iinet
connect better

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12 September 2006

2006 FULL YEAR RESULT & PRELIMINARY FINAL REPORT

iiNet LIMITED (ASX: IIN) today announced Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) of $24.6 million for the year ended 30 June 2006, in line with market guidance.

Revenue for the year was $248.5 million, up 58% on FY05 revenue of $157.2 million.

The Company produced positive operating cashflow of $20.8 million for the full financial year.

"Our recent financial performance indicates we are tracking towards an annualised EBITDA run rate for FY07 greater than the $25 million reported to the market in May this year," said iiNet Executive Chairman Mr Peter Harley. "We now have a strong financial basis from which to implement our Australian growth strategy.

"Behind the improved trading performance are extensive cost savings, continued transition of broadband customers onto our own network and major improvements in customer service and operations," said Mr Harley.

The Company also announced a $65 million write down of intangible assets, driven by the prescriptive impairment criteria laid down in the AIFRS accounting standards and structural changes in the telecommunications industry. This has resulted in a net loss after tax of $60 million. The Company made a net profit after tax before impairment and amortisation of $2.6 million.

iiNet Chief Executive Officer Michael Malone said the operating environment for the Company had shown dramatic improvement in the past 6 months, including:

- Rationalisation of customer support through consolidation of call centres in three locations
- Over 110,000 customers now on the iiNet ADSL2+ network, with a lower and more predictable cost base
- A complete overhaul of the Company's product lines
- More clarity on major regulatory uncertainties

"It is obvious that the integration of the OzEmail business and changes to the wholesale market put strain on the business," said Mr Malone. "However, we have emerged from that period with a strong platform to support future growth.

"Our focus in the current year is firmly on our core activities – delivering high speed broadband with excellent customer service and innovative products.

"After considerable recent investment, our network now has coverage in all metropolitan areas, and the PowerTel Alliance extends this to several major regional centres," said Mr Malone. "We will concentrate on getting more customers onto our network directly and through the PowerTel wholesale channel.

"The objective is to leverage our investment with only incremental capital expenditure."

Mr Malone said that consistent government support for the regulatory environment had created a more stable and certain marketplace for organisations such as iiNet.

"We are very confident the lower cost base and more favourable regulatory climate will drive improved profitability in FY07."

In July, the Company announced that it was selling iiNet's New Zealand subsidiary. Mr Harley said that the sale of iHug remained on track with completion scheduled by the end of the calendar year. A portion of the proceeds from the sale of iHug will be applied to reduce group debt.

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Operational Highlights

Customer Service

iiNet has a long history of award winning customer service and regards service as a long term sustainable differentiator.

As a result of past acquisitions, iiNet had five separate call centres, in four cities, operating under five different brands. Each call centre operated with its own systems, measurements, management practices, knowledge base, training requirements and culture.

In FY06, the Company's Perth, Sydney and Auckland call centres were consolidated into a single Virtual Contact Centre (VCC), delivering substantial cost and customer service benefits.

The VCC allows all three centres to be a treated as a single large call centre with over four hundred staff. When a customer calls, they will be directed to the first available and suitable skilled agent, regardless of where that person is sitting.

The technology behind this is very impressive, but the cultural change is far more significant. By having a single large pool of staff, all the supporting material and processes have also been consolidated.

High Speed Broadband Network

Broadband offerings available through most other ISPs in Australia only allows speeds of up to 1.5M, with a standard speed of 256k – only five times faster than dial up.

ADSL2+ is the 'next generation' of broadband, offering speeds of up to 24M, around four hundred times the maximum speed available from dial up. ADSL2+ is distance dependent. The closer a customer is to their local exchange, the better speeds are possible. Results in suburban Australia show that customers are typically getting 6M to 10M, still a long way from dial up!

iiNet has the largest ADSL2+ network in Australia, covering 270 exchanges in the major capital cities. That gives about 90% coverage of the Company's customer base in Perth and Sydney and around 60% in the other cities, an addressable market of about three million households.

From the customer's point of view, the proposition is "faster broadband, same price". High speed plans are available at about the same price points as 256K broadband from major competitors.

The Company's target was to get 100,000 customers onto this network by July. This was achieved in June and there are now over 110,000 customers on the network.

Wholesale Alliance

In May 2006, iiNet and PowerTel (ASX: PWT) announced a wholesale Alliance agreement. iiNet is predominantly a retail supplier, serving households and small businesses. PowerTel has a strong position in the wholesale and corporate market. Under the Alliance Agreement, PowerTel will sell access to iiNet's ADSL2+ network to other ISPs as a wholesale product.

There are significant scale benefits in ADSL2+. Getting more customers onto the iiNet network in a single exchange reduces the operating costs per customer in that exchange. This is particularly important in outer suburban exchanges, where it is more difficult to get a high density of customers.

Wholesale gives iiNet the ability to better leverage its investment in its network, gaining benefits from scale and also expanding faster than would be possible through a single retail brand alone.

Product Changes

iiNet has made significant progress in migrating customers onto its own broadband network – with major benefits to customers in terms of faster and better service and substantial improvements to iiNet's margins.

iiNet's own ADSL2+ network now reaches a large proportion of the Australian population. However, outside of that 'footprint', the Company uses Telstra's slower ADSL network.

In the past, the products have been "infrastructure neutral" where iiNet sought to deliver the same product to customers whether it was on the iiNet network or on the Telstra Wholesale network.

Over the past few months, products have been changed to reflect the difference in costs. However, products based on the Telstra Wholesale network remain competitive.

Regulatory Environment

Over the past six months, there has been considerable progress in all the regulatory disputes that iiNet is involved in:

- **Unbundled Local Loop** (ULL) – This involved access to the full copper line. iiNet's dispute was the first to be settled by the ACCC, with the results published by the ACCC in August. Telstra was arguing for a $30 national rate, but the decision of the regulator for band 2 (mainly suburbia) is $17.70. This currently has very little impact on iiNet, but it opens the door for some interesting voice and broadband bundles in coming months.

- **Fibre to the Node** (FTTN) – Telstra and the ACCC have been negotiating to use FTTN to replace the copper regime, effectively returning Telstra to a monopoly position. Telstra argued that higher speeds were not possible without FTTN. iiNet, Optus and other carriers continued to roll out high speed broadband using ADSL2+, and in July Telstra abandoned the talks with the ACCC.

- **Line Sharing Service** (LSS) – This is similar to ULL, but only refers to the broadband part of the line, the voice part staying with Telstra. This is the service that iiNet uses to provide ADSL2+. At the moment, the rate is $9 per month per service. The Company has argued it should be much lower, closer to $3 per month. A decision is expected on this in the next few months and iiNet is confident of a fair and positive outcome for the Company.

Telstra will continue to appeal these decisions, but the Federal Government and the ACCC have taken a determined and firm stance in favour of competition. The

regulatory environment we are seeing today is far more stable and positive than it was six months ago.

Sale of ihug

When ihug was acquired in 2003, it operated as an ISP in both New Zealand and Australia. Since then, ihug's Australian customers have been integrated into the core iiNet customer base.

In May 2006, the New Zealand Government announced sweeping changes to the regulatory environment, opening up the future to infrastructure investment, such as iiNet's ADSL2+ network.

The Company took the decision to offer ihug for sale after receiving a number of unsolicited offers for the business and after making a strategic decision to concentrate on growing iiNet's core Australian business.

iiNet continues to progress the sale process for its New Zealand iHug subsidiary, with completion on schedule for the end of the calendar year.

IINET LIMITED

ABN 48 068 628 937

PRELIMINARY FINANCIAL REPORT FOR THE YEAR ENDED 30 JUNE 2006 AND ASX APPENDIX 4E

PRELIMINARY FINANCIAL REPORT FOR THE YEAR ENDED 30 JUNE 2006

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RESULTS FOR ANNOUNCEMENT TO MARKET (APPENDIX 4E)

CURRENT REPORTING PERIOD: YEAR ENDED 30 JUNE 2006
PREVIOUS CORRESPONDING PERIOD: YEAR ENDED 30 JUNE 2005

	PERCENTAGE CHANGE %	AMOUNT $A'000
REVENUE AND NET PROFIT		
Revenues from continuing operations	58%	248,545
Earnings before Interest, Taxation, Depreciation and Amortisation (EBITDA)	(31%)	24,626
Net profit after tax before amortisation and impairment	(84%)	2,558
Net (loss) from ordinary activities after tax	-	(60,081)
Net (loss) for the period attributable to members	-	(60,081)

	AMOUNT PER SHARE	FRANKED AMOUNT PER SHARE
DIVIDENDS		
Final Dividend for 2006		0.0 cents

BRIEF EXPLANATION OF REVENUE AND NET PROFIT

Consolidated revenues from continuing operations were $248.5 million. This represented a 58% increase from the corresponding period in the previous year. This increase is attributed to 12 months contribution from the OzEmail acquisition in February 2005 and the change in iiNet's product mix as customers move from low priced dial products through to broadband and bundled broadband and voice products.

The net loss after tax of $60.1 million includes an impairment adjustment of $65.0 million and amortisation of subscriber bases of $9.4 million. The net profit after tax before impairment and amortisation was $2.6 million.

	YEAR ENDED 30 JUNE 06	YEAR ENDED 30 JUNE 05
NTA BACKING		
Net tangible asset backing per security	(0.25)	(0.44)

DETAILS OF ENTITIES WHERE CONTROL HAS BEEN GAINED OR LOST DURING THE PERIOD
The group has not gained or lost control over any entities during the year ended 30 June 2006.

DIVIDENDS PAID AND PROPOSED - REFER Note 3 to the Financial Statements

DETAILS OF DIVIDENDS OR DISTRIBUTION RE-INVESTMENT PLANS - Not Applicable

DETAILS OF ASSOCIATES AND JOINT VENTURE ENTITIES - Not Applicable

AUDIT REPORT

The preliminary final report is based on accounts which are in the process of being audited.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006

	NOTE	2006 $	2005 $
CONTINUING OPERATIONS			
Rendering of services		240,124,341	153,657,056
Sale of goods		7,544,590	2,612,103
Other revenue	2(a)	876,630	890,879
Total revenue		248,545,561	157,160,038
Direct service expenses			
Cost of sales and services rendered		(152,621,251)	(71,518,857)
Gross profit		**95,924,310**	**85,641,181**
Other income/(expenses)	2(b)	586,056	14,023
Employee expenses		(45,282,292)	(31,390,532)
Marketing expense		(5,214,995)	(3,008,411)
Office costs		(11,556,523)	(9,684,541)
Other expenses		(9,030,067)	(5,971,818)
Depreciation and amortisation expense	2(c)	(26,371,671)	(18,570,016)
Impairment of non-current assets		(65,023,117)	-
(LOSSES)/PROFIT FROM CONTINUING OPERATIONS BEFORE TAX AND FINANCE COSTS		**(65,968,299)**	**17,029,886**
Financing costs	2(e)	(4,955,884)	(2,671,164)
(LOSSES)/PROFIT FROM CONTINUING OPERATIONS BEFORE INCOME TAX		**(70,924,183)**	**14,358,722**
Income tax benefit/(expense)		10,843,564	(3,946,152)
(LOSSES)/PROFIT ATTRIBUTABLE TO MEMBERS OF IINET LIMITED		(60,080,619)	10,412,570
(Loss)/Earnings per share (cents per share)			
- basic for profit for the year		(54.6)	11.8
- diluted for profit for the year		(54.5)	11.7
- dividends per share		1.0	6.5

CONSOLIDATED BALANCE SHEET
AS AT 30 JUNE 2006

	2006 $	2005 $
CURRENT ASSETS		
Cash and cash equivalents	7,390,535	25,387,373
Trade and other receivables	23,331,842	21,835,649
Inventories	480,351	497,087
Prepayments	5,351,628	3,183,279
Other	306,751	2,612,840
TOTAL CURRENT ASSETS	36,861,107	53,516,228
NON-CURRENT ASSETS		
Receivables	-	375
Property, plant and equipment	50,694,607	25,843,699
Intangible assets and goodwill	144,510,027	217,165,499
Deferred income tax asset	10,735,047	5,120,743
TOTAL NON-CURRENT ASSETS	205,939,681	248,130,316
TOTAL ASSETS	242,800,788	301,646,544
CURRENT LIABILITIES		
Trade and other payables	41,366,315	32,401,110
Unearned revenue	18,743,732	16,529,856
Interest bearing loans and borrowings	13,536,323	11,994,823
Income tax payable	-	851,405
Provisions	3,577,586	5,875,891
TOTAL CURRENT LIABILITIES	77,223,956	67,653,085
NON-CURRENT LIABILITIES		
Interest bearing loans and borrowings	44,372,016	53,804,061
Deferred income tax liabilities	7,101,026	10,815,712
Provisions	35,818	128,328
TOTAL NON-CURRENT LIABILITIES	51,508,860	64,748,101
TOTAL LIABILITIES	128,732,816	132,401,186
NET ASSETS	114,067,972	169,245,358
EQUITY		
Issued capital	180,800,726	170,195,672
Accumulated losses	(68,458,513)	(2,917,300)
Other reserves	1,725,759	1,966,986
TOTAL EQUITY	114,067,972	169,245,358

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2006

	Issued Capital	Accumulated Losses	Employee Equity Benefits Reserve	Foreign Currency Translation Reserve	Total
30 June 2004	84,720,239	(8,081,768)	455,911	543,393	77,637,775
Profit for the period	-	10,412,570	-	-	10,412,570
Currency translation differences	-	-	-	(12,655)	(12,655)
Issue of share capital	87,111,751	-	-	-	87,111,751
Transaction costs on share issue	(1,636,318)	-	-	-	(1,636,318)
Cost of share-based payment	-	-	980,337	-	980,337
Equity Dividends	-	(5,248,102)	-	-	(5,248,102)
Other	-	-	-	-	-
30 June 2005	170,195,672	(2,917,300)	1,436,248	530,738	169,245,358

Consolidated	Issued Capital	Accumulated Losses	Employee Equity Benefits Reserve	Foreign Currency Translation Reserve	Total
30 June 2005	170,195,672	(2,917,300)	1,436,248	530,738	169,245,358
Profit for the period	-	(60,080,619)	-	-	(60,080,619)
Currency translation differences	-	-	-	(936,201)	(936,201)
Issue of share capital	10,819,254	-	-	-	10,819,254
Transaction costs on share issue	(214,200)	-	-	-	(214,200)
Cost of share-based payment	-	-	694,974	-	694,974
Equity Dividends	-	(5,460,594)	-	-	(5,460,594)
Other	-	-	-	-	-
30 June 2006	180,800,726	(68,458,513)	2,131,222	(405,463)	114,067,972

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006

	Notes	2006 $	2005 $
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from customers		248,552,404	145,274,870
Payments to suppliers and employees		(220,160,576)	(115,924,057)
Interest received		852,895	839,677
Interest and other costs of finance paid		(5,571,314)	(952,330)
Income tax paid		(2,881,023)	(7,068,674)
NET CASH FLOWS FROM OPERATING ACTIVITIES	7(b)	20,792,386	22,169,486
CASH FLOWS FROM INVESTING ACTIVITIES			
Payment for establishment of exchange space		(4,796,106)	(3,849,588)
Payment for subscriber acquisition costs		(6,220,341)	(2,364,927)
Purchase of plant and equipment		(22,988,973)	(19,152,044)
Proceeds from sale of plant and equipment		36,146	76,959
Proceeds from sale of intangibles		678,153	431,204
Acquisition of business, net of cash acquired		-	(117,475,308)
Payment of other development costs		(2,045,663)	(50,706)
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(35,336,784)	(142,384,410)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares		10,819,254	87,111,751
Payments for capital raising costs		(214,200)	(2,337,596)
Proceeds from borrowings		5,867,187	94,286,276
Repayment of borrowings		(13,757,732)	(33,041,174)
Equity dividends paid		(5,460,594)	(5,248,102)
NET CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES		(2,746,085)	140,771,155
Net (decrease)/increase in cash		(17,290,483)	20,556,231
Net foreign exchange difference		(1,227,949)	(12,655)
Cash and cash equivalents at beginning of period		26,785,261	6,241,685
CASH AND CASH EQUIVALENTS AT END OF PERIOD	7(a)	8,266,829	26,785,261

NOTES TO THE PRELIMINARY FINANCIAL REPORT
FOR THE YEAR ENDED 30 JUNE 2006

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of accounting

This preliminary financial report has been prepared in accordance with the requirements of the Corporations Act 2001, applicable Accounting Standards and other mandatory professional reporting requirements. The preliminary financial report has been prepared on a historical cost basis.

The preliminary financial report is presented in Australian dollars.

(b) Statement of compliance

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

This is the first preliminary financial report prepared based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly, except for the adoption of AASB 132 "Financial Instruments: Disclosure and Presentation" and AASB 139 "Financial Instruments: Recognition and Measurement". The Company has adopted the exemption under AASB 1 "First Time Adoption of AIFRS" from having to apply AASB 132 and AASB 139 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 preliminary financial report are detailed in Note 8.

Australian Accounting Standards that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ended 30 June 2006. These are:

AASB Amendment	Affected Standard(s)	Nature of Change to Accounting Policy	Application Date of Standard*	Application Date for Group
2004 – 3	AASB 1 *First-time Adoption of AIFRS,* AASB 101 *Presentation of Financial Statements,* AASB 124 *Related Party Disclosures*	No change to accounting policy required. Therefore no impact.	1 Jan 06	1 Jul 06
2005 – 4	AASB 1"First Time Adoption of AIFRS" AASB 139 "Financial Instruments: Recognition and Measurement"	No change to accounting policy required. Therefore no impact.	1 Jan 06	1 Jul 06
2005 – 5	AASB 1"First Time Adoption of AIFRS" AASB 139 "Financial Instruments: Recognition and Measurement"	No change to accounting policy required. Therefore no impact.	1 Jan 06	1 Jul 06
2005 – 6	AASB 3 "Business Combinations"	No change to accounting policy required. Therefore no impact.	1 Jan 06	1 Jul 06
2005 – 9	AASB 139 *Financial Instruments – Recognition and Measurement* and AASB 132 *Financial Instruments – Disclosure and Presentation*	No change to accounting policy required. Therefore no impact.	1 Jan 07	1 Jul 07
2006 – 1	AASB 121 *The Effects of Changes in Foreign Exchange Rates*	No change to accounting policy	31 Dec 06	1 Jul 07

		required. Therefore no impact.		
2005 – 10	AASB 132 "Financial Instruments: Disclosure and Presentation" AASB 101 "Presentation of Financial Statements" AASB114 "Segment Reporting" AASB 117 "Leases" AASB 133 "Earnings Per Share" AASB 139 "Financial Instruments: Recognition and Measurement" AASB 1"First Time Adoption of AIFRS" AASB 4 "Insurance Contracts" AASB 1023 "General Insurance Contracts" AASB 1038 "Life Insurance Contracts"	No change to accounting policy required. Therefore no impact.	1 Jan 07	1 Jul 07
New standard	AASB 7 "Financial Instruments: Disclosures"	No change to accounting policy required. Therefore no impact.	1 Jan 07	1 Jul 07
UIG – 4	Determining whether an arrangement contains a lease	No change to accounting policy required and no such arrangements have been in place during the reporting period. Therefore no impact.	1 Jan 06	1 Jul 06

* Application date is for the annual reporting periods beginning on or after the date shown in the above table.

AASB Amendment	Affected Standard(s)
New Standard	AASB 119 *Employee Benefits* (Revised Dec 04) – Accounting policy options contained within the revised standard affect accounting for defined benefit schemes only. As iiNet do not have or do not contribute to a defined benefit scheme, there is no impact of this change.
2005 – 1	AASB 139 "Financial Instruments: Recognition and Measurement"
2005 – 2	AASB 1023 *General Insurance Contracts*
2005 – 3	AASB 119 *Employee Benefits*
2005 – 4	AASB 132 *Financial Instruments – Disclosure and Presentation*, AASB 1023 *General Insurance Contracts* and AASB 1028 *Life Insurance Contracts*
2005 – 9	AASB 4 *Insurance Contracts,* AASB 1023 *General Insurance Contracts*
2005 – 12	AASB 1038 *Life Insurance Contracts* and AASB 1023 *General Insurance Contracts*
UIG – 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds
UIG – 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment
UIG – 7	Applying the restatement approach under AASB 129 *Preliminary financial reporting in Hyperinflationary Economies*
UIG – 8	Scope of AASB 2 *Share-based Payments*
UIG – 9	Reassessment of embedded derivatives

(c) Principles of Consolidation

The consolidated financial statements comprise the financial statements of iiNet Limited and its subsidiaries ('the Group') as at 30 June each year.

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.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

(d) Significant accounting judgements, estimates and assumptions

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(i) *Significant accounting estimates and assumptions*

The carrying amount of certain assets and liabilities is often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

Impairment of goodwill and intangibles with indefinite useful lives

The Group determines whether goodwill and intangibles with indefinite useful lives are impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash generating units to which the goodwill and intangibles with indefinite useful lives are allocated.

Share based payment transactions

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by an external valuer using a binomial model.

The Group measures the cost of cash-settled share-based payments at fair value at the grant date using the Black-Scholes formula taking into accounts the terms and conditions upon which the instruments were granted.

(e) Income Tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted by the balance sheet date.

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 or loss.

- in respect of taxable temporary difference associated with investments in subsidiaries, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences and carry forward of unused tax assets and tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets can be utilised:

- except where the deferred income tax asset relating to the deductible temporary difference 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 or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, 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 difference can be utilised.

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

Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be 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.

Income taxes relating to items recognised directly in equity are recognised in equity and not in the income statement.

Deferred tax assets and deferred tax liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

(f) Other taxes

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

- 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

-receivables and payables are stated with the amount 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 balance sheet.

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

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

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

(i) Rendering of services
Revenue is recognised over the period for which the service is provided.

Unearned revenue represents the component of cash received from the customer for the period from balance date to the expiry date of the customer's subscription. Unearned revenue also represents the amounts received from customers in advance of their subscription period.

(ii) Sale of goods
Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be measured reliably. Risks and rewards are considered passed to the buyer at the time of delivery of the goods to the customer.

(iii) Interest Income
The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 for 1 July 2005. Outlined below are the relevant accounting policies for interest income applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

Accounting policies applicable for the year ending 30 June 2005
Revenue is recognised when the Group's right to receive payment is established.

(h) Foreign Currency Translation
The functional currency of iiNet Limited and its Australian subsidiaries is Australian dollars (A$). The functional currency of iiNet New Zealand Limited and ihug Ltd is New Zealand Dollars. The presentation currency of the Group is Australian dollars.

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate 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 differences in the consolidated preliminary financial report are taken to the income statement.

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.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

As at the reporting date the assets and liabilities of iiNet New Zealand and ihug Limited are translated into the presentation currency of the Group at the rate of exchange ruling at the balance sheet date and the income statements are translated at the weighted average exchange rate for the period. The exchange differences arising on the retranslation are taken directly to a separate component of equity.

On disposal of a foreign entity, the deferred cumulative amount recognised as equity relating to that particular foreign operation is recognised in profit or loss.

(i) Cash and Cash Equivalents
Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(j) Trade and other receivables
The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other receivables applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Trade receivables, which generally have 30 to 90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.
An allowance for doubtful debts is made when there is objective evidence that the Group will not be able to collect the debts. Bad debts are written off when identified.

Accounting policies applicable for the year ending 30 June 2005
Trade receivables were recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts was made when collection of the full amount was no longer probable. Bad debts were written off as incurred.

(k) Inventories
Inventories are valued at the lower of cost and net realisable value.

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

(l) Prepayments
Prepayments are recognised when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.

(m) Acquisition of Assets
Assets acquired are recorded at the cost of acquisition, being the purchase consideration determined as at the date of acquisition plus costs incidental to the acquisition.

(n) Impairment of Assets
The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and the asset's value in use cannot be estimated to be close to its fair value. In such cases the asset is tested for impairment as part of the cash-generating units exceeded its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount.

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. Impairment losses relating to continuing operations are recognised in those expense categories consistent with the function of the impaired asset unless the asset is carried at the revalued amount (in which case the impairment loss is treated as a revaluation decrease).

An assessment is also made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at the revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(o) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value, where applicable.

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

Plant and equipment	over 2 - 5 years
Equipment under finance lease	over 3 - 15 years or the lease term, whichever is shorter
Leasehold improvements	over 3 - 15 years or the lease term, whichever is shorter

(i) Impairment

The carrying values of plant and equipment are reviewed for impairment at each reporting date, with recoverable amount being estimated when events or changes in circumstances indicate that the carrying value may be impaired.

The recoverable amount of plant and equipment is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flow 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 risk specific to the assets.

For an asset that does not generate largely independent cash inflows, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless the asset's value in use can be estimated to be close to its fair value.

An impairment exists when the carrying value of an asset or a cash-generating units exceeds its estimated recoverable amount. The assets or cash-generating units are then written down to their recoverable amount.

For plant and equipment, impairment losses are recognised in the income statement in the cost of sales line item.

(ii) Derecognition and disposal

An item of property, plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in the profit or loss in the year the asset is derecognised.

(p) Borrowing costs

Borrowing costs are recognised as an expense when incurred.

(q) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependant on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments.

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

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

(r) Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Group interest in the net fair value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is not amortised.

Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

As at the acquisition date, any goodwill acquired is allocated to each of the cash generating units expected to benefit from the combination's synergies.

Impairment is determined by assessing the recoverable amount of the cash generating unit to which the goodwill relates. Recoverable amount is the greater of fair value less costs to sell and value in use.

Where the recoverable amount of the cash-generating unit is less than the carrying amount an impairment loss is recognised. Impairment losses recognised for goodwill are not subsequently reversed.

Where goodwill forms part of a cash generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation.

Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash generating unit retained.

(s) Intangibles

Acquired both separately and from a business combination

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible acquired in a business combination is its fair value at the date of acquisition.

Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of these intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year-end. Changes in the expected useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, which is a change in accounting estimate. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

Intangible assets, excluding development costs, created within the business are not capitalised and expenditure is charged against profits in the period in which the expenditure is incurred.

Intangible assets are tested for impairment where an indicator of impairment exists, and in the case of indefinite lived intangibles annually, either individually or at the cash generating unit level. Useful lives are also examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured.

Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses.

Any expenditure carried forward is amortised over the period of expected future economic benefits from the related project.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use or more frequently when an indicator of impairment arises during a reporting period indicating that the carrying amount may not be recoverable.

A summary of the policies applied to the Group's intangible assets is as follows:

	SUBSCRIBER BASES	PATENTS, TRADEMARKS AND LICENCES	DEVELOPMENT COSTS
Useful lives	finite	finite	finite
Amortisation - Method used	5 years – straight line	20 years – straight line	18 months to 5 years – straight line
Acquired / internally generated	acquired	acquired	internally generated
Impairment testing / recoverable amount testing	Reviewed annually for indicator of impairment.	Reviewed annually for indicator of impairment.	Reviewed annually for indicator of impairment.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

(t) Trade and other payables

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for trade and other payables applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

Trade payables and other payables are carried at amortised costs and represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services.

Accounting policies applicable for the year ending 30 June 2005

Trade payables and other payables are carried at costs which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity.

(u) Interest Bearing Loans and Borrowings

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for interest bearing loans and borrowings applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

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

Accounting policies applicable for the year ending 30 June 2005

All loans were measured at the principal amount. Interest was recognised as an expense as it accrued.

Bills of exchange and promissory notes were carried at the principal amount plus deferred interest.

(v) 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.

When 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.

Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

(w) Share-based payment transactions

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

The Employee Share Option Plan (ESOP) provides benefits to directors and eligible employees.

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

The cost of these equity settled transactions with employees is measured by reference to the fair value of the equity instrument at the date they are granted. The value is determined using a binomial model. The cost of equity settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("vesting date").

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

- The extent to which the vesting period has expired; and
- The number of awards that, in the opinion of the directors, will ultimately vest. The opinion is formed based on the best available information at balance date.

No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

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

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

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

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

(x) Issued Capital

Ordinary share capital is recognised at the fair value of the consideration received by the company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received, net of tax.

(y) Earnings per Share

Basic EPS is calculated as net profit attributable to members, adjusted to exclude costs of servicing equity by the weighted average number of ordinary shares, adjusted for any bonus element.

Diluted EPS is calculated as net profit attributable to members, adjusted for:

- costs of servicing equity;
- the after tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and

- other non-discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares;
- divided by the weighted average number of ordinary shares and dilutive potential ordinary shares adjusted for any bonus element.

(z) Employee Leave Benefits

(i) Wages, 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. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for non-accumulating sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

(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 yields at the reporting date on national government bonds with terms to maturity and currencies that match, as closely as possible, the estimated future cash outflows.

(aa) Defined Contribution Plans
Our commitment to defined contribution plans is limited to making contributions in accordance with our minimum statutory requirements. We do not have any legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to current and past employee services.

Contributions to defined contribution plans are recorded as an expense in the income statement as the contributions become payable. We recognise a liability when we are required to make future payments as a result of employee services provided.

(bb) Investments and other financial assets
The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for investments and other financial assets applicable for the years ending 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ending 30 June 2006
Financial assets in the scope of AASB 139 Financial Instruments: Recognition and Measurement are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available –for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The Group determines the classification of its financial assets after initial recognition and, when allowed and appropriate, re-evaluate this designation at each financial year-end.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Accounting policies applicable for the year ending 30 June 2005

Recoverable amount

Non-current financial assets measured using the cost basis were not carried at an amount above their recoverable amount, and when a carrying value exceeded this recoverable amount, the financial asset was written down to its recoverable amount. In determining recoverable amount, the expected net cash flows were discounted to their present value market determined risk pre-tax adjusted discount rate of 15%.

2 REVENUE AND EXPENSES

REVENUE AND EXPENSES FROM CONTINUING OPERATIONS	CONSOLIDATED 2006 $	2005 $
(a) Other revenue		
Finance revenue - interest received		
- other entities	784,029	626,905
- related entities	-	-
Rental revenue	92,601	263,974
	876,630	890,879
(b) Other income		
Gain/(loss) on disposal of non-current assets	586,056	14,023
(c) Depreciation and Amortisation		
Depreciation of plant and equipment	6,204,936	6,290,957
Amortisation of:		
Subscriber bases	9,423,292	8,269,946
Equipment under finance lease	4,007,399	1,886,955
Leasehold improvements	188,522	411,596
Capitalised development costs	6,542,796	1,707,307
Patents and trademarks	4,726	3,255
	26,371,671	18,570,016
(d) Lease payments and other expenses included in the Income Statement		
Operating lease rentals – minimum lease payments	3,888,881	2,563,066
Net bad and doubtful debts arising from other entities	2,597,506	1,227,281
(e) Finance Costs		
Interest – other entities	3,940,594	2,023,370
Finance lease interest charges	619,882	256,604
Other borrowing costs	395,408	391,190
	4,955,884	2,671,164

3 DIVIDENDS PAID AND PROPOSED

	2006		2005	
	Cents per share	Total $	Cents per share	Total $
(a) *Dividends paid during the year*				
Current year interim dividend - franked to 30 percent	1.0	1,093,703	2.5	2,030,824
Previous year final dividend - franked to 30 percent	4.5	4,366,891	4.0	3,217,278
	5.5	5,460,594	6.5	5,248,102
b) *Dividends proposed and not recognised as a liability*				
Final dividend - franked to 30 percent	-	-	4.0	4,364,945

	2006 $	2005 $
(c) *Franking credit balance*		
Franking credits available for the subsequent financial year are:		
Franking account balance as at the end of the financial year at 30 percent (2005: 30 percent)	6,895,887	8,086,894
Franking debits that will arise from the payment of recommended final dividends for the end of the financial year	-	(1,870,691)
Franking credits that will arise from the payment of income tax payable at the end of the financial year	-	698,810
	6,895,887	6,951,013

4 ISSUED CAPITAL

	2006		2005	
	Number	$	Number	$
Ordinary shares				
Issued and fully paid	121,841,016	180,800,726	109,126,616	170,195,672
(a) Movements in shares on issue				
Balance at beginning of financial year	109,126,616	170,195,672	79,591,416	84,720,239
Shares issued as part capital raising	12,600,000	10,710,000	27,870,000	85,003,500
Costs of capital raising	-	(214,200)	-	(1,636,318)
Other Costs	-	-	-	(24,764)
Issues of shares under the employee share option plans	114,400	109,254	462,200	339,871
Exercise of Options under Director and executive scheme	-	-	1,200,000	1,793,144
	121,841,016	180,800,726	109,123,616	170,195,672

5 SEGMENT REPORTING

The consolidated entity operates in the Telecommunications industry in the geographical locations of Australia and New Zealand.

	AUSTRALIA		NEW ZEALAND		CONSOLIDATED	
	2006	2005	2006	2005	2006	2005
	$	$	$	$	$	$
Rendering of services	213,808,254	124,579,310	33,860,677	31,689,849	247,668,931	156,269,159
Other revenue	577,042	505,889	299,588	384,990	876,630	890,879
Segment Revenue	214,385,296	125,085,199	34,160,265	32,074,839	248,545,561	157,160,038
Segment result before tax	**(53,660,395)**	**12,149,555**	**(17,263,788)**	**2,209,167**	**(70,924,183)**	**14,358,722**

6 EVENTS AFTER THE BALANCE SHEET DATE

On 20 July 2006, iiNet announced to the ASX it had initiated a formal sales process for the New Zealand operations of ihug for the following reasons:-

- The Company had received several unsolicited approaches in regard to the sale of the business from both industry and private equity;
- The opportunity to dispose of the business had been enhanced by recent announcements regarding de-regulation; and
- The funds from the sale of ihug would be employed in growing the Australian business and reducing gearing levels.

iiNet has appointed Grant Samuel to manage the sale process and an information memorandum was distributed during July 2006 to potential buyers with non-binding indicative offers received on 23 August 2006. Subject to reaching agreement with a potential buyer, it is expected that the sale process will be completed by December 2006.

On 23 August, iiNet announced it had agreed to issue 3,763,986 shares to PowerTel Ltd (“PowerTel”) at a price of 69.6 cents per share, which was the volume weighted average price for iiNet shares over the prior week. The issue of these shares raised $2,619,734 and formed part of the second tranche of the Placement Agreement between iiNet and PowerTel.

7 NOTES TO THE STATEMENT OF CASH FLOWS

	2006	2005
a) Reconciliation of cash		
Cash balance comprises		
- cash at bank	7,219,326	4,605,145
- short term deposits - at call	171,209	20,782,228
	7,390,535	25,387,373
- short term deposits incl in receivables	876,298	1,397,888
	8,266,833	**26,785,261**

b) Reconciliation of net profit after tax to net cash flows from operations

	2006	2005
Net profit after income tax	(60,080,619)	3,685,530
Depreciation and amortisation	26,371,671	23,458,234
Impairment of non-current assets	65,023,117	-
Net loss/(gain) on sale of non current assets	(586,056)	91,406
Share-based payment	694,974	-
(Increase)/decrease in assets:		
- Receivables	196,468	(13,323,978)
- Inventory	16,736	(99,629)
- Prepayments	(2,168,349)	-
Increase/(decrease) in liabilities:		
- Payables	8,379,949	10,496,672
- Provision for employee entitlements	245,042	939,011
- Provision - other	(2,635,856)	1,984,947
- Income tax payable	(5,195,448)	(3,357,263)
- Other tax balances	(9,469,243)	(1,705,444)
Net cash flow from operating activities	**20,792,386**	**22,169,486**

8 TRANSITION TO AIFRS

Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 1 July 2004

	Note		Consolidated	
		AGAAP	AIFRS impact	AIFRS
		$	$	$
Current Assets				
Cash and cash equivalents		6,241,685	-	6,241,685
Trade and Other receivables		4,473,138	-	4,473,138
Inventories		397,458	-	397,458
Other		803,160	-	803,160
Total Current Assets		11,915,441	-	11,915,441
Non-Current Assets				
Trade and Other receivables		375	-	375
Property, plant and equipment		17,075,855	-	17,075,855
Intangible assets and goodwill		88,023,980	-	88,023,980
Deferred income tax asset	(C)	2,039,937	323,126	2,363,063
Other		-	-	-
Total Non-Current Assets		107,140,147	323,126	107,463,273
Total Assets		119,055,588	323,126	119,378,714
Current Liabilities				
Trade and other payables		12,518,860	-	12,518,860
Unearned revenue		7,034,196	-	7,034,196
Interest bearing loans and borrowings		3,041,174	-	3,041,174
Income tax payable		4,208,669	-	4,208,669
Provisions		2,385,941	-	2,385,941
Total Current Liabilities		29,188,840	0	29,188,840
Non-Current Liabilities				
Interest bearing loans and borrowings		1,512,608	0	1,512,608
Deferred income tax liabilities	(C)	375,061	9,970,113	10,345,174
Provisions		694,317	-	694,317
Total Non-Current Liabilities		2,581,986	9,970,113	12,552,099
Total Liabilities		31,770,826	9,970,113	41,740,939
Net Assets		87,284,762	-9,646,987	77,637,775
Equity				
Issued capital	(C)	84,397,113	323,126	84,720,239
Accumulated losses	(B), (C)	2,344,256	- 10,426,024	-8,081,768
Other reserves	(B)	543,393	455,911	999,304
Total Equity		87,284,762	-9,646,987	77,637,775

Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 30 June 2005

	Note		**Consolidated**	
		AGAAP	**AIFRS impact**	**AIFRS**
		$	**$**	**$**
Current Assets				
Cash and cash equivalents		25,387,373	-	25,387,373
Trade and Other receivables		21,835,649		21,835,649
Inventories		497,087		497,087
Other		5,796,119		5,796,119
Total Current Assets		53,516,228	-	53,516,228
Non-Current Assets				
Trade and Other receivables		375	-	375
Property, plant and equipment		25,843,699	-	25,843,699
Intangible assets and goodwill	(A)	209,338,542	7,826,957	217,165,499
Deferred income tax asset	(C)	4,301,219	819,524	5,120,743
Total Non-Current Assets		239,483,835	8,646,481	248,130,316
Total Assets		293,000,063	8,646,481	301,646,544
Current Liabilities				
Trade and other payables		32,401,110	-	32,401,110
Unearned revenue		16,529,856	-	16,529,856
Interest bearing loans and borrowings		11,994,823	-	11,994,823
Income tax payable		851,405	-	851,405
Provisions		5,875,891	-	5,875,891
Total Current Liabilities		67,653,085	0	67,653,085
Non-Current Liabilities				
Interest bearing loans and borrowings		53,804,061	-	53,804,061
Deferred income tax liabilities	(C)	930,899	9,884,813	10,815,712
Provisions		128,328	-	128,328
Total Non-Current Liabilities		54,863,288	9,884,813	64,748,101
Total Liabilities		122,516,373	9,884,813	132,401,186
Net Assets		170,483,690	- 1,238,332	169,245,358
Equity				
Issued capital	(B)	169,171,268	1,024,404	170,195,672
Accumulated losses	(A),(B), (C),(D)	781,684	- 3,698,984	-2,917,300
Other reserves	(B)	530,738	1,436,248	1,966,986
Total Equity		170,483,690	- 1,238,332	169,245,358

Income Statement reflecting reconciliation of adjustments to AIFRS for the year ended 30 June 2005

	Note	Consolidated		
		AGAAP	**AIFRS impact**	**AIFRS**
		$	**$**	**$**
Revenue				
Rendering of services		153,657,056	-	153,657,056
Sale of goods		2,612,103	-	2,612,103
Other revenue	(E)	1,399,042	(508,163)	890,879
Total Revenue		157,668,201	(508,163)	157,160,038
Cost of sales and services rendered		(71,518,857)	-	(71,518,857)
Gross Profit		86,149,344	(508,163)	85,641,181
Other income	(E)	-	14,023	14,023
Employee Expenses	(B),(D)	(30,410,195)	(980,337)	(31,390,532)
Depreciation and amortisation expense	(A)	(23,458,233)	4,888,217	(18,570,016)
Impairment losses		-	-	-
Marketing expenses		(3,008,411)	-	(3,008,411)
Office costs		(9,684,541)	-	(9,684,541)
Other expenses	(E)	(5,882,317)	89,501	(5,971,818)
Profit from continuing operations before tax and finance costs		13,705,647	3,324,239	17,029,886
Financing costs		(2,671,164)	-	(2,671,164)
Profit from continuing operations before income tax		11,034,483	3,324,239	14,358,722
Income tax expense	(C)	(7,348,953)	3,402,801	(3,946,152)
Profit attributable to members of iiNet Limited		3,685,530	6,727,040	10,412,570

NOTES

(A) *Goodwill*

Under AASB 3 "Business Combinations" goodwill is not subject to amortisation, but must be tested for impairment annually and whenever there is an indication goodwill may be impaired. Under AGAAP, the Group amortised goodwill on a straight-line basis over 20 years. The Group has not elected to apply AASB 3 retrospectively and hence, prior year amortisation would not be written back as at the date of transition.

(B) *Share-based payment*

Share-based payment expenses are charged to the Income Statement under AASB 2 "Share-based payment" but were not recognised under AGAAP.

(C) *Deferred tax liability*

AASB 112 "Income Taxes" requires the Group to use a balance sheet liability method, rather than the income statement liability method, and recognise deferred tax balances where there is a difference between the carrying value of an asset or liability and its tax base.

AASB 112 "Income Taxes" would require the Group to recognise the deferred tax liability arising on initial recognition of subscriber base assets acquired as part of a business combination. Such deferred taxes are not recognised under AGAAP. On transition, the deferred tax would be required to be recognised in retained earnings and not as an adjustment to goodwill.

(D) *Redundancy costs expensed*

The adjustment relates to provisions for redundancies recognised as part of the acquisition accounting for OzEmail and Virtual Communities under AGAAP which are not allowable under AIFRS. Under AIFRS the cost of redundancies are expensed as incurred.

(E) *Gain on sale of non-current assets*

Under AGAAP gains on sale of assets were included in "revenue". Under AIFRS gains do not meet the recognition criteria of revenue and have been reclassified as "other income".