers is 60 days and new customers are required to pay 30% deposit in advance before the delivery of goods and 70% remaining upon delivery of goods. The Group has not provided for all receivables over 120 days because historical experience is such that receivables that are past due beyond 120 days are still recoverable. Trade receivables are provided for based on estimated irrecoverable amounts from the sale of goods, determined by reference to past default experience.

Of the trade receivables balance at the end of the year, \$499,250 due from Norinco Equipment Co. Ltd and Aussen Engine (Dalian) Co Ltd which comprises 64% of the Groups trade receivables. There are no other customers who represent more than 5% of the total balance of trade receivables.

Receivables owing by Weifang Weichai Peterson Gas Engine Co. Ltd was recovered by returned kits and insurance claims received. The outstanding as at 30 June 2010 is \$Nil.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

14. Trade and Other Receivables (continued)

(a) Ageing of trade receivables past due but not impaired

	2010	2009
	\$	\$
60 – 90 days	12,304	4,092
90 – 120 days	97,842	15,826
3 months – 6 months	6,225	1,249
6 months +	499,250	2,078,232
Total	615,621	2,099,399

(b) Movement in the allowance for doubtful debts

	2010	2009
	\$	\$
Balance at the beginning of the year	(172,728)	(184,728)
Amount written off during the year	156,935	-
Amount recovered during the year	-	12,000
Balance at the end of the year	(15,793)	(172,728)

In determining the recoverability of a trade receivable, the Group considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and unrelated. Accordingly, the Directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

(c) Ageing of impaired trade receivables

As at 30 June 2010, \$15,793 (2009: \$172,728) of trade receivables for the Group were impaired. The amount of the provision was \$15,793 (2009: \$172,728).

	2010	2009
	\$	\$
60 – 90 days	-	-
90 – 120 days	-	-
120 days +	15,793	172,728
Total	15,793	172,728

(d) Fair value and credit risk

Due to the short-term nature of these receivables, their carrying amount is assumed to approximate their fair value.

The maximum exposure to credit risk at the reporting date is the carrying amount of each class of receivables mentioned above. Refer to note 28 for more information on the risk management policy of the Group and the credit quality of the Group's trade receivables.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

14. Trade and Other Receivables (continued)

(e) Foreign currency of trade receivables

	2010	2009
	\$	\$
RMB	567,144	2,632,992
EURO	145,310	504,527
Total	712,454	3,137,519

15. Inventories

	2010	2009
	\$	\$
Raw materials – at cost	372,209	453,066
Work in progress – at cost	197,792	202,590
Finished goods – at cost	1,134,616	948,966
Total Inventories at the lower of cost and net realisable value	1,704,617	1,604,622

Inventories recognised as an expense during the year ended 30 June 2010 amounted to \$1,179,398 (2009: \$2,563,079) which includes inventories of \$584,628 (2009: \$Nil) written off during the year ended 30 June 2010.

16. Investments Accounted for Using the Equity Method (Non-Current)

The Company has entered into a joint venture arrangement in Thailand to build new natural gas (“NG”) powered vehicles and re-power existing diesel vehicles with NG engines. The Company is partners in joint venture with Monika Motors Limited (63%) and a Thai based individual with wide experience in Thailand’s public transport and government (11%). The Company’s shareholding is 26% as at 30 June 2010.

	2010	2009
	\$	\$
Investment in jointly controlled entity	40,317	40,317

	2010	2009
	\$	\$
Balance as at 1 July	40,317	40,317
Addition	-	-
Share of loss	-	-
Balance as at 30 June	40,317	40,317

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

16. Investments Accounted for Using the Equity Method (Non-Current) (continued)

The interest in the joint venture is accounted for in the consolidated financial statement using the equity method of accounting and is carried at cost by the Company. The Group has not recognised the loss relating to Monika AEC Limited for the year ended 30 June 2010 based on an evaluation of risks and rewards. Information relating to the joint venture for the year ended 30 June 2010 not adjusted for the percentage ownership holding by the Group is set out below.

	<u>2010</u>	<u>2009</u>
	\$	\$
Share of joint venture's assets and liabilities		
Current assets	1,224,308	607,168
Non-current assets	<u>32,210</u>	<u>28,421</u>
Total assets	<u>1,256,518</u>	<u>635,589</u>
 Current liabilities	 <u>861,864</u>	 <u>472,526</u>
Total liabilities	<u>861,864</u>	<u>472,526</u>
 Net assets	 <u>394,654</u>	 <u>163,063</u>
 Share of revenue, expenses and results		
Revenue	299,430	1,387,137
Expenses	<u>(483,669)</u>	<u>(1,348,000)</u>
Profit/(loss) before income tax	<u>(184,239)</u>	<u>39,137</u>

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

17. Plant and Equipment

	Plant and Equipment	Leasehold Equipment	Capital WIP	Total
	\$	\$	\$	\$
Year ended 30 June 2009				
Opening net book amount	282,839	139,032	177,553	599,424
Additions	4,638	-	2,319	6,957
Depreciation charge	(172,500)	(19,218)	-	(191,718)
Exchange difference	4,263	-	-	4,263
Closing net book amount	119,240	119,814	179,872	418,926
At 30 June 2009				
Cost or deemed cost	2,445,399	233,503	179,872	2,858,774
Accumulated depreciation	(2,330,422)	(113,689)	-	(2,444,111)
Exchange difference	4,263	-	-	4,263
Net book amount	119,240	119,814	179,872	418,926
Year ended 30 June 2010				
Opening net book amount	119,240	119,814	179,872	418,926
Additions	17,797	-	25,709	43,506
Transfer from Capital WIP	-	77,946	(77,946)	-
Depreciation charge	(86,216)	(101,296)	-	(187,512)
Exchange difference	380	-	-	380
Closing net book amount	51,201	96,464	127,635	275,300
At 30 June 2010				
Cost or deemed cost	2,463,196	311,449	127,635	2,902,280
Accumulated depreciation	(2,416,638)	(214,985)	-	(2,631,623)
Exchange difference	4,643	-	-	4,643
Net book amount	51,201	96,464	127,635	275,300

- (i) Plant and equipment are subject to a first charge to secured loan from 698 Capital Asia Pacific Limited.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

18. Intangible Assets

	Development Costs
	\$
At 1 July 2008	3,586,873
Additions – internal development (i)	1,153,578
Government grant received	(116,140)
Amortisation charge	(340,541)
Impairment	(50,800)
Net of accumulated amortisation at 30 June 2009	4,232,970
Additions – internal development (i)	1,011,312
Government grant received	(11,830)
Amortisation charge	(310,906)
Impairment	(364,209)
Net of accumulated amortisation at 30 June 2010	4,557,337

Development costs have been capitalised at cost. This intangible asset has been assessed as having a finite life of five years and amortised using a straight-line method over the period from commencement of commercial sales.

- (i) During the year total development costs incurred were \$2,030,981 (2009: \$2,594,162). Of this \$1,019,669 (2009: \$1,440,584) was expensed, whilst \$1,011,312 (2009: \$1,153,578) was capitalised. The carrying amount of unamortised development costs was \$4,058,188 (2009: \$3,326,233).

Impairment assessment

In accordance with AASB 136 Impairment of Assets, AEC assesses at each reporting date whether there is an indication that an asset may be impaired. An asset is impaired if its carrying amount exceeds its recoverable amount which is the amount to be recovered through use or sale of the asset. The recoverable amount of AEC's various cash generating units (CGU's) have been determined based on value-in-use calculations of these units.

An impairment charge of \$364,209 (2009: \$50,800) has been recorded during year ended 30 June 2010.

(a) Key assumptions used for value-in-use calculations

Value-in-use calculations use cash flow projections based on financial budgets approved by management covering a 5 year period to determine a unit's recoverable amount that is then compared with the carrying value of the assets of that unit.

In calculating the value-in-use for each CGU, the following key assumptions were used:

- a pre-discount rate of 11.48% is applied, which represents the Group's average cost of debt (2009: 12.45%)
- gross margin 26% (2009: 25%)
- growth rate 10% (2009: 30%)

The change in pre-discount rate from 12.45% to 11.48% was because of the decrease in average lending rate for the Group's borrowings. The change in gross margin from 25% to 26% was because there was lower margin for certain products and the change in growth rate from 30% to 10% reflects the current economic situation.

Based on current contract negotiations the Directors expect to meet the forecast sales growth and growth margins, as indicated above.

(b) Impact of possible changes in key assumptions

As indicated above, the impairment testing process utilised a range of key assumptions. Recoverability of the amounts capitalised as development costs are dependent upon AEC being able to achieve the key assumptions as stated above.

Given the volatility of the current economic climate, it is possible that market conditions could occur that fall outside the range of sensitivity analysis conducted, the impact of which will continue to be monitored. The impact on changes of key assumptions would increase the impairment to \$2.1 million for the next 5 years. Change in pre-discount rate from 12.45% to 11.48% was because of the decrease in average lending rate for the Group's borrowings. Change in gross margin from 25% to 26% was because there was lower margin for certain products and changes in growth rate from 30% to 10% reflect the current economic situation.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

19. Trade and Other Payables

	2010	2009
	\$	\$
Trade payables (i)	523,379	635,541
Other payables (ii)	747,846	1,731,794
GST payables	-	91,212
Non-hedging foreign currency payable (iii)	149,662	275,920
	<u>1,420,887</u>	<u>2,734,467</u>

- (i) Trade payables are non-interest bearing and are predominantly settled on 60-day terms.
- (ii) Other payables includes \$Nil (2009: \$962,531) of accrued interest owing on the convertible notes held by 698 Capital Asia Pacific Limited (refer note 22) a related party.
- (iii) Information regarding effective interest rate and credit risk of current payables is set out in note 28.

(a) Foreign currency of trade payables

	2010	2009
	\$	\$
RMB	98,266	38,033
USD	49,159	206,008
EURO	2,237	31,006
THB	-	873
Total	<u>149,662</u>	<u>275,920</u>

(b) Amount not expected to be settled within the next 12 months

Other payables include accruals for annual leave. The entire obligation is presented as current, since the Group does not have an unconditional right to defer settlement. However, based on past experience, the Group does not expect all employees to take the full amount of accrued leave within the next 12 months. The following amounts reflect leave that is not expected to be taken within the next 12 months.

	2010	2009
	\$	\$
Annual leave obligation expected to be settled after 12 months	<u>140,612</u>	<u>131,246</u>

Refer to note 28 for the risk exposure.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

20. Borrowings (Current Liabilities)

	2010	2009
	\$	\$
Unsecured		
Insurance premiums finance (i)	149,381	134,922
Loan from 698 Capital Asia Pacific Ltd (ii)	-	869,589
Loan from Norvest Corporate Pty Ltd (iv)	-	46,361
Loan from CCM Global Limited (v)	1,010,393	1,010,393
Secured		
Loan from 698 Capital Asia Pacific Ltd (vi)	4,435,284	2,994,476
Loan from Syndicate (iii)	728,877	759,247
Convertible Note held by 698 Capital Asia Pacific Ltd (vii)	-	2,975,451
Commercial loan from Westpac (viii)	-	31,141
	6,323,935	8,821,580

(i) Terms are 3.95% (2009: 3.51%) interest per annum on borrowed amount repayable over 10 months to February 2011.

(ii) Terms are 9% interest per annum payable quarterly in arrears. The principal and accrued interest as at 31 January 2010 were consolidated into 698's secured loan per note (vi) below.

(iii) Terms are 15% interest per annum and \$30,000 of the principal was repaid on 12 April 2010. The remaining principal of \$720,000 is repayable on demand. Secured by a fixed charge over the Irisbus Contract with the Company by Deed of Charge dated 9 March 2009. The Syndicate consists of parties related to the Directors of AEC.

(iv) Terms are 15% interest per annum and the principal was fully repaid during the year ended 30 June 2010.

(v) The Company facilitated a US\$700,000 (AUD1,010,393) loan from an unrelated company, CCM Global Limited, to the Thailand joint venture company, Monika AEC Limited. The loan was delivered directly to Monika AEC Limited and did not involve cash flow through the Company. The Company has recorded an asset and a liability of US\$700,000 (AUD1,010,393) in the consolidated accounts for the year ended 30 June 2009. Monika AEC Limited repaid USD85,000 (AUD94,835) during the year ended 30 June 2010. For facilitating the loan the Company is entitled to a margin on interest payable. The amount payable to CCM Global Limited is not repayable until the amount receivable from Monika AEC Limited is collected.

(vi) 698 Capital Asia Pacific Ltd's ("698") \$750,000 short term loan and \$3,000,000 sales financing facility, together with all outstanding interest, were consolidated as one loan repayable at call. Terms are 11.68% interest per annum payable quarterly in arrears. Secured by a fixed charge over the accounts receivable and inventory of the Group excluding those associated with the Irisbus Contract.

(vii) The convertible note expired on 31 December 2009 and was restructured as a non current loan and extended to 31 December 2011 (note 22). The accrued interest on the convertible note was offset against 698's equity subscription under the rights issue. Secured by a fixed and floating charge over the assets of the Company. The lender has agreed to allow the Syndicate prior charge over the Irisbus Contract and Westpac Bank prior charge over certain plant & equipment.

(viii) Terms are 8.5% interest per annum repayable along with principal over 48 months for the year ended 30 June 2009 and was fully repaid during the year ended 30 June 2010. Secured by a fixed charge over certain plant & equipment.

(ix) Total facilities

Insurance premium finance loan	186,827	168,753
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Notes to the Financial Statements for the Financial Year Ended 30 June 2010

20. Borrowings (Current Liabilities) (continued)

	2010	2009
	\$	\$
Assets pledged as security		
<i>The carrying amounts of assets pledged as security are:</i>		
Fixed & floating charge over assets		
- Current assets	3,660,177	5,803,942
- Plant and equipment (the Company)	37,851	101,025
- Intangible assets	4,557,337	4,232,970

(x) Fair value disclosures

Details of the fair values of borrowings and interest rate exposure for the Group are set out in note 28.

21. Provisions

	2010			2009		
	Warranties	Long Service Leave	Total	Warranties	Long Service Leave	Total
	\$	\$	\$	\$	\$	\$
Opening balance	90,166	234,088	324,254	82,840	174,162	257,002
Arising during the year	2,388	134,563	136,951	28,853	59,926	88,779
Utilised	(6,821)	(10,652)	(17,473)	(21,527)	-	(21,527)
Closing balance	85,733	357,999	443,732	90,166	234,088	324,254
Current	85,733	238,880	324,613	90,166	234,088	324,254
Non current	-	119,119	119,119	-	-	-

(a) Warranties

A provision is recognised for expected warranty claims on products sold during the year based on past experience of the level of repairs and returns. Assumptions used to calculate the provision for warranties were based on current sales levels and current information available about returns based on the warranty period for all products sold.

(b) Amounts not expecting to be settled within 12 months

The current provision for long service leave includes all entitlements where employees have completed 7 years services. The non-current provision for long service leave includes all entitlements where employees have not completed 7 years services. However, based on past experience, the Group does not expect all employees to take the full amount of accrued long service leave or require payment within the next 12 months. The following amounts reflect leave that is not expected to be taken or paid within the next 12 months.

	2010	2009
	\$	\$
Long service leave obligation expected to be settled after 12 months	119,119	-

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

22. Borrowings (Non-current Liabilities)

	2010	2009
	\$	\$
Secured		
Loan from 698 Capital Asia Pacific Ltd (i)	3,120,082	-
	3,120,082	-

- (i) The \$3,000,000 due under the convertible note that expired on 31 December 2009 (note 20(vii)) was restructured as a non current loan and extended to 31 December 2011. Terms are 9.74% interest per annum payable quarterly in arrears. Secured by a fixed and floating charge over the assets of the Company. The lender has agreed to allow the Syndicate prior charge over the Irisbus Contract.

Details of the fair values of borrowings and interest rate exposure for the Group are set out in note 28.

23. Contributed Equity and Reserves

	2010	2009
	\$	\$
(a) Share capital		
Ordinary shares	21,193,635	18,208,020

Movement in Ordinary shares on issue

	Number	\$
At 1 July 2008	143,436,019	17,324,203
Shares Issued -		
• Options exercised	6,450	826
• Pursuant to Underwriting Agreement with KGI	4,361,529	872,306
• Part settlement of creditor accounts	1,254,118	72,600
• Share issue costs		(61,915)
Balance as at 30 June 2009	149,058,116	18,208,020
Shares Issued -		
• Options exercised	479	61
• Placement	21,818,182	1,200,000
• Non-renounceable rights issue	32,806,611	1,804,364
• Share issue costs		(18,810)
Balance as at 30 June 2010	203,683,388	21,193,635

(b) Convertible notes

Balance as at 1 July	158,000	158,000
Convertible notes restructure (i)	(158,000)	-
Balance as at 30 June	-	158,000
Total contributed equity as at 30 June	21,193,635	18,366,020

- (i) 698 Capital Asia Pacific Ltd's convertible note expired on 31 December 2009 and was restructured as a non current loan and extended to 31 December 2011 (note 22).

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

23. Contributed Equity and Reserves (continued)

Ordinary shares entitle the holder to participate in dividends and the proceeds of winding up of the Company in proportion to the number of and amounts paid on the shares held.

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

(c) Options

As at 30 June 2010, the following were options over unissued ordinary shares:

- Nil (2009: 7,119,272) options exercisable at 12.8 cents per share on or before 30 November 2009.
- 1,180,000 (2009: 1,180,000) options exercisable at 18 cents per share on or before 31 December 2010.
- 5,505,000 (2009: 5,505,000) options exercisable at 20 cents per share on or before 31 December 2010.
- 2,500,000 (2009: 2,500,000) options exercisable at 6.0 cents per share on or before 30 November 2011.
- 4,250,000 (2009: 1,250,000) options exercisable at 5.5 cents per share on or before 30 November 2011.
- 2,000,000 (2009: 1,250,000) options exercisable at 5.0 cents per share on or before 30 November 2011.
- 3,220,000 (2009: 30,000) options exercisable at 4.7 cents per share on or before 30 November 2011.
- 750,000 (2009: 30,000) options exercisable at 4.4 cents per share on or before 30 November 2011.
- 750,000 (2009: Nil) options exercisable at 4.3 cents per share on or before 30 November 2011.
- 1,750,000 (2009: Nil) options exercisable at 3.6 cents per share on or before 30 November 2011.
- 1,750,000 (2009: Nil) options exercisable at 3.7 cents per share on or before 30 November 2011.
- 1,750,000 (2009: Nil) options exercisable at 7.1 cents per share on or before 30 November 2011.
- 1,750,000 (2009: Nil) options exercisable at 6.2 cents per share on or before 30 November 2011.
- 750,000 (2009: Nil) options exercisable at 5.9 cents per share on or before 30 November 2011.
- 1,000,000 (2009: Nil) options exercisable at 5.65 cents per share on or before 30 November 2011.
- 750,000 (2009: Nil) options exercisable at 5.4 cents per share on or before 30 November 2011.
- 750,000 (2009: Nil) options exercisable at 5.3 cents per share on or before 30 November 2011.

Refer to note 28 for the risk exposure.

(d) Reserves

	Asset Revaluation Reserve	Share Based Payments Reserve	Foreign Currency Translation Reserve	Total
	\$	\$	\$	\$
Reserves				
Balance as at 1 July 2008	750,000	329,166	69,961	1,149,127
Value of share based payment	-	165,774	-	165,774
Currency translation	-	-	(7,488)	(7,488)
Balance as at 30 June 2009	750,000	494,940	62,473	1,307,413
Value of share based payment	-	108,340	-	108,340
Currency translation	-	-	17,518	17,518
Balance as at 30 June 2010	750,000	603,280	79,991	1,433,271

Nature and purpose of reserves

Asset revaluation reserve

The asset revaluation reserve is used to record increases in the fair value of plant and equipment and decreases to the extent that such decreases relate to an increase on the same asset previously recognised in equity.

Share based payments reserve

This reserve is used to record the value of equity benefits to employees, Directors and consultants, as part of their remuneration, and to financiers as part of their financing package. When the options are exercised the amount recorded in the Share Based Payments Reserve relevant to those options is transferred to share capital.

Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiary.

Options

Refer note 26 for details of Employee Share Option Plan.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

24. Accumulated Losses

	2010	2009
	\$	\$
Accumulated losses at the beginning of the year	(20,777,624)	(17,937,097)
Net loss after income tax	(3,795,896)	(2,840,527)
Accumulated losses at the end of the year	(24,573,520)	(20,777,624)

25. Commitments for Expenditure

Operating leases

Leasing arrangements

	2010	2009
	\$	\$
Not later than 1 year	169,939	144,356
Later than 1 year and not later than 5 years	384,346	356,106
	554,285	500,462

The Group leases property and equipment under non-cancellable and cancellable operating leases expiring from 1 to 4 years. Leases generally provide the Group with a right of renewal at which time all terms are re-negotiated.

26. Share Based Payments

(a) Employee Share Option Plan

There were no share options granted to eligible staff during the year ended 30 June 2010 (2009: Nil). The exercise price of the Employee Share Option Plan options is equal to 110% of the weighted average sale price of shares trading on ASX calculated over a 5 business day period ending on the day prior to the date of grant.

The following table details number, weighted average exercise prices (WAEP) and movements in share options issued under the Employee Share Option Plan during the year.

	2010 Nos.	2010 WAEP	2009 Nos.	2009 WAEP
Outstanding at the beginning of the year	1,180,000	18 cents	1,620,000	18.3 cents
Cancelled during the year	(40,000)	18 cents	(440,000)	19.0 cents
Exercised during the year	-	-	-	-
Granted during the year	-	-	-	-
Outstanding at the end of the year	1,140,000	18 cents	1,180,000	18 cents
Exercisable at the end of the year	1,140,000	18 cents	1,180,000	18 cents

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

26. Share Based Payments (continued)

(a) Employee Share Option Plan (continued)

- (i) The outstanding balance as at 30 June 2010 is represented by 1,140,000 (2009: 1,180,000) options, granted on 23 November 2007, over ordinary shares with an exercise price of \$0.18 each, exercisable on or before 31 December 2010.
- (ii) The weighted average remaining contractual life for the share options outstanding as at 30 June 2010 is 6 months.
- (iii) The exercise price for 1,140,000 options outstanding at the end of the year was \$0.18.
- (iv) The fair value of the equity settled options granted under the options is estimated using Black-Scholes options pricing model taking into account the terms and conditions upon which the instruments were granted.
- (v) There is no alternative to equity settlement option.

The following table lists the inputs to the model used for the years ended 30 June 2010 and 2009:

	2010	2009
Dividend Yield (%)	-	0%
Expected volatility (%)	-	126.8%
Risk-free interest rate (%)	-	3.18%
Expected life of option (years)	-	2.0 years
Option exercise price (\$)	-	\$0.20
Spot share price at grant date (\$)	-	\$0.07

(b) Options issued for Services Rendered

During the year the following options were issued, as approved by shareholders at the 2009 Annual General Meeting or approved by shareholders at the 3 July 2009 or 11 May 2010 General Meetings:

Options issued #	Services rendered	Value \$
6,000,000(i)	In lieu of interest	2,354
3,000,000 (ii)	In lieu of interest	57,452
9,660,000(iii)	Part consideration for finance	48,534

- (i) 6,000,000 options were issued to 698 Capital International Limited (as nominee for 698 Capital Asia Pacific Limited) as consideration for a 0.75% reduction in the base interest rate of the \$670,000 extension to the financing facility. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in each of the six months preceding the date of issue. The value was calculated based on the value of the interest forgone by the lender.
- (ii) 3,000,000 options were issued to 698 Capital International Limited (as nominee for 698 Capital Asia Pacific Limited) in lieu of a 1% increase in the base interest rate of the \$3,000,000 loan. The options are exercisable on or before 30 November 2011 at an exercise price of 5.5 cents per share. The value was calculated based on the value of the interest saving to the Company.
- (iii) 9,660,000 options were issued to loan syndicate members as part consideration for extending existing loan facilities and in lieu of increasing the interest rate of 1% per month. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in the month preceding the date of issue. The value was calculated based on the value of the interest saving to the Company.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

27. Controlled Entities

Name of Entity	Country of Incorporation	Ownership Interest	
		2010 %	2009 %
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
AEC China Holdings Ltd.	British Virgin Island	100	100
AEC China Ltd.	China	100	100

28. Financial Risk Management

The Group's activities expose it to a variety of financial risks: market risk (including currency risk and interest risk), credit risk and liquidity risk. The Group uses different methods to measure different types of risk to which it is exposed. These methods include sensitivity analysis in the case of interest rate and foreign exchange, aging analysis for credit risk. Please refer to methods below for each risk.

Risk management is carried out by the Financial Department under policies approved by the Board of Directors. The Financial Department identifies and evaluates financial risks in close co-operation with the Group's operating units. The Board provides direction on overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of non-derivative financial instruments, and investment of excess liquidity.

The Group's Financial Department function provides services to the business, co-ordination of access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Group. These risks include market risk (including currency risk, fair value and interest rate risk), credit risk and liquidity risk.

The Group does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

(a) Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from year 2009.

The capital structure of the Group consists of debt, which includes the borrowings disclosed in notes 20 and 22, cash and cash equivalents disclosed in note 13, equity attributable to equity holders of the parent, comprising issued capital, reserves and accumulated losses as disclosed in notes 23 and 24. The Group operates in Australia, France, China and South East Asia, primarily through subsidiary companies and a jointly controlled entity established in the markets in which the Group trades. None of the Group's entities are subject to externally imposed capital requirements.

Operating cash flows are used to maintain and expand the Group's manufacturing and distribution assets, as well as to make the routine outflows of repayment of maturing debt and interest. The Group's policy is to borrow centrally, using a variety of borrowing facilities, to meet anticipated funding requirements.

Gearing ratio

The Directors review the capital structure on an ongoing basis. As a part of this review the Directors consider the cost of capital and the risks associated with each class of capital. A high gearing ratio is expected as the Group is in its development stage and more debts are required to fund the operation and development activities.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

28. Financial Risk Management (continued)

(a) Capital risk management (continued)

Gearing ratio (continued)

	<u>2010</u>	<u>2009</u>
	\$	\$
<u>Financial assets</u>		
Debt (i)	9,444,017	8,821,580
Cash and cash equivalents	<u>(828,891)</u>	<u>(279,955)</u>
Net debt	8,615,126	8,541,625
 Equity (ii)	 (1,946,614)	 (1,104,191)
Net debt to equity ratio	443%	774%

(i) Debt is defined as long term and short term borrowings, as detailed in notes 20 and 22.

(ii) Equity includes all capital, reserves and accumulated losses.

(b) Categories of financial instruments

	<u>2010</u>	<u>2009</u>
	\$	\$
<u>Financial assets</u>		
Loans and receivables	1,955,560	4,199,320
Cash and cash equivalents	<u>828,891</u>	<u>279,955</u>
<u>Financial liabilities</u>		
Trade and other payables	1,420,887	2,734,467
Borrowings	<u>9,444,017</u>	<u>8,821,580</u>

The carrying amount reflected above represents the Group's maximum exposure to credit risk for such loans and receivables.

(c) Market risk

(i) Foreign currency

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates as set out below and interest rates (refer note (c)(ii)).

There has been no change to the Group's exposure to market risks or the manner in which it manages and measures the risk from the previous period.

The Group undertakes certain transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters.

Part of the Group's core operations are located in China where both revenues and expenses are recorded. Foreign exchange risks arise from commercial transactions and recognised assets and liabilities denominated in a currency that is not the Group's functional currency. Foreign currency exposure is mitigated by translating in the Group's functional currency.

The Group is mainly exposed to USD and EURO. RMB exposure arises from translation of China operations in AUD.

No Group foreign currency sensitivity analysis is disclosed as foreign currency risk is not considered to have a material impact on profit / loss or equity for both years 2009 and 2010.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

28. Financial Risk Management (continued)

(c) Market risk (continued)

(ii) Interest rate risk management

The Group is not exposed to interest rate risk on borrowings as entities in the Group borrow funds at fixed interest rate only. The risk is managed by the Group by maintaining borrowings with fixed interest rates by ensuring the interest rates are below or close to the market interest rate. In addition, the Group maintains its fixed interest rate borrowings with interest rates consistent with the market interest risk in order to minimise the interest rate risk for the Group. The Group is however exposed to interest rate risk due to variable interest earned on its bank accounts.

(iii) Cash flow interest rate risk

The Group's exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section (e).

Interest rate sensitivity analysis

No Group interest rate sensitivity analysis is disclosed as interest rate risk is not considered to have a material impact on profit / loss or equity for both years 2009 and 2010.

(d) Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults. The Group only transacts with entities with established relationships and known repayment history. The Group's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties.

Trade receivables consist of a number of customers spread across diverse geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The credit risk on liquid funds is limited because the counterparties are all with established relationships and 30% deposit is required for new customers.

The carrying amount of financial assets recorded in the financial statements, net of any allowance for losses, represents the Group's maximum exposure to credit risk without taking account of the value of any collateral obtained.

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

28. Financial Risk Management (continued)

(d) Credit risk management (continued)

	2010	2009
	\$	\$
Trade receivables		
Counterparties without external credit ratings*		
Group 1	20,227	1,273
Group 2	147,531	663,400
Group 3	2,013	454,558
Total trade receivables	169,771	1,119,231
Cash at bank and short term deposits		
A-	126,989	4,045
AA	694,297	263,750
Deposits with suppliers (rating not available)	7,605	7,668
Total cash at bank	828,891	275,463

* Group 1 – new customers (less than 6 months)

Group 2 – existing customers (more than 6 months) with no defaults in the past

Group 3 – existing customers (more than 6 months) with some defaults in the past.

(e) Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors, who have built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Liquidity and interest risk tables

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

28. Financial Risk Management (continued)

(e) Liquidity risk management (continued)

2010	Weighted Average Interest Rate %	<6 months \$	>6 - 12 months \$	> 12 months \$	Total Contractual Cash Flows \$	Carrying Amount \$
Non-derivatives						
Financial liabilities						
Non-interest bearing	-	471,192	1,212,242	-	1,683,434	1,683,434
Insurance finance	3.95	112,036	37,345	-	149,381	149,381
Loan – 698 Capital	9.93	4,435,284	-	3,559,583	7,994,867	7,994,867
Loan – Syndicate	15.00	728,877	-	-	728,877	728,877
		5,747,389	1,249,587	3,559,583	10,556,559	10,556,559

2009	Weighted Average Interest Rate %	<6 months \$	>6 - 12 months \$	> 12 months \$	Total Contractual Cash Flows \$	Carrying Amount \$
Non-derivatives						
Financial liabilities						
Non-interest bearing	-	1,392,618	529,236	-	1,921,854	1,921,854
Insurance finance	3.51	3,427	131,495	-	134,922	134,922
Loan – 698 Capital	12.43	4,083,014	-	-	4,083,014	4,083,014
Loan – Syndicate	15.00	56,712	786,986	-	843,698	843,698
Convertible note	7.57	3,114,483	-	-	3,114,483	3,114,483
Loan from Norvest Corporate Pty Ltd	15.00	46,417	-	-	46,417	46,417
Commercial loan	8.50	1,066	31,536	-	32,602	32,602
		8,697,737	1,479,253	-	10,176,990	10,176,990

(f) Fair value measurements

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes.

The Group's financial assets and liabilities that are recorded on the balance sheet are carried at amounts that approximate net fair values.

Valuation approach

Net fair values of financial assets and liabilities are determined by the Group on the following basis:

Cash, cash equivalents: The carrying amount approximates fair value because of their short-term to maturity.

Receivables and payables: The carrying amount approximates fair value.

Short term borrowings: The carrying amount approximates fair value because of their short- term to maturity.

Long-term borrowings: The fair value of long-term loans receivable does not have material difference from the carrying amount as the long term borrowings are repayable within 18 months

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

29. Related Party Disclosure

Transactions and balances with Key Management Personnel

Directors

Mr Keys

Mr Keys is a Director and the major Shareholder of Norvest Corporate Pty Ltd, which provides various corporate, capital raising, accounting, management and company secretarial services to the Company at normal commercial rates. During the year Norvest Corporate Pty Ltd supplied these services to the Company to the value of \$297,812 (2009: \$286,088). As at 30 June 2010, the Company owed Norvest Corporate Pty Ltd \$342,409 (2009: \$234,733), this amount is reflected in payables and is non interest bearing.

During the year, Norvest Corporate Pty Ltd made various unsecured loans to the Company with a maximum outstanding at any point in time of \$46,361 (2009: \$300,000). At 30 June 2010 the amount outstanding was \$Nil (2009: \$46,361). Interest of 15%pa was payable on the daily outstanding balance.

In April 2009, Norvest Corporate Pty Ltd facilitated refinancing of the CIM SSF \$750,000 loan through a syndicate of investors. Mr Keys, through his private company Seibu Pty Ltd ATF G L Keys FT, provided \$315,000 of the funding. Pursuant to the terms of the refinancing, and shareholder approval granted on 3 July 2009, Seibu Pty Ltd is entitled to receive interest of 15%pa, calculated on the outstanding daily loan balance, and has been granted 4,117,000 options. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in the month preceding the date of issue. \$47,250 (2009: \$7,897) interest was paid during the year ended 30 June 2010 and \$315,000 (2009: \$315,000) was still outstanding as at 30 June 2010.

During the year Norvest Corporate Pty Ltd facilitated \$400,000 of the rights issues monies be placed on deposit at call with an associated company. The monies on deposit earned 9% pa interest. At 30 June 2010 the balance owing to AEC, inclusive of accrued interest, was \$318,621. Subsequent to year end AEC has redrawn the deposit in full to meet ongoing cash flow requirements.

Mr Middleton

Mr Middleton, through his private company Jildane Pty Ltd ATF Middleton Super Fund, provided \$30,000 of the syndicate funding to refinance the CIM SSF \$750,000 loan. Pursuant to the terms of the refinancing, and shareholder approval granted on 3 July 2009, Jildane Pty Ltd is entitled to receive interest of 15%pa, calculated on the outstanding daily loan balance, and has been granted 368,000 options. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in the month preceding the date of issue. \$4,500 (2009: \$1,122) interest was paid during the year ended 30 June 2010 and \$30,000 (2009: \$30,000) was still outstanding as at 30 June 2010.

Mr Pun

Mr Pun is a Director of AEC's major shareholder 698 Capital International Ltd and its related entity, 698 Capital Asia Pacific Limited ("698 Capital").

In August 2008, 698 Capital agreed to provide AEC with a \$2 million sales financing facility. Interest is charged at the National Australia Bank Indicator rate at the time of execution of the agreement together with a \$17,500 facility fee. As AEC shareholders agreed to the issue of 5 million options, exercisable at 20 cents on or before 31 December 2010, the interest rate was reduced by 0.75%. 698 Capital subsequently agreed to increase the sales financing facility to \$3 million in 2009. 698 Capital received a \$16,750 facility fee and 6 million options, as approved by shareholders on 25 November 2009, for increasing and extending the facility. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in each of the six months preceding the date of issue.

In February 2010, 698 Capital's \$750,000 short term loan and \$3,000,000 sales financing facility, together with all outstanding interest, were consolidated as one loan repayable at call (note 20(vi)).

During the 2010 financial year, the \$3,000,000 due to 698 Capital under the convertible note that expired on 31 December 2009 (note 20(vii)) was restructured as a non current loan and extended to 31 December 2011 (note 22). The accrued interest on the convertible note was offset against 698 Capital's equity subscription under the rights issue. The Company issued 3,000,000 options to 698 Capital, as approved by shareholders, for extending the loan and in lieu of a 1% increase in the base interest rate on the loan. The options are exercisable on or before 30 November 2011 at an exercise price of 5.5 cents per share.

698 Capital provided \$375,000 of the syndicate funding to refinance the CIM SSF \$750,000 loan. Pursuant to the terms of the refinancing, and shareholder approval granted on 3 July 2009, 698 Capital is entitled to receive interest of 15%pa, calculated on the outstanding daily loan balance, and has been granted 4,875,000 options. The options are exercisable on or before 30 November 2011 at various exercise prices calculated on the volume weighted average share price in the month preceding the date of issue.

Total interest of \$56,250 (2009: \$14,024) was paid during the year ended 30 June 2010.

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

29. Related Party Disclosure (continued)

Transactions and balances with Key Management Personnel (continued)

Other balances with related parties

The Company has certain loans with 698 Capital Asia Pacific Ltd ("698"), a company of which Mr A Pun is a Director, which are disclosed above and included in notes 20 and 22.

698 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 signature of the Directors Declaration. This support is subject to 698 Capital International Limited remaining the majority shareholder of the Company.

30. Key Management Personnel Disclosures

(a) Key Management Personnel Compensation

	2010	2009
	\$	\$
Short-term employee benefits	569,235	611,438
Post-employment benefits	166,740	161,547
Long-term employee benefits	6,586	34,433
Share-based payments	-	8,718
	<u>742,561</u>	<u>816,136</u>

Detailed remuneration disclosures are provided in the Remuneration Reports on pages 10 to 15.

Other than as disclosed in Related Party Disclosure (note 29) no director or executive of the Company has entered into a material contract with the Company or Group since the end of the previous financial year and no material contracts exist at year end.

(b) Equity Instruments Disclosures Relating to Key Management Personnel

(i) Options provided as remuneration and shares issued on exercise of such options

Details of options provided as remuneration and shares issued on the exercise of such options, together with terms and conditions of the options, can be found below and section (d), (e) and (f) of the remuneration report.

(ii) Option holdings

Details of options held directly, indirectly or beneficially by Directors and key management personnel including their related parties are as follows:

Parent Entity		Opening Balance	Granted as Remuneration	Options Exercised	Net Change Other	Closing Balance	Total Vested and Exercisable as at Year End	Unvested as at Year End
Directors		#	#	#	#	#	#	#
Mr. G Keys	2010	419,298	-	-	3,972,702	4,392,000	4,392,000	-
	2009	144,298	275,000	-	-	419,298	419,298	-
Mr. A Middleton	2010	540,649	-	-	227,351	768,000	768,000	-
	2009	540,649	-	-	-	540,649	540,649	-
Mr. A Pun*	2010	9,258,153	-	-	9,616,847	18,875,000	18,875,000	-
	2009	4,258,153	-	-	5,000,000	9,258,153	9,258,153	-
Mr. A Chan***	2010	-	-	-	-	-	-	-
	2009	-	-	-	-	-	-	-
Mr. V Nathan **	2010	-	-	-	-	-	-	-
	2009	-	-	-	-	-	-	-
Mr. M Gathani**	2010	-	-	-	-	-	-	-
	2009	-	-	-	-	-	-	-
Total	2010	10,218,100	-	-	13,816,900	24,035,000	24,035,000	-
	2009	4,943,100	275,000	-	5,000,000	10,218,100	10,218,100	-

* Options held by 698 Capital International Limited and related entities

** Appointed 18 February 2010

*** Resigned 24 September 2010

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

30. Key Management Personnel Disclosures (continued)

(b) Equity Instruments Disclosures Relating to Key Management Personnel (continued)

Parent Entity Key Management Personnel		Opening Balance #	Granted as Remuneration #	Options Exercised #	Net Change Other #	Closing Balance #	Total Vested and Exercisable as at Year End #	Unvested as at Year End #
Mr. B Neumann	2010	117,639	-	-	-	117,639	117,639	-
	2009	117,639	-	-	-	117,639	117,639	-
Mr. McLaren	2010	106,389	-	-	-	106,389	106,389	-
	2009	106,389	-	-	-	106,389	106,389	-
Mr. D Wang	2010	-	-	-	-	-	-	-
	2009	100,000	-	-	(100,000)	-	-	-
Mr. M McKay	2010	100,000	-	-	-	100,000	100,000	-
	2009	100,000	-	-	-	100,000	100,000	-
Total	2010	324,028	-	-	-	324,028	324,028	-
	2009	424,028	-	-	(100,000)	324,028	324,028	-

(iii) Share holdings

The number of shares in the Company held by Directors and other key management personnel of the Group, including their related parties, during the financial year were as follows:

		Opening Balance #	Received During Year on Exercise of Options #	Net Change Other #	Closing Balance #
Group Directors and Related Parties					
Mr. G Keys (i)	2010	3,700,000	-	1,233,334	4,933,334
	2009	3,401,017	-	298,983	3,700,000
Mr. A Middleton (i)	2010	3,562,947	-	1,450,317	5,013,264
	2009	3,562,947	-	-	3,562,947
Mr. A Pun (ii)	2010	250,000	-	83,334	333,334
	2009	250,000	-	-	250,000
Mr. A Chan (iv)	2010	-	-	-	-
	2009	-	-	-	-
Mr. V Nathan (iii)	2010	-	-	30,590,910	30,590,910
	2009	-	-	-	-
Mr. M Gathani (iii)	2010	-	-	-	-
	2009	-	-	-	-
Other Key Management Personnel					
Mr. B Neumann	2010	644,778	-	15,556	660,334
	2009	644,778	-	-	644,778
Mr. N McLaren	2010	127,778	-	-	127,778
	2009	127,778	-	-	127,778
Mr. M McKay	2010	110,000	-	-	110,000
	2009	110,000	-	-	110,000
Mr. D Wang	2010	-	-	-	-
	2009	-	-	-	-
Total	2010	8,395,503	-	33,373,451	41,768,954
	2009	8,096,520	-	298,983	8,395,503

Notes to the Financial Statements for the Financial Year Ended 30 June 2010

30. Key Management Personnel Disclosures (continued)

(b) Equity Instruments Disclosures Relating to Key Management Personnel (continued)

- (i) These shares are held nominally.
- (ii) Mr. A Pun is a director of 698 Capital International Limited which owns 84,423,731 shares in the Company (2009: 64,423,731).
- (iii) Mr. Nathan and Mr. Gathani were appointed directors of the Company on 18 February 2010.
- (iv) Mr. Chan resigned on 24 September 2010.

(c) Loans to Key Management Personnel

There were no loans made to the Directors of the Company or other key management personnel of the Group, including their related parties during the financial year (2009: \$Nil).

(d) Other Transactions with Key Management Personnel

All other transactions with key management personnel are set out in note 29.

31. Contingencies

There were no contingent liabilities at 30 June 2010 (2009: Nil).

32. After Balance Sheet Date Events

There are no matters or circumstances that have arisen since 30 June 2010 that have or may significantly affect the operations, results, or state of affairs of the Group in the future financial years.

Directors' Declaration

In accordance with a resolution of directors of Advanced Engine Components Limited, I state that

In the opinion of the Directors:

- (a) the financial report and notes of the consolidated entity are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards and the Corporations Regulations 2001;
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2.
- (c) the remuneration disclosures set out in the directors report (as part of the Audited Remuneration Report), for the year ended 30 June 2010, comply with Section 300A of the Corporations Act 2001; and
- (d) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

This declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial period ended 30 June 2010.

On behalf of the Board



A Middleton
Managing Director

Perth, 30 September 2010

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ADVANCED ENGINE COMPONENTS LIMITED

Report on the Financial Report

We have audited the accompanying financial report of Advanced Engine Components Limited, which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 2 (a), the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001* would be in the same terms if it had been given to the directors at the time that this auditor's report was made.

Basis for Qualified Auditor's Opinion

Attention is drawn to the recoverability of the consolidated entity's trade receivables with a carrying value of \$769,599 as disclosed in Note 14. We have not been able to obtain sufficient audit evidence to support the recoverability of \$499,250 of these receivables. Due to this limitation of scope, we have not been able to determine if an impairment provision against these trade receivables is necessary or the amount of the effect, if any, that an impairment provision would have on the consolidated statement of financial position and statement of comprehensive income.

Attention is drawn to the recoverability of the consolidated entity's intangible asset relating to engine development costs with a carrying value of \$4,557,337 as disclosed in Note 18. The entity has forecast sales based upon their best estimates and have utilised this information for assessing the asset for impairment in accordance with AASB 136. Due to the inherent uncertainties of future sales forecasts we have not been able to obtain sufficient appropriate evidence to support the likelihood of the sales being achieved nor have we been able to perform sufficient appropriate alternative procedures to support the sales forecasts to assess the recoverability of the asset. Due to this limitation of scope, we have not been able to determine if an impairment provision against this intangible asset is necessary or the amount of the effect, if any, that an impairment provision would have on the consolidated statement of financial position and statement of comprehensive income.

Qualified Auditor's Opinion

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves on the matters referred to in the proceeding paragraphs:

- (a) the financial report of Advanced Engine Components Limited is in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 2 (a).

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our opinion, we draw attention to Note 7 in the financial report which indicates that the consolidated entity incurred a net loss of \$3,795,896 during the year ended 30 June 2010 and, as of that date, the entity's total current liabilities exceeded its total current assets by \$3,580,367. These conditions, along with other matters as set forth in Note 7, indicate the existence of a material uncertainty which may cast significant doubt about the consolidated entity's ability to continue as a going concern and therefore whether it will realise its assets and settle its liabilities in the normal course of business and at the amounts stated in the financial report.



Report on the Remuneration Report

We have audited the Remuneration Report included in the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

In our opinion, the Remuneration Report of Advanced Engine Components Energy Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

BDO Audit (WA) Pty Ltd

A handwritten signature in blue ink, appearing to read 'Peter Toll', is written over the printed name. Above the signature, the letters 'BDO' are handwritten in blue ink.

Peter Toll
Director

Perth, Western Australia
Dated this 30th day of September 2010

Additional Stock Exchange Information

as at 29 September 2010

Number of Holders of Equity Securities

Ordinary Share Capital

203,683,388 shares are held by 902 individual holders.

Options

For details of options on issue refer note 23(c).

Distribution of Holders of Equity Securities

			Fully Paid Ordinary Shares		
			Holders	Total Units	%
1	-	1,000	69	17,263	0.01
1,001	-	5,000	129	425,296	0.21
5,001	-	10,000	128	1,009,308	0.50
10,001	-	100,000	454	16,296,398	8.00
100,001 and over			122	185,935,123	91.28
Totals			902	203,683,388	100.00

Substantial Shareholders

<i>Ordinary Shareholders</i>	<i>Fully Paid</i>	
	Number	Percentage
698 Capital International Ltd	84,423,731	41.45
Mr Vivekananthan M V Nathan	30,590,910	15.02

Twenty Largest Holders of Quoted Equity Securities

		<i>Fully Paid</i>	
<i>Ordinary Shareholders</i>		Number	Percentage
1	698 Capital International Ltd	84,423,731	41.45
2	Mr Vivekananthan M V Nathan	30,590,910	15.02
3	HSBC Custody Nominees (Australia) Limited	14,416,682	7.08
4	Seibu Pty Ltd GL Keys Super Fund Account	4,933,334	2.42
5	DBS Vickers Securities (Singapore) Pte Ltd	3,801,336	1.87
6	Citicorp Nominees Pty Limited	2,666,666	1.31
7	Mr Mark John Conway	2,629,203	1.29
8	Jildane Pty Ltd <Middleton Super Fund A/C>	2,091,336	1.03
9	Jildane Pty Ltd <Middleton Super Fund A/C>	2,047,853	1.01
10	Mr. Paul Massarotto	1,893,185	0.93
11	Mr Paul Robert Baster <Baster Family A/C>	1,700,000	0.83
12	Jingie Investments Pty Ltd	1,600,000	0.79
13	H L Fry Holdings Pty Ltd <Super Fund No 2 Account>	1,200,000	0.59
14	Rodney Ralph Gregory and Philip Geoffrey Gregory	1,017,000	0.50
15	Mr Boyd Stewart Milligan	948,418	0.47
16	Mr Paul Robert Baster <Baster Family Account>	900,000	0.44
17	Jildane Pty Ltd	874,075	0.43
18	Mr Robert Bruce Thompson & Mrs Lorraine Florence Thompson <RB & LF Thompson S/P/F A/C>	830,000	0.41
19	Mr Allan Graham Jenzen & Mrs Elizabeth Jenzen <A&E Jenzen P/L No.2 S/F A/C>	750,000	0.37
20	Aileendonan Investments Pty Ltd	700,000	0.34
		160,013,729	78.58

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