iiNet Limited Annual Report **2006**

06

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06 our history

2006
iiNet surpasses milestone of 100,000 customers on its ADSL2+ network, the largest ADSL2+ deployment in Australian history.

iiNet implements world-class technology to create a single virtual contact centre (VCC) spread across three centres in Perth, Sydney and Auckland.

iiNet forms strategic alliance with PowerTel to offer ADSL2+ wholesale to other ISPs.

iiNet doubles the highest attainable speed on ADSL from 12,000kpbs to 24,000kbps using its own ADSL2+ technology.

iiNet's Voice over IP (VoIP) product was launched in August 2005 and grows to more than 30,000 services offering untimed local calls to anywhere in Australia.

iiNet wins award for Contact Centre of the Year for its VCC, Telecommunications Project of the Year for its VoIP product, and the Service Providers Association (SPAN) award for Excellence in Competition and Growth for its ADSL2 product range.

2005
iiNet acquires OzEmail and becomes Australia's third largest ISP.

iiNet launches fast broadband2 products and full phone service, with attractive bundled options offering speeds of up to 12,000kbps.

iiNet expands deployment of its DSL network to the Eastern States of Australia.

iiNet launches Australia's first large-scale Voice over Internet Protocol (VoIP) service.

2004
iiNet acquired Virtual Communities, to increase its subscriber base to over 400,000. iiNet acquired the FlowCom ISP, incorporating Froggy Internet.

iiNet announces the rollout of its own DSL broadband infrastructure (DSLAM) following the successful completion of a three month customer pilot and feasibility study.

iiNet releases bundled telephony service offering (iiphone).

2003
iiNet makes a series of acquisitions in Victoria, Tasmania, Northern Territory, Queensland, New South Wales and the Australian Capital Territory, making it a truly national company. bliink services are made available nationwide.

iiNet acquires ihug, a significant ISP boasting over 170,000 customers in both Australia and New Zealand.

2002
iiNet releases second generation DSL products for home and business under the bliink brand name. bliink provides flat rate broadband Internet access at an affordable price.

2001
iiNet launches Chime Communications, a wholly owned telecommunications carrier. Chime's focus is to provide wholesale telephony and data services to corporate clients and ISPs.

2000
iiNet launches broadband services: Cable Internet Access, Cityspan Wireless Internet Access and DSL Internet Access. The Australian Consumers Association again ranks iiNet number one in the country for customer service.

1999
iiNet acquired Wantree and listed on the ASX. Directly following listing, Networx and a number of other metropolitan and regional ISPs are acquired. The company starts 24 hours a day, 7 days a week support, as well as opening new services in Gingin, Margaret River and Toodyay in Western Australia.

1998
iiNet increases its market position and acquires fourteen ISPs.

1997
Within the space of 10 months, iiNet South Australia becomes the third largest dial up ISP in South Australia and the operation was sold at a profit. iiNet acquires one of its largest competitors, Online Information Systems, as well as Access Communications.

1996
iiNet expands services into rural Western Australia.

1995
iiNet expands to South Australia. iiNet introduces a $400pa unlimited download premium dial up account, now called Explorer.

1994
The number of Internet users in Australia starts to explode, as does the number of ISPs. iiNet is one of only five or six ISPs in Western Australia.

1993
iiNet commences business in Padbury, Western Australia.


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highlights

06 highlights

November 2005

10,000 VoIP Subscribers
After just two and a half months in market, the iiNet Voice over Internet Protocol (VoIP) phone service grows to more than 10,000 customers, making it the fastest growing VoIP service in Australia.

December 2005

ADSL2+ speeds of up to 24,000kbps launched
iiNet rips the speed cap off it's broadband2 product, offering speeds "as fast as your line can go".

March 2006

Popularity of broadband/phone bundle continues
Bundle rate (broadband with phone) increases to 80% for new customers.

April 2006

Virtual Contact Centre (VCC) in place
VCC system implemented and producing significant improvements with customer service ratings at industry best practice levels.

June 2006

100,000 high-speed milestone
iiNet announces the 100,000th customer to move onto it's ADSL2+ network, lowering cost of service and improved broadband features.

July 2006

WA Contact Centre of the Year
VCC system continues to produce improvements as iiNet is named WA Contact Centre of the Year by the Australian Teleservices Association.

August 2006

New broadband plans launched
iiNet launches a new suite of residential and business broadband plans, improving features for those on the iiNet ADSL2+ network including an increased unbundled speed to 3000kbps – twice that offered by the industry incumbent.

financial calendar

Annual General Meeting

The Annual General Meeting of iiNet Limited will be held at the Sheraton Hotel, 207 Adelaide Terrace, Perth, Western Australia, on Monday 27 November, 2006 at 10.30am.

Annual General Meeting	27 November 2006
Half-year results	February 2007
Half-year Shareholder brochure	February 2007
Full-year results	August 2007
Annual report and Notice of Annual General Meeting mailed to shareholders	October 2007
Annual General Meeting	November 2007

corporate governance statement

Introduction

The Board of iiNet are committed to ensuring that the Company complies with the ASX Corporate Governance Council's "Principles of Good Corporate Governance and Best Practice Recommendations".

Through the continual pursuit of the highest standards of corporate governance, iiNet is able to respect the following values to which it publicly subscribes.

- We will endeavour to provide staff with a challenging, rewarding and safe working environment;
- We will deliver quality products, excellent service and value for money to customers;
- We will take a responsible and ethical approach to the conduct of our business;
- We will maximise the value of shareholders' investment in the Company.

iiNet aims for best practice in the area of corporate governance and the Board is continually reviewing and updating our corporate governance practices. As new corporate governance requirements and guidance notes are issued by the ASX, the Board evaluates and where appropriate, implements the relevant proposals with the aim of ensuring that we maintain best practice in corporate governance.

The main corporate governance and Board practices in place are described in this section. Further information regarding iiNet's corporate governance practices can be found on the Company's website, www.iinet.net.au.

The Board of Directors

Role of the Board and Board Charter

The Board has adopted a formal charter that details the functions and responsibilities of the Board. The Board Charter can be viewed on the Company's website.

The Board of iiNet are charged with the following overall responsibilities:

(a) Charting the direction, strategies and financial objectives for the Company and monitoring the implementation of those policies, strategies and financial objectives; and

(b) Monitoring compliance with regulatory requirements and ethical standards.

In addition, the following more prescriptive tasks have been assigned to the Board:

(c) Appointing and monitoring the performance of Directors, including the Managing Director, Chief Financial Officer and Company Secretary;

(d) Providing input to and approving strategic plans and objectives, and approving the annual operating and capital budgets;

(e) Monitoring systems that assess performance against the above; and

(f) Approving and monitoring processes that provide financial control and accountability and ensure accurate and timely financial reporting.

Structure of the Board

The Board comprises two Executive Directors, being the Executive Chairman and the Managing Director, and five Non-Executive Directors.

We will endeavour to provide staff with a challenging, rewarding and safe working environment

Directors in Office

The skills, experience and expertise relevant to discharging their responsibilities as Directors of iiNet held by each Director in office at the date of this report are detailed in the Directors' Report on pages 18 to 19.

Director Independence

The majority of the Board of Directors of iiNet Limited, including the Chairman, is required to be independent of management and free of any business or other relationship that could materially interfere with or could reasonably be perceived to materially interfere with the exercise of the Director's unfettered and independent judgement. In considering whether a Director is independent, the Board considers:

- The criteria for assessing the independence of a Director in the ASX Corporate Governance Council's "Principles of Good Corporate Governance and Best Practice Recommendations";
- Any information, facts or circumstances that the Board considers relevant; and
- Any materiality thresholds, standards or guidelines that the Board may adopt from time to time.

In the context of Director independence "materiality" is considered from both the Company and individual Director perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal or less than 5% of the appropriate base amount.

In accordance with the established criteria for assessing independence above, and the materiality thresholds set, the following Directors of iiNet Limited are considered to be independent:

Name & Position	Term in Office (at 30 June 2006)
Mr Keith Goodall Non-Executive Director	3 years 8 months
Mr Peter James Non-Executive Director	3 years 7 months
Mr Andrew Milner Non-Executive Director	6 years 10 months
Mr Paul Broad Non-Executive Director	1 month
Mr Tony Grist Non-Executive Director	nil

We will deliver quality products, excellent service and value for money to customers

Independence of the Chairman

At the beginning of May 2006, the Board determined that in light of the increasingly competitive business environment in which the Company found itself operating, the increased executive workload resulting directly from this, and the additional challenges posed to the Company by legacy integration issues, it was in the best interests of the Company for the then Non-Executive Chairman, Mr Peter Harley, to adopt an Executive role.

This change in the functional relationship of the Chairman to the Company's management is not considered by the Board to be permanent, and will revert to its previous status at the Board's discretion.

Remuneration Committee

The Board have established a remuneration committee in order to better facilitate the Board's stated responsibilities with regards to reviewing remuneration policies and practices of employees, Executives and Directors.

The remuneration committee has a formal charter which establishes clearly its role, responsibilities, composition, structure and membership.

Further information regarding iiNet's Remuneration Committee charter can be found on the Company's website, *www.iinet.net.au*.

The following Non-Executive Directors are members of the remuneration committee at the date of this report and were members during the year to the date of this report:

Name
Mr Peter James (Chairman)
Mr Keith Goodall
Mr Andrew Milner

The role of the committee in relation to remuneration is to:

- Review and recommend to the Board as appropriate remuneration policy, including employee share option plans and superannuation;
- Review and evaluate recommendations made by the Managing Director concerning remuneration and other conditions of appointment for Executives reporting directly to the Managing Director;
- Determine the broad structure and objectives of the remuneration policy and its relationship to Company performance;
- Review prior to implementation any new Executive incentive schemes and any proposed changes to existing Executive incentive schemes, including the appropriateness of performance hurdles and the total payments proposed; and
- Advise the Board on remuneration of Non-Executive Directors.

The committee is to meet as required, but at least 2 times a year. Committee members must not be present at any part of any meeting and must not participate in any decisions or vote on any resolution of the committee in relation to their own remuneration or the specific remuneration policies applicable to them.

Committee members may be present at meetings and may participate in the development, review and formulation of recommendations to the Board in relation to the remuneration of Non-Executive Directors. Directors who are not members of the committee, other Executives and/or parties external to iiNet may attend meetings of the committee at the invitation of the committee Chairman.

We will take a responsible and ethical approach to the conduct of our business

Fees paid to Non-Executive Directors are determined by the Board within the aggregate amount approved by shareholders currently standing at $400,000. In determining fees the Board seeks appropriate external advice. Board fees are not paid to Executive Directors since the responsibility of Board membership is considered in determining the remuneration provided as part of their normal employment conditions.

The committee also approves invitations to employees to subscribe for options under the terms of the 2006 iiNet Limited Employee Share Option Plan.

Particulars concerning Directors' and Executives' remuneration and the Company's employee share option plans are set out in the Directors Report on pages 20 to 30 and in the financial statements on pages 34 to 37 of this report.

Nomination Committee

Due to the size of the Board and the Company, the Board has not established a nomination committee. The Board consider that a formal nomination committee structure would not add value to the practices and procedures already followed by the Board with regards to tasks traditionally charged to nomination committees.

The responsibilities that the Board have adopted with regards to the appointment to and monitoring the performance of the Board are as follows:

- Review the size and composition of the Board;
- Review the range of skills available on the Board and ensure an appropriate balance of skills for future Board membership;
- Develop criteria and procedures for the identification of candidates for appointment as Directors, with the criteria including a consideration at least of the candidates:
  - Skills, experience, expertise and personal attributes;
  - Capability to devote the necessary time and commitment to the role; and
  - Potential conflict of interest, and independence;
- Apply these criteria and procedures to identify prospective candidates for appointment as director;
- Appoint external experts where appropriate to advise on the matters listed above.

The Board may:

- Review the recommendations of any external expert appointed by the Board in relation to Board membership and candidates, and may make any further inquiries deemed necessary; and
- Interview candidates for election to the Board.

Independent Professional Advice

The Board may have access to independent advisers where the need arises. If it becomes appropriate for a Director to obtain external professional advice separate from advice obtained on behalf of the Company that advice should ordinarily be provided to all Directors. The cost of obtaining the advice will be met by the Company.

Code of Conduct and Share Trading

Code of Conduct

All Directors, Executives and employees are charged with the responsibility to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the Company.

iiNet has established a Code of Conduct which aims to develop a consistent understanding of, and approach to, the desired standards of conduct and behaviour of the Directors, officers, employees and contractors in carrying out their roles for the Company. Through this code, iiNet seeks to encourage and develop a culture of professionalism, honesty and responsibility in order to maintain and enhance our reputation as a valued employer, business operator and "corporate citizen".

Further information regarding iiNet's Code of Conduct can be found on the Company's website, *www.iinet.net.au.*

Share Trading

The Company has in place a share trading policy which restricts all Directors, officers, employees and contractors of the Company from dealing in shares of the Company whilst in the possession of market sensitive information or similarly passing information to other parties in order to buy or sell iiNet shares.

At no time may a Director, officer, employee or contractor trade in iiNet shares whilst subject to a non-disclosure agreement.

In addition to Insider Trading prohibitions arising from the Corporations Act, Directors, Executive Officers and members of the Executive management team are prohibited from trading in Company shares, except in a 30-day period following seven days after the release of the final and half-yearly results.

The Chairman reserves the right to approve share dealings outside of this policy after evaluating the relevant circumstances. Before trading in the Company's shares, Directors and employees must:

- Advise the Company Secretary of their intention to trade in the Company's shares;
- Confirm they are not aware of any unpublished market sensitive information; and
- Have been advised by the Company Secretary that there is no reason to preclude trading in the Company's shares.

Further information regarding iiNet's Share Trading Policy can be found on the Company's website, *www.iinet.net.au.*

Integrity in Financial Reporting

Audit Committee

The Board have established an audit committee in order to better facilitate the Board's stated responsibilities with regards to verifying and safeguarding the integrity of the Company's financial reporting. The audit committee has a formal charter which establishes clearly its role, responsibilities, composition, structure and membership.

Further information regarding iiNet's Audit Committee charter can be found on the Company's website, *www.iinet.net.au.*

Membership

The names of Directors appointed to the audit committee at any time during the year to the date of this report, are as follows:

- Mr Keith Goodall (Chairman)
- Mr Peter Harley (resigned July 2006)
- Mr Andrew Milner
- Mr Peter James
- Mr Paul Broad (appointed August 2006)
- Mr Tony Grist (appointed August 2006)

As referred to earlier in this statement, Mr Peter Harley became an Executive Director of the Company in May 2006. At this time he was still a member of the audit committee, which is in contravention of the ASX Best Practice recommendation on the composition of audit committees.

The audit committee did not meet at any time during the period Mr Harley was both a member of it and an Executive Director, and accepted Mr Harley's resignation from the committee in July 2006.

Attendance at Meetings

During the year and to the date of this report, the audit committee convened on eight occasions. Attendance at these meetings, including attendance via video conference or telephone, by members of the committee is as follows:

• Mr Keith Goodall	8
• Mr Peter Harley	2
• Mr Andrew Milner	8
• Mr Peter James	8
• Mr Paul Broad	3
• Mr Tony Grist	3

Market Disclosure and Shareholder Communications

Continuous Disclosure Policy

iiNet has in place comprehensive procedures for the purposes of compliance with its continuous and periodic disclosure obligations under the Corporations Act 2001 and the ASX Listing Rules, including a formal Continuous Disclosure Policy.

Further information regarding iiNet's Continuous Disclosure Policy can be found on the Company's website, *www.iinet.net.au.*

Shareholder Communications Policy

iiNet has also developed a formal policy for communicating with shareholders, and other integral stakeholders.
Many of the tenets of the Company's approach to communications with shareholders, analysts and the media are contained in the Continuous Disclosure Policy referred to above.

All announcements made to the ASX and major media release can be viewed on the Company's website, *www.iinet.net.au.*

Further information regarding iiNet's Shareholder Communications Policy can be found on the Company's website, *www.iinet.net.au.*

Risk Management

The Board acknowledges that it is responsible for the overall internal control framework but recognises that no cost effective internal control system will preclude all errors and irregularities. The Board periodically undertakes a review of business risks using the assistance of outside specialists and internal management to identify the source of the risk and loss, quantify the impact of these sources and control and reduce the risks through practical and effective control mechanisms.

These mechanisms include establishing procedures, guidelines, and organisational structures that provide an appropriate division of responsibility, a program of external audit, and the careful selection and training of qualified personnel.

The Board assigns the responsibilities for the operation and conduct of the business to the Managing Director who is directly accountable to the Board through established policies and authority levels.

We will maximise the value of shareholders' investment in the Company

chairman's review

chairman's review

Peter Harley
Chairman

The 2006 year has been a difficult one for the Company. Towards the end of calendar 2005, our major wholesale provider raised prices significantly, resulting in a profit downgrade issued in December. We then had to further revise the profit guidance in May of this year. A detailed explanation of the reasons for the downgrade was issued at the time.

Needless to say the Board and management were deeply disappointed for the necessity and reasons behind the further downgrade. As a result of these events I was asked to step in as Executive Chairman at the end of April to assist management in implementing a recovery strategy.

The first step in that process was to engage leading management and strategic consultants, GEM Consulting, to conduct a complete review of the Company's strategy and profitability. After two months in the business and working closely with management, their report was tabled in early July with the main conclusions being:
(a) several broadband products needed to be repriced given the changes to wholesale pricing;
(b) a number of cost reduction initiatives were identified to increase profitability;
(c) the Company's strategy of rolling out DSLAM infrastructure in Telstra exchanges was confirmed.

A number of the initiatives have been or are in the process of being implemented which should increase underlying EBITDA profitability in the 2007 year.

The result of these and other actions, is that the Board is confident 2007 will see an improvement in the performance of the business.

There have also been changes on the Board with the appointment of two additional members of the Board of Directors representing the interests of our two new substantial shareholders.

Already we are seeing the benefit of the input of the recent Board Members and I welcome their contribution.

As part of the strategic review process, the situation with our New Zealand business, ihug, was also examined. This was against the background of an announcement in May by the New Zealand Government of a changed and more liberal regulatory environment and unsolicited approaches by parties interested in purchasing the business. A decision was made in July to sell ihug and to that end an Information Memorandum was distributed to qualified parties in early August. It is expected that the sale of the business will be complete by the end of this calendar year.

I would like to thank all staff for their loyalty and hard work during the year. Despite the difficulties experienced, there have been a number of positives achieved including the completion of the integration of all businesses acquired over the past few years (and particularly the OzEmail business in 2005); the continued roll out of the DSLAM infrastructure extending our addressable market for high speed broadband to over four million households nationally; and a complete overhaul of our call centre infrastructure.

I would also take this opportunity to thank the Board for their assistance, particularly over the past several months. It was most important that the Board stayed united through this difficult period and remained focused on achieving the best outcomes for shareholders.

On behalf of management and the Board I extend our thanks and appreciation to our customers for choosing iiNet as their telecommunications provider. Let me assure all of you that we remain committed to providing the best service and products to our customers in what is a highly competitive market place.

We know that there is a great deal of choice of providers and we need to continue to strive in the areas of service and product to continue to grow.

Peter Harley
Chairman

managing director's review

06

mdr

managing director's review

Michael Malone
Managing Director

The six months until June 2006 has been the most difficult period the company has experienced in its thirteen year life. The major factors contributing to this result were:

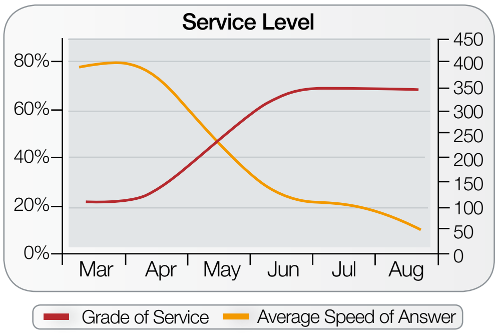
- significant wholesale price increases applying from January;
- an industry wide migration from high margin dialup to highly competitive broadband;
- the impact of under-resourcing the integration of OzEmail;
- the immaturity of our own internal systems.

These issues have been detailed in previous announcements and examined in detail in the media and market reports. Since April, the team has put in immense work to address all of these issues and to reposition iiNet on a solid platform to operate in this new environment.

Service
iiNet's brand represents innovation and service. Our basic proposition is to lead with products, typically attracting early technology adopters. We then seek to retain those customers with awesome customer service. On this basis those early customers are also happy to refer us to their friends, family and work colleagues as the technology matures.

Over the past year, service levels have not been up to the standard we expect for excellent customer service. We have completed over thirty acquisitions in the past, including ihug, a company that was larger than iiNet at the time we purchased it. We put on eighty new staff for the OzEmail integration, but the OzEmail customers generated a far higher number of calls than we had previously experienced. The result was long hold times, particularly in November and February.

The call centre infrastructure was overhauled in February, allowing us to create a single Virtual Call Centre. Calls are now spread seemlessly between Perth, Sydney and Auckland, with the next available and suitably skilled agent able to take the call. It has also allowed us to improve training, quality and consistency.



The dramatic improvement process in customer service levels culminated in July when iiNet was recognised as the Contact Centre of the Year by the Australian Telecentres Association, the industry body for call centres.

Technology
In 2000, iiNet commenced the rollout of its own dial up infrastructure. We obtained a telecommunications carrier license, built exchanges around the country and interconnected with Telstra, Optus and other carriers. We used next generation soft switching equipment that was highly effective for dial up customers, but much cheaper than the traditional voice infrastructure used by other carriers. The result of this was that iiNet now had the lowest cost base for dial up Internet access in the country. It was this low cost network that allowed us to acquire our dial up competitors and expand nationally.

In 2003, we leveraged our existing experience with dial up and began putting our own broadband equipment into Telstra exchanges as well. Using this equipment, we offer customers speeds of up to 24 megabits per second, which is about one hundred times faster than the standard broadband offered by Big Pond. Our costs using this equipment are much cheaper than if we purchased directly from Telstra Wholesale.

The DSLAM rollout has hit all published targets in the past two years. iiNet's DSLAM network now covers 270 exchanges, reaching over 90% of the Perth and Sydney metropolitan area and over 60% of Brisbane, Canberra, Melbourne and Adelaide. We passed 100,000 customers on this network in June 2006. It is the largest high speed ADSL2+ network in the country.

In the coming year, we expect to expand our DSLAM footprint further, primarily by taking advantage of the partnership with PowerTel.

Broadband Products

iiNet's DSLAM network allows us to offer compelling products to customers who are within our footprint, particularly those who value high speeds. We refer to these customers as being "on-net".

We continue to serve other customers using Telstra Wholesale. However, for those customers the costs are higher and the speeds are lower. These are our "off-net" customers.

In the past, we have offered the same products to customers, regardless of whether they were on-net or off-net. The intent was that from the customer's point of view, the product was technology neutral. In the background, we then converted customers over to our own network wherever this was economic. While this was a successful strategy for expansion, wholesale pricing changes in January meant that off-net customers became unprofitable.

Commencing from the middle of 2006, we have changed our approach, and now offer different product lines. For customers who are fortunate enough to be on-net, we can offer very high speeds and generous downloads quotas at excellent prices. For customers who are off-net, our new product line is fair and competitive, but not dramatically better value than that available from our major competitors.

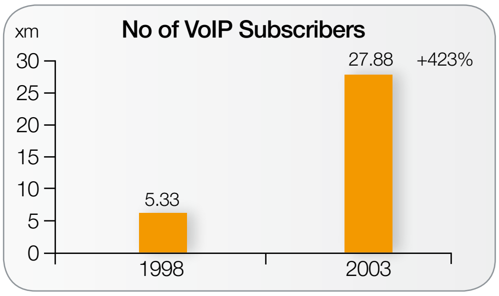
The result of these changes is that all our products are now profitable, whether the customer is off-net or on-net. But from the point of view of the market place, our sales proposition is far better for on-net customers. As a result, our marketing effort is now focused tightly on areas where we can provide customers with access to our own DSLAM network.

Telephony Products

iiNet released a standard home phone product in March 2005. This is a simple re-sold Telstra product, on tight margins, where we really only provide billing and support. Nonetheless, we have aggressively and successfully pursued a bundling strategy over the past year, with over 70% of new broadband customers taking our telephony product as well. This had a two-fold benefit.

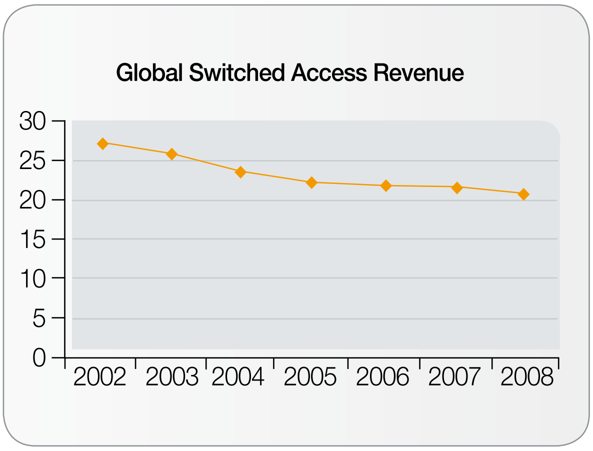
Firstly, churn of bundled customers is lower than unbundled customers. Secondly, we were happy to do this on the basis that we would aggregate a large customer base, then install our own equipment, called an MSAN, which would reduce the costs and make the product more profitable.

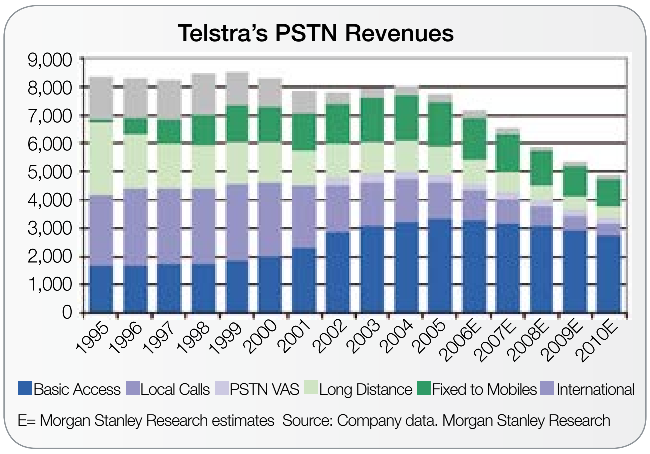
We also released a Voice over Internet Protocol (VoIP) service in October 2005. We expected VoIP to be a niche product, appealing only to more technical customers, but it has been a surprising success, with over 36,000 customers signing up in the past year. Following overseas trends, our expectation is that VoIP will continue to grow in the coming year, as a substitute to more expensive fixed line telephony products. The following graph shows the forecast of VoIP subscribers in the Japanese market.



Source: UNI Liaison Council Japan Bulletin October 2004 No 9.

As a result of customers moving to mobile telephony and VoIP, the average monthly revenue per user from fixed line telephony has been steadily declining in the past year, with Telstra experiencing a 12% reduction in revenue from its fixed line revenue in the past year. Given this trend, the investment in MSAN equipment has now been deferred and will not be revisited until next year.





With these trends in mind, we will continue to offer a reasonably priced standard telephony service, but we also expect to focus significantly more attention on VoIP. As a result, we are now offering customers the same bundling incentives for using VoIP as they receive for using fixed line telephony.

New Zealand

iiNet operates in New Zealand under the brand name ihug, which was acquired in 2003. ihug has over one hundred thousand customers and is a solid number three, behind Telecom New Zealand and Telstra Clear.

Mark Rushworth was appointed to lead ihug in July 2005. Mark and David Diprose, our GM Regulatory, led the campaign to open the telecommunications regime in New Zealand to competitive infrastructure. In May, the government announced a comprehensive overhaul, which should allow ihug to install its own DSLAMs, as iiNet has done in Australia. ihug is well positioned to take advantage of the new environment.

Since changes the recent changes to the regulatory environment, we have had considerable interest from parties interested in acquiring the business. In July, the decision was made to formally put the business up for sale.

We expect the sale to be complete by the end of the year. The funds will be used to reduce debt and to support our DSLAM capital program in Australia.

We have a call centre in Auckland supporting Australian calls. We intend to retain that call centre and grow it further.

The four to five hour time difference with Perth is very useful for twenty four hour coverage and, along with Sydney, it provides redundancy for our customers.

Wholesale

iiNet now has two new substantial shareholders: PowerTel and Amcom. Both companies are ASX listed (PWT and AMM) and their principle business is to provide fibre and other services to corporate, government and wholesale customers. Amcom's coverage is primarily in Perth and Adelaide, while PowerTel's assets are mainly in Sydney, Melbourne and Brisbane.

iiNet covers 270 exchanges with its DSLAM network, all in metropolitan areas. PowerTel covers 120 exchanges, mainly inner city, but also in some major regional centres on the east coast. The two networks have considerable overlap, but combined, we reach over 300 exchanges.

In May, iiNet entered into an Alliance Agreement with PowerTel. In brief, the Agreement has the following principle terms:

- iiNet has appointed PowerTel as its preferred supplier for fibre where it is required;
- iiNet and PowerTel will provide each other with DSLAM ports at an agreed reciprocal rate;
- PowerTel will exclusively wholesale iiNet's DSLAM ports to other ISPs.

The first two elements will have the affect of reducing costs for both companies wherever possible. The final point, about wholesaling, is the most exciting. A large proportion of the costs of getting a DSLAM into an exchange are fixed, so additional scale reduces our cost per customer significantly. This effectively gives us an additional and substantial channel to market to leverage our investment in our DSLAM network.

Given the market trends described below and based on our experience in wholesale dial up, we expect wholesale ADSL to be an exciting area of growth in FY08.

Market Trends

Broadband has been positioned until now as just being faster Internet access. As a result, consumers presently don't differentiate between an entry level 256k connection from BigPond and a multi megabit connection from iiNet. They are both regarded as being just broadband.

Broadband is not just faster access to email and web browsing. The number of people on broadband in Australia has increased to be a mass market and content providers are now beginning to specifically tailor their content to this audience.

A broadband connection is a gateway to the home and it opens the door to new applications that are not practical on dial up.

We expect the type of offerings to broaden further in the next three years, with applications such as VoIP, Video on Demand and Massive Multiplayer Online Gaming moving from niche to mass market.

Other applications such as home security monitoring, remote maintenance, video conferencing and virtual private networks are also growing in popularity.

Having 256k will not be enough to take advantage of these new trends and consumers will be seeking higher speeds. iiNet is the best positioned ISP in Australia to deliver high speed broadband to a mass market.

Outlook

In the past six months, the primary focus of senior management has been to tighten the business, ensuring all products are profitable, systems are robust, and service levels are meeting customer expectations. Non-core products have been exited and the management team has been significantly strengthened. We have built a solid platform to support future growth.

In the past five years, we have primarily grown our subscriber base through corporate activity, by buying our competitors. Despite the significant issues with OzEmail, this strategy has been successful in giving us the necessary scale to be able to build our own infrastructure and compete effectively in a market that will be dominated by network owners.

iiNet is positioned to lead the market in high speed broadband, wholesale ADSL, VoIP and to partner effectively with content providers. From now on, the business has to deliver on this promise.

Michael Malone
Managing Director

management structure

Board of Directors

Non-Executive Directors

Andrew Milner
Non-Executive Director

Keith Goodall
Non-Executive Director

Tony Grist
Non-Executive Director

Peter James
Non-Executive Director

Paul Broad
Non-Executive Director

Executive Directors

Peter Harley
Executive Chairman

Michael Malone
Managing Director

Executive Committee

Executives

Stephen Fewster
Chief Financial Officer/ Company Secretary

Steve Dalby
General Manager Regulatory, Australia

Linda French
General Manager, Marketing

Maryna Pienaar
General Manager, Human Resources

David Dans
Chief Information Officer

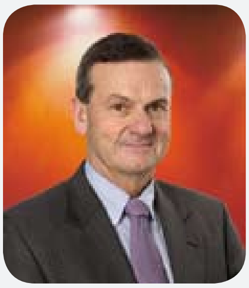
Mark Rushworth
General Manager, New Zealand

David Diprose
General Manager Regulatory, New Zealand

Mark White
Chief Operating Officer

Greg Bader
Chief Technology Officer

board of directors



Peter Harley B.Comm, FCPA, FAICD.
Chairman, Age 56. Director since 1999.
Appointed Chairman 2002.

Peter has significant and wide-ranging commercial experience, particularly in relation to growth focused companies, with which he has worked closely over the past 27 years.

For several years, Peter has been a senior consultant to a number of organisations providing advice on areas including: business planning, strategic marketing and acquisitions and investments. Until his resignation from that committee on 3 July 2006, Peter was a member of the Company's audit committee.

Peter has been a director of the following listed companies over the past three years:

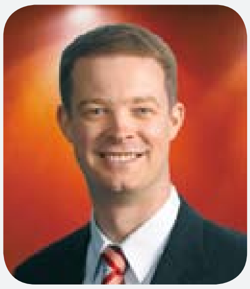
- Gunson Resources Ltd (January 2000 to present)
- Perilya Ltd (November 2003 to present)
- Blaze International Ltd (September 2005 to present)

Michael Malone B.Sc, DipEd.
Managing Director, Age 37.
Director since 1993.

One of the founding partners of iiNet Limited, Michael has been responsible for driving the rapid growth and innovation which has seen iiNet develop from a small WA-based Internet pioneer into the third largest Internet Service Provider (ISP) in Australia and New Zealand.

Michael is active in all facets of the company and has managed to maintain his strong rapport with staff even as the company continues to grow.

Recognised for his dedication and achievements in the industry, Michael has received several industry awards, presented at numerous events and conferences and is widely quoted in the national press.



Andrew Milner B.Bus, (IT)
Non-Executive Director, Age 35.
Director since 1999.

Andrew has 15 years experience in the IT sector, having founded and managed a number of successful high-growth businesses during that time.

Prior to his appointment to the iiNet board in 1999, Andrew was the Managing Director and principal shareholder of Western Australia's second largest ISP, Wantree Internet.

Andrew served as General Manager of iiNet's carrier business Chime Communications until his appointment as non-executive director in 2003.

He also serves as Chairman of L7 Solutions, one of Western Australia's largest and fastest growing IT Systems Integrators.

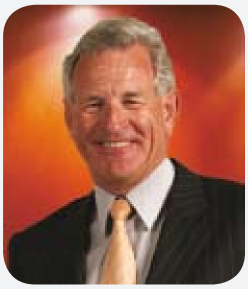
Peter James BA, FAICD
Non-Executive Director, Age 56.
Appointed Director 28 Nov 2003.

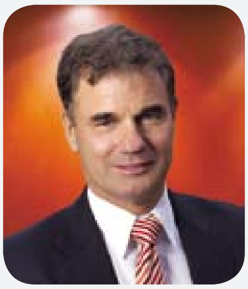
Peter is Managing Director of Adcorp Australia Limited, a publicly listed advertising and communications company. Based in Sydney, Peter has a successful track record across a range of complex businesses including technology, outsourcing, services, recruitment, education and manufacturing. He has over 14 years experience as a Board member of public companies and nine years as CEO/Group Managing Director.

Peter brings significant experience in business development, strategic planning and marketing and has over 30 years experience in the communication and information technology industries.

Peter holds a number of Board positions including director of the following listed companies over the past three years:

- AdCorp Australia Limited (January 2004 to present)
- Ainsworth Game Technology Limited (June 2002 to August 2003)
- Harvest Road Limited (December 1999 to January 2003)





Keith Goodall CA(PP), CMA, FCIS
Non-Executive Director, Age 60.
Appointed Director 21 Oct 2003.

Keith is an Auckland-based chartered accountant who has extensive experience in business consulting on merger and acquisition strategies. Keith operates two successful businesses of his own and joined ihug, now part of the iiNet Group, as Chairman in 2002.

Keith is also Chairman of:

- Bayswater Marina Group
- St Marks Group Ltd
- RX Plastics Ltd
- United Flower Auction Ltd
- Deputy Chairman of Multi-Serve Education Trust Ltd.

Keith heads up the iiNet Audit Committee and is Deputy Chairman of the iiNet Board.

Paul Broad BComm(Hons), MComm (Econ)
Non-Executive director, Age 55.
Appointed Director 6 June 2006.

Paul Broad is the Managing Director of PowerTel Limited, he was formerly Managing Director of Energy Australia from 1997 to 2004. Prior to this he was Managing Director of Sydney Water from 1993 to 1997 where he introduced significant changes in business principals and values, leading to it's corporatisation in 1995. Previoiusly he had implemented similar reform as Managing Director of the Hunter Water Corporation.

Paul Broad holds a Master of Commerce degree from Newcastle University.

Paul holds the following board position including director of the following listed companies over the past three years.

- PowerTel Limited
  (November 2004 to present)

Tony Grist ASIA, FAIC, BComm
Non-Executive director, Age 43.
Appointed Director 26 July 2006.

Tony Grist is Chairman of Amcom Telecommunications Limited, an ASX listed company. Tony established a Western Australian based private investment group in 1991, and brings to the board significant international public company management expertise.

Tony holds a number of board positions including director of the following listed companies over the past three years:

- Amcom Telecommunications Limited
  (October 1997 to present)
- Alto Energy International Limited
  (January 2006 to present)
- Hillgrove Resources Limited
  (November 2002 to April 2005)

Stephen Fewster B.Bus, CA, ASIA
Chief Financial Officer/
Company Secretary, Age 40.
Appointed November 2005.

Stephen joined iiNet as the Business Development Manager in February 2004 and was appointed as Chief Financial Officer in November 2005. Stephen was previously with Ernst & Young predominantly in the Corporate Finance group and has extensive mergers and acquisition experience.

During his short tenure as Chief Financial Officer Stephen has focussed on reviewing and enhancing iiNet's financial reporting processes. He oversees the preparation of the Company's statutory reports, business development and analysis, credit management and company secretarial services.

Stephen is a member of the Consultative Committee for the School of Accounting at Edith Cowan University and is an assessor for the Securities Institute of Australia.

Clayton Hollingsworth, B.Bus, M.Ec, ACA, ASIA
Chief Financial Officer/Company Secretary. Age 37 (resigned November 2005)

Clayton joined iiNet in December 1999 after successful tenures with Wesfarmers' Business Development division and Ernst & Young's Corporate Finance department. During his time with iiNet, Clayton led the growth of the business through several strategic acquisitions, managing the acquisition process from initiation through to execution in-house.

He oversaw the corporate finance, business development, financial analysis, corporate services and company secretary activities for iiNet.

directors' report

Your Directors submit their report for the year ended 30 June 2006.

Directors

The names and particulars of the Directors of the Company during or since the end of the financial year are detailed on pages 18 to 19. Directors were in office for the entire year unless stated otherwise.

Interests in the shares and options of the company and related bodies corporate

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

Director	Number of ordinary shares	Number of options over ordinary shares
P. C. Harley	140,000	-
M. M. Malone	24,328,167	-
P. A. Broad	-	-
K. N. Goodall	40,000	50,000
P. R. James	20,000	50,000
A. L. Milner	2,300,000	50,000
A. J. Grist	-	-

Dividends

	Cents	$
Final dividends recommended:		
On ordinary shares	-	-
Dividends paid in the year:		
Interim for the year		
On ordinary shares	1.0	1,093,703
Final for 2005 as recommended in the 2005 report		
On ordinary shares	4.0	4,366,891

Principal Activities

The principal activities during the year of entities within the consolidated entity were the provision of Internet and telephony services in Australia and New Zealand.

Operating and Financial Review

Operating Result for the Year

Operating revenue of $248.5 million was 52% above that reported for the previous year. Earnings before interest, tax, depreciation and amortisation were $24.6 million, down 33% on the previous year. The net loss for the Group after tax was $62.6 million after a write down of $65.0 million of intangible assets. The write down of intangible assets was a result of the significant change in wholesale prices and terms the Company pays its major supplier and the accelerated trend from high margin dial products to lower margin ADSL products.

Dividend

A fully franked interim dividend of one cent per share was declared on February 24,2006 with a record date of March 7, 2006.

Review of Operations

A detailed review of the operations of the Group is contained in the Chairman's review and Managing Directors report appearing on pages 11 to 16 of this report.

Performance Indicators

Management and the Board monitor the Group's overall performance, from implementation of the strategic plan through to the performance of the Company against operating plans and financial budgets. The Board, together with management, have identified key performance indicators (KPI's) used to measure and monitor performance.

Review of Financial Condition

- During the year $10.7 million was raised by the issue of 12,600,000 shares at $0.85 to PowerTel Ltd. The proceeds were used for working capital.
- The Group produced net cash flows from operating activities of $20.9 million. There was however, significant investment in the network, primarily the capital expenditure associated with the roll out of DSLAM infrastructure over the year (the equipment used to deliver broadband services to our customers "on net").
- With the sale of the ihug business expected to be finalised by December, the ongoing operating cash flow generated by the business and a significant reduction in capital expenditure, there is expected to be a substantial reduction in bank debt during the current year. A placement to PowerTel in August 2006 raised a further $2.6 million.

Risk Management

Refer to corporate governance section.

Significant Changes in the State of Affairs

- The Company issued 12,600,000 shares to PowerTel Ltd at 85 cents per share raising $10.7 million.
- The Company entered into a strategic alliance agreement whereby PowerTel has access to its network under an exclusive wholesale arrangement and PowerTel will in turn provide the Company with wholesale network services.
- A decision was made to write down the carrying value of intangibles by $65 million. The write down of intangible assets was a result of the significant change in wholesale prices and terms the Company pays its major supplier, the accelerated trend from high margin dial products to lower margin ADSL products and an inability to reliably measure future profitability of acquired subscriber bases (refer note 12).

Significant Events After Balance Date

- The Company announced that it was selling its New Zealand subsidiary, ihug Ltd in July 2006. The sale process is expected to be completed by December.
- The Company issued 3,763,986 shares at 69.6 cents per share in August to PowerTel Ltd.
- For further information, please refer to Note 35 to the financial statements.

Likely Developments and Expected Results

A detailed review of the Company's activities and prospects is contained in the Chairman's review and Managing Director's report contained on pages 11 to 16 in this annual report.

Share Options

Unissued Shares

As at the date of this report and the reporting date, there were 3,907,900 unissued ordinary shares under options. Refer to Note 30 of the financial statements for further details of the options outstanding.

Option holders do not have any right by virtue of the options they hold to participate in any share issue of the Company or any related body corporate.

Shares Issued as a Result of the Exercise of Options

During the financial year, employees and executives have exercised options to acquire 114,400 fully paid ordinary shares in iiNet Limited at a weighted average exercise price of $0.76.

Indemnification and Insurance of Directors and Officers

During the year the company paid a premium in respect of a contract insuring the directors of the Company (as named previously), the Company secretary and all executive officers of the Company and of any related body corporate against liabilities incurred in acting in such capacity, to the extent permitted under the Corporations Act 2001. The contract for insurance prohibits the disclosure of the nature of the liability and the amount of the premium.

Remuneration Report (Audited)

(a) Remuneration of Key Management Personnel (KMP)

The Company has applied the exemption under Corporations Amendments Regulation 2006 which exempts listed companies from providing remuneration disclosures in relation to their key management personnel in their annual financial reports by Accounting Standard AASB 124 "Related Party Disclosures".

The following disclosures have been audited.

Key Management Personnel

(i) Directors

P. C. Harley	Chairman (Executive)
M. M. Malone	Managing Director
K. N. Goodall	Director (Non-Executive)
P. R. James	Director (Non-Executive)
A. L. Milner	Director (Non-Executive)
P. A. Broad (appointed 6 June 2006)	Director (Non-Executive)
A. J. Grist (appointed 26 July 2006)	Director (Non-Executive)

(ii) Executives

C. W. Hollingsworth	Chief Financial Officer Company Secretary (resigned November 2005)
S. R. Fewster	Chief Financial Officer Company Secretary (appointed November 2005)
G. Bader	Chief Technology Officer
D. J. Dans	Chief Information Officer (appointed December 2005)
L. G. French	General Manager - Marketing
S. Dalby	General Manager - Regulatory, Australia
M. Pienaar	General Manager - Human Resources
M. Rushworth	General Manager - New Zealand (appointed August 2005)
M. White	Chief Operating Officer (appointed September 2006)
D. Diprose	General Manager - Regulatory, New Zealand

Remuneration Philosophy

The performance of the Company depends upon the quality of its directors and executives. To prosper, the Company must attract, motivate and retain highly skilled directors and executives. To this end, the Company embraces the following principles in its remuneration framework:

- Provide competitive rewards to attract high calibre executives;
- Link executive rewards to shareholder value;

- Place a significant portion of executive remuneration "at risk" and dependent upon meeting pre-determined performance benchmarks;
- Establish appropriate, demanding performance hurdles in relation to variable executive remuneration;
- Recommendation that directors sacrifice a portion of their fees to acquire shares in the Company at market price.

Remuneration Committee
The Remuneration Committee of the Board of directors of the Company is responsible for determining and reviewing compensation arrangements for the directors, the Managing Director and the senior management team. The Remuneration Committee assesses the appropriateness of the nature and amount of remuneration of directors and senior managers on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and executive team.

Remuneration Structure
In accordance with best practice corporate governance, the structure of directors and senior managers remuneration is separate and distinct.

Non-Executive Director Remuneration

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

Structure
The Constitution and the ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. An amount not exceeding the amount determined is then divided by the directors as agreed. The latest determination was at the Annual General Meeting held on 28 November, 2003 when shareholders approved an aggregate remuneration of $400,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned amongst directors is reviewed annually. The Board considers advice from external consultants as well as the fees paid to non-executive directors of comparable companies when undertaking the annual review process.

Each director receives a fee for being a director of the Company. An additional fee may also be paid for each board committee on which a director sits. The payment of additional fees for serving on a committee recognises the additional time commitment required by directors who serve on one or more sub committees. Currently, additional fees are only paid for service on the Audit Committee.

Non-executive directors have long been encouraged by the board to hold shares in the company (purchased by the director on the market). It is considered good governance for directors to have a stake in the company whose board he or she sits. Subject to shareholder approval the non-executive directors of the company can participate in specified issues of discretionary options, which provide incentives where specified criteria are met.

The remuneration of non-executive directors for the period ending 30 June 2006 is detailed on page 27 of this report.

Senior Manager and Executive Director Remuneration

Objective
The company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the company so as to:
- Reward executives for company, business unit and individual performance against targets set by reference to appropriate benchmarks;
- Align the interests of executives with those of shareholders;
- Link reward with the strategic goals and performance of the company; and
- Ensure total remuneration is competitive by market standards.

Structure
In determining the level and make-up of executive remuneration, the Remuneration Committee sourced independent research on the market of remuneration for comparable executive roles meeting from which the Committee makes its recommendations to the Board.

Remuneration packages contain the following key elements:

- Fixed compensation;
- Variable compensation;
  - Short Term Incentive (STI); and
  - Long Term Incentive (LTI).

Fixed Compensation
Fixed compensation is structured as a total employment cost package which may be delivered as a mix of cash and prescribed non-financial benefits.

Executives are offered a competitive fixed base pay. The remuneration committee obtains relevant comparative information and seeks independent advice to ensure base pay is set to reflect the market for a comparable role. Base pay for senior executives is reviewed annually to ensure the executive's pay is competitive with the market. An executive's pay is also reviewed on promotion.

There are no guaranteed base pay increases for any senior executives.

Benefits
Executives can elect to salary sacrifice in order to receive fringe benefits such as motor vehicles and expense payment plans. Retirement benefits are delivered under the Superannuation Guarantee Legislation.

Variable Compensation
Short Term Incentives – Performance Related Bonuses

The objective of the performance related bonuses is to link the achievement of the Company's operational targets with remuneration received by executives charged with meeting those targets.

The total potential bonus available is set at a level so as to provide sufficient incentive to the senior manager to achieve the operational targets and such that the cost to the company is reasonable in the circumstances.

Structure
Actual bonus payments granted to each senior manager depend on the extent to which specific operating targets set at the beginning of the financial year are met.

The operational targets consist of a number of Key Performance Indicators (KPIs) covering both financial and non-financial measures of performance.

Typically included are measures such as contribution to net profit after tax, customer service, risk management, product management, and leadership/team contribution.

The company has predetermined benchmarks which must be met in order to trigger payments under the performance related bonus scheme. On an annual basis, after consideration of the performance against KPIs, an overall performance rating for the company and each individual business unit is approved by the Remuneration Committee.

The individual performance of each executive is also rated and all three ratings are taken into account when determining the amount, if any, of the performance related bonus pool allocated to each executive.

The aggregate of annual bonus payments available for executives across the Company is subject to the approval of the Remuneration Committee. Payments are usually delivered as a cash bonus.

For the 2005 financial year, 100% of cash bonus vested to executives has been paid. Bonus payments for the 2006 financial year were $159,940 from a maximum pool of $253,328.

Long Term Incentives – iiNet Employee Share Option Plan

This long term incentive component of the remuneration package is to reward executive directors and senior managers in a manner which aligns a proportion of their remuneration package with operational targets consisting of both financial and non-financial measures of performance over a longer period than the short term incentives.

The long term incentive benefits are delivered in the form of options to acquire ordinary shares in the Company.

The use of options that are issued with an exercise price at market price ensures that the executive director or senior manager only receives a benefit where shareholder wealth has increased through an increase in the market value of the Company's shares.

The options issued under the 2002 Employee Share Option Plan are issued on the basis that 50 percent of the total number issued will vest on the 18 month and 36 month anniversary dates following their issue. The options have a 5 year life and can be exercised at any time after they have vested. The exercise price is set at the prevailing market price of the Company's ordinary shares at the time of the issue of the options.

The options do not entitle the holder to voting or dividend rights.

Options that have not vested are cancelled if the executive director or senior manager ceases to be an employee of the Company.

The options are allocated to executive directors and senior management personnel on the basis of the incumbent's position and responsibilities on the recommendation of the Managing Director and the approval of the Board. Options issued to the Managing Director are on the recommendation of the Chairman and are approved by the Board.

All options granted to executive directors are approved in advance by shareholders.

Relationship Between Remuneration Policy and the Performance of iiNet

iiNet's remuneration policy aims to achieve a link between the remuneration received by executives and operational targets consisting of both internal financial benchmarks and internal non-financial measures of performance.

Employment Agreements

The following executives (all Australian based) are Permanent Employees employed under Australian Workplace Agreements (AWA's):

- M. M. Malone (Executive Director)
- C. W. Hollingsworth (resigned 2 November 2005)
- S. R. Fewster (appointed November 2005)
- G. Bader
- S. Dalby
- D. J. Dans (appointed December 2005)
- L. G. French
- M. White (appointed September 2006)

AWA agreements Name	Agreement Commence	Agreement Expire
M.M. Malone	28 Jul 2006	30 Jun 2009
C.W. Hollingsworth	23 Dec 2004	Resigned 2 Nov 2005
S.R. Fewster	14 Sep 2006	30 Jun 2009
G. Bader	01 Aug 2006	30 Jun 2009
S. Dalby	02 Aug 2006	30 Jun 2009
D.J. Dans	01 Aug 2006	30 Jun 2009
L.G. French	23 Dec 2004	31 Oct 2007

If no new agreements are made prior to the expiry of the agreements, the agreements will continue under the same terms and conditions that existed under the expired agreements until the parties sign a new AWA.

Under the terms of the AWA's:

- The Executive Director and Officers may resign from their positions and thus terminate their contracts by giving 4 weeks notice if tenure is less than 12 weeks or 12 weeks notice if tenure is greater than 12 weeks. On resignation any options will be forfeited.

- The company may terminate their employment agreement by providing the following notice or provide payment in lieu of the notice period:

Period of Service	Period of Notice
Up to 12 weeks	4 weeks
More than 12 weeks	12 weeks

The period of notice is increased by 1 week if the Employee is over 45 years of age and has completed at least 2 years continuous service with the Company.

The Company may dismiss the Employee at any time without notice for refusal of duty, neglect of duty or misconduct which contravenes rules and regulations as set out in the Company's Policies and Procedures, or misconduct which at law would justify summary dismissal.

If the Employee is dismissed on this basis, the Employee will be entitled to be paid for work up to the time of the Employee's dismissal only.

In the event the Company terminates the employee's services, any options that have vested or will vest during the notice period will be released. Options that have not yet vested will be forfeited.

The following executives (all New Zealand based) are Permanent Employees employed under New Zealand Employment Agreements. Their agreements commenced on the stated dates and are ongoing (i.e. have no expiry date):

- M. Pienaar
  (1 April 2003 commencement)
- D. Diprose
  (1 April 2003 commencement)
- M. Rushworth
  (1 August 2005 commencement)

Under the New Zealand Agreement:

- Either party may terminate the agreement by providing twelve weeks notice, provided that nothing shall prevent the summary termination of employment for serious misconduct.
- Where due notice is given all money due shall be paid at the time of termination. If the Employee is dismissed, the Employee will be entitled to be paid for work up to the time of the Employee's dismissal only.

On resignation any options will be forfeited.

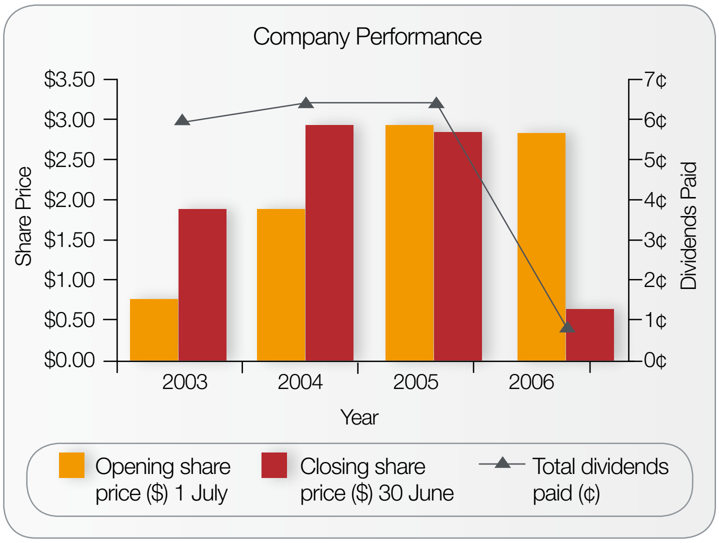
In the event the Company terminates the employee's services, any options that have vested or will vest during the notice period will be released. Options that have not yet vested will be forfeited.

Relationship Between Remuneration Policy and the Performance of iiNet

iiNet's remuneration policy aims to achieve a link between the remuneration received by executives, increased earnings and the creation of shareholder wealth.

Company Performance and Shareholder Wealth

iiNet's performance as measured by dividends paid during the year and the opening and closing prices at which the company's ordinary shares are traded on Australian Stock Exchange for the past four years is as follows:



Compensation of Key Management Personnel

The table below includes remuneration details of the directors and 5 executives who received the highest remuneration for the year ended 30 June 2006.

	Short-term				Post Employment		Long-term	Share-based payment		
Directors	Salary & fees	Cash bonus	Non-monetary benefits	Other	Superannuation	Retirements benefits	Incentive plans	Options [i]	Total	Total performance related (%)
P. C. Harley										
2005	89,500	-	-	-	8,055	-	-	-	97,555	0
2006	134,750	-	-	-	8,550	-	-	-	143,300	0
M. M. Malone										
2005	245,512	-	12,913	-	14,481	-	-	-	272,906	0
2006	300,000	-	5,486	-	12,139	-	-	-	317,625	0
P. A. Broad										
2005	-	-	-	-	-	-	-	-	-	0
2006	-	-	-	-	-	-	-	-	-	0
K. N. Goodall										
2005	62,500	-	-	-	5,625	-	-	44,067	112,192	0
2006	63,920	-	-	-	-	-	-	15,925	79,845	0
P. R. James										
2005	52,500	-	-	-	4,725	-	-	44,067	101,292	0
2006	50,962	-	426	-	4,587	-	-	15,925	71,900	0
A. L. Milner										
2005	52,500	-	-	-	8,213	-	-	44,067	104,780	0
2006	70,000	-	288	-	4,950	-	-	15,925	91,163	0
Executives										
C. W. Hollingsworth [1]										
2005	255,577	-	-	-	14,389	-	-	207,932	477,898	0
2006	150,944	-	1,624	-	5,371	-	-	8,528	166,467	0
S. R. Fewster [ii]										
2006	105,705	-	8,702	-	9,104	-	-	27,981	151,492	0
G. Bader										
2005	153,404	30,000	13,924	-	13,856	-	-	174,287	385,471	60
2006	160,000	37,500	11,164	-	12,139	-	-	140,754	361,557	75
D. J. Dans [iii]										
2006	77,000	-	-	-	6,572	-	-	8,390	91,962	0
L. G. French										
2005	146,115	37,500	-	-	13,593	-	-	46,674	243,882	75
2006	159,942	25,000	854	-	12,139	-	-	39,735	237,670	42
S. Dalby										
2005	105,193	10,000	4,278	-	10,350	-	-	18,056	147,877	50
2006	110,000	10,000	426	-	10,269	-	-	15,888	146,583	50
M. Pienaar										
2005	103,502	9,940	-	-	-	-	-	17,293	130,735	40
2006	103,603	29,478	-	-	-	-	-	20,583	153,664	78
M. Rushworth [iv]										
2006	132,084	54,745	-	-	-	-	-	8,390	195,219	100

1 Resigned November 2005

Retirement benefits were previously paid to directors upon retirement, being one third of the maximum prescribed benefit by s200G of the Corporations Act 2001. The Board resolved in November 2003 that no additional benefits accrue under this arrangement. The benefit payable to that time of $74,790 to P. C. Harley on retirement has been fully provided for, and will be payable on his retirement from the Board, but is not reflected in the above remuneration table.

i Refer to Note 30 Employee Benefits for details of the calculation of fair values of equity settled share based payments.
ii S. Fewster did not meet the definition of a key management person under AASB 124 "Related Party Disclosures" for the 2005 financial year but is a key management person from 2 November 2005.
iii D. J. Dans joined iiNet Limited on 5 December 2005.
iv M. Rushworth joined iiNet Limited on 1 August 2005.

Compensation of Key Management Personnel

Options granted as part of remuneration

30 June 2006

Executives	Grant date	Granted (number)	Vested (number)	Fair value per option at grant date (Note 30)	Exercise price (Note 30)	Expiry date	First exercise date	Last exercise date
S. R. Fewster	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
G. Bader	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
D. J. Dans	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
L. G. French	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
S. Dalby	31 Jan 2006	45,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
M. Pienaar	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011
M. Rushworth	31 Jan 2006	75,000	-	0.5140 & 0.5830	1.74	31 Jan 2011	31 Jul 2008	31 Jan 2011

30 June 2005

Executives	Grant date	Granted (number)	Vested (number)	Fair value per option at grant date (Note 30)	Exercise price (Note 30)	Expiry date	First exercise date	Last exercise date
C. W. Hollingsworth	29 Jul 2004	250,000	-	1.02	2.80	29 Jul 2009	29 Jan 2006	29 Jul 2009
G. Bader	2 Jul 2004	200,000	-	0.84	4.00	2 Jul 2009	2 Jan 2005	2 Jul 2009
G. Bader	2 Jul 2004	200,000	-	0.64	5.00	2 Jul 2009	2 Jan 2005	2 Jul 2009
L. G. French	2 Jul 2004	80,000	-	1.17	2.88	2 Jul 2009	2 Jan 2005	2 Jul 2009
S. R. Fewster	2 Jul 2004	50,000	-	1.17	2.88	2 Jul 2009	2 Jan 2005	2 Jul 2009

Please refer to the terms and conditions of the options issued under the executive option schemes. These options lapse automatically on cessation of employment.

Shares Issued on Exercise of Compensation Options

No shares were issued on exercise of compensation options in the year ended 30 June 2006.

The following shares were issued on exercise of compensation options in the year ended 30 June 2005:

	Number of options exercised and Shares issued Number	Paid per share	Unpaid per share	Grant date	Grant number	Value per option at grant date $	Value of options exercised
Directors							
P. C. Harley	100,000	$1.50	-	1 Dec 2000	100,000	0.0055	$550
P. C. Harley	60,000	$1.00	-	1 Sep 1999	60,000	0.0500	$3,000
M. M. Malone	500,000	$1.50	-	1 Nov 2000	500,000	0.0055	$2,750
Executives							
C. W. Hollingsworth	500,000	$1.50	-	1 Dec 2000	500,000	0.0055	$2,750
C. W. Hollingsworth	100,000	$0.48	-	6 Dec 2001	200,000	2.8198	$281,980
C. W. Hollingsworth	31,500	$1.42	-	3 May 2003	63,000	0.9333	$29,399

Directors' Meetings
The number of meetings of directors (including meetings of committees of directors) held during the year and the number of meetings attended by each director were as follows:

	Directors' Meetings	Audit	Remuneration
Number of meetings held:	25	4	2
Number of meetings attended:			
P. C. Harley	25	2	1
M. M. Malone	25	*	*
P. A. Broad	1	*	*
K. N. Goodall	25	4	2
P. R. James	25	4	2
A. L. Milner	25	4	2

* denotes director was not a member of the board or the committee at the date of the meeting and is therefore not eligible to attend other than by invitation.

All directors were eligible to attend all meetings except P. A. Broad who was eligible to attend one (1) meeting.

Committee Membership
As at the date of this report the company had an Audit Committee and a Remuneration Committee of the Board of Directors.

Members acting on the committees of the Board during the year were:

Audit
K. N. Goodall (Chairman)
P. R. James
A. L. Milner
P. C. Harley (resigned July 2006)

Remuneration
P. R. James (Chairman)
A. L. Milner
K. N. Goodall
P. C. Harley

Auditor Independence and Non-Audit Services
The directors received the following declaration from the auditor of iiNet Limited (refer page 31).

Non-Audit Services
The following non-audit services were provided by the Company's auditors, Ernst & Young. The directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act (2001). The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Ernst & Young received or are due to receive the following amounts for the provision of non-audit services:

Taxation services	$359,223
Other Assurance	$635,676

Signed in accordance with a resolution of directors.

Michael Malone
Managing Director
Friday 29 September 2006

The Ernst & Young Building
11 Mounts Bay Road
Perth WA 6000
Australia

GPO Box M939
Perth WA 6843

Tel 61 8 9429 2222
Fax 61 8 9429 2436

Auditor's Independence Declaration to the Directors of iiNet Limited

In relation to our audit of the financial report of iiNet Limited for the financial year ended 30 June 2006, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

G. H. Meyerowitz
Partner
Perth
29 September 2006

ERNST & YOUNG

The Ernst & Young Building
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Independent audit report to members of iiNet Limited

Scope

The financial report, remuneration disclosures and directors' responsibility

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

The company has disclosed information as required by paragraphs Aus 25.4 to Aus 25.7.2 of Accounting Standard 124 Related Party Disclosures ("remuneration disclosures"), under the heading "Remuneration Report" on pages 22 to 29 of the Directors' Report, as permitted by Corporations Regulation 2M.6.04.

The directors of the company are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the company and the consolidated entity, and that complies with Accounting Standards in Australia, in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for the remuneration disclosures contained in the Directors' report.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with Accounting Standard AASB 124 Related Party Disclosures. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the remuneration disclosures comply with Accounting Standard AASB 124 Related Party Disclosures.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report and the remuneration disclosures; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report and the remuneration disclosures. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the company.

Independence

We are independent of the company and the consolidated entity and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the Directors' Report. In addition to our audit of the financial report and the remuneration disclosures, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Audit opinion

In our opinion:

1. the financial report of iiNet Limited is in accordance with:

(a) the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of iiNet Limited and the consolidated entity at 30 June 2006 and of their performance for the year ended on that date; and

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

(b) other mandatory financial reporting requirements in Australia.

2. the remuneration disclosures that are contained on pages 22 to 29 of the Directors' Report comply with Accounting Standard AASB 124 Related Party Disclosures.

Ernst & Young

G H Meyerowitz
Partner
Perth

29 September 2006

directors' declaration

In the opinion of the directors:

1. (a) the financial statements and notes of the Company and of the consolidated entity are in accordance with the Corporations Act 2001, including:

   (i) giving a true and fair view of the Company's and consolidated entity's financial position as at 30 June 2006 and of their performance for the year ended on that date; and
   (ii) complying with Accounting Standards and Corporations Regulations 2001

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

2. 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 ending 30 June 2006.

3. In the opinion of the directors, as at the date of the declaration, there are reasonable grounds to believe that the members of the closed group identified in note 10 will be able to meet any obligations or liabilities to which they are or may become subject, by virtue of the Deed of Cross Guarantee.

Signed in accordance with a resolution of the directors.

On behalf of the directors

M. M. Malone
Managing Director
Perth, Western Australia
29 September 2006

P. C. Harley
Chairman
Perth, Western Australia
29 September 2006

income statement

For the year ended 30 June 2006	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Rendering of services		240,124,341	153,657,056	143,487,264	72,788,766
Sale of goods		7,544,590	2,612,103	7,544,590	2,612,103
Intercompany dividends		-	-	11,485,381	11,922,785
Other revenue	3(a)	876,630	890,879	545,029	2,264,115
Total revenue		248,545,561	157,160,038	163,062,264	89,587,769
Direct Service Expenses					
Cost of sales and services rendered		(152,621,251)	(71,518,857)	(123,938,540)	(45,405,815)
Gross Profit		95,924,310	85,641,181	39,123,724	44,181,954
Other income	3(b)	586,056	14,023	228,054	918
Employee expenses		(45,282,292)	(31,390,532)	(33,861,578)	(20,187,668)
Marketing expense		(5,214,995)	(3,008,411)	(2,300,674)	(912,666)
Office costs		(11,556,523)	(9,684,541)	(6,065,756)	(4,384,670)
Administrative expenses		(9,030,067)	(5,971,818)	(7,269,260)	(3,199,729)
Depreciation and amortisation expense	3(c)	(26,371,671)	(18,570,016)	(12,575,202)	(6,364,390)
Impairment losses	3(f)	(65,023,117)	-	(51,672,709)	-
(Losses)/Profit from continuing operations before tax and finance costs		(65,968,299)	17,029,886	(74,393,401)	9,133,749
Financing costs	3(e)	(4,955,884)	(2,671,164)	(4,830,028)	(2,594,250)
(Losses)/Profit from continuing operations before income tax		(70,924,183)	14,358,722	(79,223,429)	6,539,499
Income tax (expense)/benefit	4	8,373,272	(3,946,152)	9,158,943	1,054,681
(Losses)/Profit attributable to members of iiNet Limited		(62,550,911)	10,412,570	(70,064,486)	7,594,180
(Loss)/Earnings per share (cents per share)	23				
- basic profit for the year		(56.9)	11.8		
- diluted for profit for the year		(56.9)	11.7		
- dividends per share		1.0	6.5		

balance sheet

As at 30 June 2006	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Current Assets					
Cash and cash equivalents	25	7,390,535	25,387,373	4,824,355	20,095,048
Trade and other receivables	5	19,237,121	21,835,649	9,103,304	13,146,131
Inventories	6	480,351	497,087	435,145	185,978
Prepayments	7	5,351,628	3,183,279	3,538,930	1,535,856
Other	8	306,751	2,612,840	336,328	345,511
Total Current Assets		32,766,386	53,516,228	18,238,062	35,308,524
Non-current Assets					
Receivables	9	-	375	140,202,103	202,516,837
Other financial assets	10	-	-	10,004	10,004
Property, plant and equipment	11	50,724,026	29,705,658	41,086,559	22,417,090
Intangible assets and goodwill	12	144,510,028	213,303,540	8,290,254	6,363,804
Deferred income tax asset	4	1,661,935	5,120,743	951,429	1,462,106
Other	14	-	-	-	220,524
Total Non-current Assets		196,895,989	248,130,316	190,540,349	232,990,365
Total Assets		229,662,375	301,646,544	208,778,411	268,298,889
Current Liabilities					
Trade and other payables	15	41,395,735	32,401,110	30,046,128	11,033,565
Unearned revenue	16	14,649,011	16,529,856	6,657,213	11,303,545
Interest bearing loans and borrowings	17	13,536,323	11,994,823	13,533,699	11,947,802
Income tax payable		-	851,405	-	1,630,557
Provisions	18	3,577,586	5,875,891	2,535,856	1,383,059
Total Current Liabilities		73,158,655	67,653,085	52,772,896	37,298,528
Non-current Liabilities					
Interest bearing loans and borrowings	19	44,372,016	53,804,061	44,372,016	53,800,555
Deferred income tax liabilities	4	498,206	10,815,712	-	1,315,519
Provisions	20	35,818	128,328	35,818	61,554
Total Non-current Liabilities		44,906,040	64,748,101	44,407,834	55,177,628
Total Liabilities		118,064,695	132,401,186	97,180,730	92,476,156
Net Assets		111,597,680	169,245,358	111,597,681	175,822,733
Equity					
Issued capital	21	180,800,726	170,195,672	180,800,726	170,195,672
(Accumulated Losses)/Retained Earnings	22	(70,928,805)	(2,917,300)	(71,334,267)	4,190,813
Other reserves	22	1,725,759	1,966,986	2,131,222	1,436,248
Total Equity		111,597,680	169,245,358	111,597,681	175,822,733

statement of changes in equity For the year ended 30 June 2006

Consolidated	Issued Capital	(Accumulated Losses) / Retained Earnings	Employee Equity Benefits Reserve	Foreign Currency Translation Reserve	Total
	$	$	$	$	$
At 1 July 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)
30 June 2005	170,195,672	(2,917,300)	1,436,248	530,738	169,245,358
Loss for the period	-	(62,550,911)	-	-	(62,550,911)
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	(70,928,805)	2,131,222	(405,463)	111,597,680

Company	Issued Capital	(Accumulated Losses) / Retained Earnings	Employee Equity Benefits Reserve	Foreign Currency Translation Reserve	Total
	$	$	$	$	$
At 1 July 2004	84,720,239	1,844,735	455,911	-	87,020,885
Profit for the period	-	7,594,180	-	-	7,594,180
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)
30 June 2005	170,195,672	4,190,813	1,436,248	-	175,822,733
Profit for the period	-	(70,064,486)	-	-	(70,064,486)
Currency translation differences	-	-	-	-	-
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	(71,334,267)	2,131,222	-	111,597,681

cash flow statement For the year ended 30 June 2006

For the year ended 30 June 2006	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Cash flows from operating activities					
Receipts from customers		248,621,271	145,274,870	152,030,763	70,456,013
Payments to suppliers and employees		(224,116,947)	(115,924,057)	(143,080,647)	(57,612,876)
Interest received		784,029	839,677	(1,034,518)	371,718
Interest and other costs of finance paid		(5,055,800)	(952,330)	(5,345,542)	(861,458)
Income tax received/(paid)		663,169	(7,068,674)	6,723,543	(2,572,335)
Net cash flows from operating activities	25(c)	20,895,722	22,169,486	9,293,599	9,781,062
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)	-	(1,633,481)
Purchase of plant and equipment		(23,376,594)	(19,152,044)	(17,553,603)	(17,138,622)
Proceeds from sale of plant and equipment		-	76,959	-	918
Proceeds from sale of intangibles		586,056	431,204	-	-
Payment for controlled entities		-	-	-	(2)
Acquisition of business, net of cash acquired		(815,417)	(117,475,308)	-	-
Payment of other development costs		(2,045,663)	(50,706)	(17,000,474)	(906,137)
Net cash flows used in investing activities		(36,668,065)	(142,384,410)	(34,554,077)	(19,677,324)
Cash flows from financing activities					
Proceeds from issue of shares		10,819,254	87,111,751	10,605,054	87,111,751
Payments for capital raising costs		(214,200)	(2,337,596)	-	(2,337,596)
Net loans (received from)/ advanced to related parties		-	-	12,482,285	(111,162,418)
Proceeds from /(repayments of) borrowings		5,867,187	94,286,276	(7,842,521)	91,435,520
Repayment of borrowings		(13,757,732)	(33,041,174)	-	(30,000,000)
Equity dividends paid		(5,460,594)	(5,248,102)	(5,460,594)	(5,248,102)
Net cash flows (used in)/from financing activities		(2,746,085)	140,771,155	9,784,224	29,799,155
Net (decrease)/increase in cash		(18,518,428)	20,556,231	(15,476,254)	19,902,893
Net foreign exchange difference		-	(12,655)	-	12,829
Cash and cash equivalents at beginning of period		26,785,261	6,241,685	20,732,898	817,176
Cash and Cash Equivalents at end of period	25(a)	8,266,833	26,785,261	5,256,644	20,732,898

1.Corporate Information

The financial report of iiNet Limited (the Company) for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors on 29 September 2006.

iiNet Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange. The nature of the operations and principal activities of the Group are described on page 21 of the Directors' Report.

2.Summary of Significant Accounting Policies

(a) Basis of accounting

The financial report is a general-purpose financial report which has been prepared in accordance with the requirements of the Corporations Act 2001, applicable Accounting Standards and other mandatory professional reporting requirements. The financial report has been prepared on a historical cost basis. The financial report is presented in Australian dollars.

(b) Statement of Compliance

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

This is the first financial report prepared based on AIFRS and comparatives for the year ended 30 June 2006 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.

The main adjustments necessary that would make the comparative financial statements comply with revised AASB 132 and AASB 139 are listed below. Similar adjustments were made at 1 July 2005 to restate the opening financial position of the company and consolidated entity to a position consistent with the accounting policies specified in note 2:

(i) the measurement of financial assets designated as held-to-maturity and loans and receivables at amortised cost, rather than at cost in accordance with the superceded policy.
(ii) the measurement of financial liabilities at amortised cost, rather than at cost in accordance with superceded policy.
(iii) the recognition of any current or deferred taxes in relation to the adjustments described above.

It is not practicable for the Company and the consolidated entity to detail the amounts of the adjustments to profit or loss and to opening retained earnings for the comparative period had the new accounting policies relating to financial instruments been applied from the beginning of the comparative period. In addition, it is not practicable for the Company and the consolidated entity to detail for the current period, the amounts of the adjustments resulting to each financial statement line item as a consequence of applying the accounting polices specified elsewhere in note 2.

Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report are detailed in Note 36.

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 required. Therefore no impact.	31 Dec 06	1 Jul 07

(b) Statement of compliance (continued)

AASB Amendment	Affected Standard(s)	Nature of Change to Accounting Policy	Application Date of Standard*	Application Date for Group
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 “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.

Acquisitions have been accounted for using the purchase method of accounting. The purchase method of accounting involves allocating the cost of the business combination to the fair value of the assets acquired and the liabilities and contingent liabilities assumed at the date of acquisition.

(d) Significant Accounting Judgements, Estimates and Assumptions

Significant accounting estimates and assumptions
The carrying amount of certain assets and liabilities are 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.

The assumptions used in this estimation of recoverable amount and the amount of goodwill and intangibles with indefinite useful lives are discussed in note 13.

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, using the assumptions detailed in note 30.

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 account the terms and conditions upon which the instruments were granted, as discussed in note 30.

Amortisation of deferred customer expenditures
In relation to the amortisation of deferred customer expenditures, management judgement is used to determine the estimated contract life. Based on management's review of historical information and customer trends, the average estimated customer life has been determined to be 5 years (2005: 5 years).

(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.

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's 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.

Tax Consolidation

Tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences are recognised in the separate financial statements of the members of the tax consolidated group using the group allocation method. Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax consolidated group are recognised by the Company (as head entity in the tax consolidated group).

Members of the tax consolidated group have entered into a tax funding agreement. Amounts are recognised as payable to or receivable by the Company and each member of the tax consolidated group in relation to the tax contribution amounts paid or payable between the parent entity and the other members of the tax-consolidated group in accordance with this agreement.

Where the tax contribution amount recognised by each member of the tax consolidated group for a particular period is different to the aggregate of the current tax liability or asset and any deferred tax asset arising from unused tax losses and tax credits in respect of that period, the distribution is recognised as a contribution from (or distribution to) equity participants.

(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 from the provision of telecommunications services includes the provision of internet and data services and other services, such as telephone calls.

iiNet records revenue earned from:

- internet and data services over the period of service provided; and
- telephone calls on completion of the call.

(ii) Unearned Income

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.

(iii) 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.

(iv) 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 ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ended 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 ended 30 June 2005

Revenue is recognised when the Group's right to receive payment is established.

(h) Subscriber Acquisitions Costs

Subscriber acquisition costs are deferred and amortised over the specific customer contract periods.

(i) 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 translated at the rate of exchange ruling at the balance sheet date.

All exchange differences arising from the above procedures are taken to the income statement.

As at the reporting date the assets and liabilities of iiNet New Zealand Limited 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 average exchange rate for the period.

The exchange differences arising on the translation 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.

(j) 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.

(k) 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 ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ended 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 ended 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.

(l) Inventories
Inventories are initially measured and recorded at cost and 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.

(m) 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.

(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 unit to which it belongs. When the carrying amount of an asset or cash-generating unit exceeds it 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.

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. 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 is 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

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

(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 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 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 it's recoverable amount.

For plant and equipment, impairment losses are recognised in the income statement in the impairment losses 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 dependent 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 ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ended 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 ended 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 ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ended 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 ended 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.

(i) Surplus lease space
Provision for surplus lease space represents the future lease payments that the consolidated entity is presently obliged to make in respect of surplus lease space under non-cancellable operating leases, less estimated future sub-lease revenue where applicable. The estimate may vary as a result of changes in utilisaton of the leased premises and the sub lease arrangements where applicable.

(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 share options or rights over shares ("equity settled transactions").

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

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked 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; and
- 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.

(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. 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) Pension Plans
The Group's commitment to pension plans is limited to making contributions in accordance with the minimum statutory requirements. There are no 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.

(ab) 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 ended 30 June 2006 and 30 June 2005.

Accounting policies applicable for the year ended 30 June 2006
Financial assets 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 adjusted discount rate of 15%.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
3. Revenue and Expenses					
Revenue and Expenses from Continuing Operations					
(a) Other Revenue					
Finance revenue - interest received					
- other entities		784,029	626,905	545,029	419,998
- related entities		-	-	-	1,844,117
Rental revenue		92,601	263,974	-	-
		876,630	890,879	545,029	2,264,115
(b) Other income					
Gain on disposal of non-current assets		586,056	14,023	228,054	918
(c) Depreciation and Amortisation					
Depreciation of plant and equipment		10,477,468	6,839,313	6,541,113	3,278,209
Amortisation of:					
Subscriber bases		9,423,292	8,000,021	836,694	896,724
Equipment under finance lease		1,944,321	1,886,955	1,615,872	1,268,151
Leasehold improvements		220,542	411,596	108,087	276,117
Capitalised development costs		1,142,646	641,936	1,057,674	337,499
Subscriber Acquisition costs		3,158,676	786,940	2,411,160	304,535
Patents and trademarks		4,726	3,255	4,602	3,155
		26,371,671	18,570,016	12,575,202	6,364,390
(d) Lease payments and other expenses included in the Income Statement					
Operating lease rentals – minimum lease payments		3,888,881	2,563,066	1,297,804	875,757
Net bad and doubtful debts arising from other entities		2,597,506	1,227,281	1,634,447	189,533
Share based payments expense		694,974	980,337	694,974	980,337
(e) Finance Costs					
Interest – other entities		3,940,594	2,023,370	3,878,071	1,957,091
Finance lease interest charges		619,882	256,604	619,882	247,142
Other borrowing costs		395,408	391,190	332,075	390,017
		4,955,884	2,671,164	4,830,028	2,594,250
(f) Impairment					
Impairment of property, plant and equipment	11	1,054,640	-	-	-
Impairment of goodwill	12	41,504,866	-	21,811	-
Writeoff of intangibles	12	22,463,611	-	1,598,298	-
Write down of intercompany loans	9	-	-	50,052,600	-
		65,023,117	-	51,672,709	-

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
4. Income Tax					
The major components of income tax are:					
Income statement					
Current income tax					
Current income tax (benefit)/charge		(2,995,020)	2,939,011	(10,357,096)	(6,498,103)
Adjustments in respect of current income tax of previous years		(1,939,147)	(571,293)	(1,939,147)	421,404
Deferred income tax					
Relating to origination and reversal of temporary differences		(4,943,476)	1,578,434	1,900,701	5,022,018
Adjustments in respect of deferred income tax of previous years		1,504,371	-	1,236,599	-
Income tax (benefit)/expense reported in the income statement		(8,373,272)	3,946,152	(9,158,943)	(1,054,681)
A reconciliation between tax expense and the product of accounting profit/(loss) before income tax multiplied by the Group's applicable income tax rate is as follows:					
Accounting profit /(loss) before income tax		(70,924,183)	14,358,722	(79,223,428)	6,539,499
At the Group's statutory income tax rate of 30% (2005: 30%)		(21,277,255)	4,307,616	(23,767,028)	1,961,850
Income/expenditure not allowable for income tax purposes:					
Add:					
- Impairment of goodwill/Intercompany writedown		12,581,206	-	15,015,780	-
- Adjustments in respect of previous years		(434,776)	(571,293)	(702,548)	421,404
- Expenditure not allowable for income tax purposes		757,553	265,011	205,134	263,901
- Other adjustments to income tax expense		-	69,818	89,719	-
- Non-assessable intercompany dividends		-	-	-	(3,576,836)
- Research and development		-	(125,000)	-	(125,000)
Income tax (benefit)/expense reported in the Income Statement		(8,373,272)	3,946,152	(9,158,943)	(1,054,681)

	Balance Sheet		Income Statement	
	2006	2005	2006	2005
Deferred income tax				
Deferred income tax at 30 June relates to the following:				
Consolidated				
Deferred tax liabilities				
Accelerated depreciation for tax purposes	(6,422,074)	(3,222,854)	3,199,220	1,151,308
Accelerated amortisation of subscriber bases for tax purposes	(438,529)	(6,929,438)	(6,490,909)	1,727,918
Other	(240,423)	(663,420)	(422,997)	30,914
Gross deferred income tax liabilities	(7,101,026)	(10,815,712)		
Deferred tax assets				
Depreciation rate less for tax purposes	(650,157)	2,272,711	2,922,868	(819,376)
Provisions	3,008,566	1,893,868	(1,114,698)	(489,027)
Leases	1,455,390	-	(1,455,390)	-
Share issue expenses recognised directly in equity	654,602	823,537	168,935	-
Other	376,762	130,627	(246,135)	(23,305)
Tax losses	3,419,592	-	-	-
Gross deferred income tax assets	8,264,755	5,120,743		
Deferred tax income/(expense)			(3,439,106)	1,578,432
Deferred tax as represented on the balance sheet				
Deferred tax asset	1,661,935	-		
Net deferred tax liability in foreign jurisdiction	(498,206)	-		
	1,163,729	-		
Company				
Deferred tax liabilities				
Accelerated depreciation for tax purposes	(6,199,997)	(585,021)	5,614,976	1,333,675
Accelerated amortisation of subscriber bases for tax purposes	-	(730,498)	(730,498)	(253,296)
Other	(217,858)	-	217,858	1,225,617
Gross deferred income tax liabilities	(6,417,855)	(1,315,519)		
Deferred tax assets				
Depreciation rate less for tax purposes	307,166	107,032	(200,134)	37,752
Provisions	760,757	254,492	(506,265)	-
Leases	1,455,390	209,765	(1,245,625)	1,626,908
Share issue expenses recognised directly in equity	620,858	819,524	198,666	828,935
Other	282,971	71,293	(211,678)	222,427
Tax losses	3,942,142	-	-	-
Gross deferred income tax assets	7,369,284	1,462,106		
Deferred tax income/(expense)			3,137,300	5,022,018
Deferred tax as represented on the balance sheet				
Net deferred tax asset	951,429			

4. Income Tax (Continued)

Tax consolidation

Effective July 1 2003, for the purpose of income taxation, iiNet Limited and its 100% Australian owned subsidiaries formed a tax consolidation group. Members of the group have entered into a tax sharing arrangement in order to allocate income tax expense to the wholly-owned subsidiaries on a pro-rata basis. The head entity of the tax consolidation group is iiNet Limited. The agreement provides for the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. At balance date, the possibility of default is remote.

Tax effect accounting by members of the tax consolidated group

Tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences are recognised in the separate financial statements of the members of the tax consolidated group using the group allocation method. Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax consolidated group are recognised by the Company (as head entity in the tax consolidated group).

Members of the tax consolidated group have entered into a tax funding agreement. Amounts are recognised as payable to or receivable by the Company and each member of the tax consolidated group in relation to the tax contribution amounts paid or payable between the parent entity and the other members of the tax-consolidated group in accordance with this agreement. Where the tax contribution amount recognised by each member of the tax consolidated group for a particular period is different to the aggregate of the current tax liability or asset and any deferred tax asset arising from unused tax losses and tax credits in respect of that period, the distribution is recognised as a contribution from (or distribution to) equity participants.

	Parent	
	2006 $	2005 $
Total increase to tax benefit of iiNet Ltd	(6,414,954)	(3,643,872)
Total increase to intercompany assets of iiNet Ltd	(6,414,954)	(3,643,872)
Total increase/(reduction) to equity accounts of iiNet Limited (Note 21)	-	-

iiNet has recognised a deferred tax asset of $1,661,935 which relates to the tax losses for the year ended 30 June 2006. Following a review of its product profitability and future strategy in June 2006, iiNet has ceased supplying unprofitable products. As a result of making this change, iiNet has assessed that the deferred tax asset relating to carry forward tax losses meet the recognition criteria under AASB 112.

		Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
5. Trade and Other Receivables					
Trade receivables	(i)	20,399,094	20,452,724	9,812,875	12,090,852
Allowance for doubtful debts	(ii)	(3,807,316)	(4,360,505)	(2,357,985)	(395,914)
Other debtors		2,645,343	5,743,430	1,648,414	1,451,193
		19,237,121	21,835,649	9,103,304	13,146,131

Terms and conditions

(i) Trade receivables are non-interest bearing and generally on 30 day terms.

(ii) Other debtors are non-interest bearing and have collection terms between 30 and 90 days.

6. Inventories - Current

	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Finished goods at the lower of cost and net realisable value	480,351	497,087	435,145	185,978

The cost of inventories expensed for the year was $5,254,190 (2005:$3,465,219)

7. Prepayments

	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Prepayments	5,351,628	3,183,279	3,538,930	1,535,856

	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
8. Other Current Assets				
GST Receivable	306,751	1,190,005	336,328	345,511
Telstra Exchange Building Access refund receivable	-	1,422,835	-	-
	306,751	2,612,840	336,328	345,511
9. Receivables – Non-current				
Loans advanced to entities in the wholly owned group (i)	-	-	140,202,103	202,516,462
Other	-	375	-	375
	-	375	140,202,103	202,516,837

Terms and Conditions:
Loans receivable from related entities are payable on demand.
(i) As part of the impairment review of the Group it was considered necessary to write down the loans advanced by the parent.

	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
10. Other Financial Assets – Non-current				
Investments - at cost				
Shares in controlled entities - unlisted	-	-	10,004	10,004

	Country of Incorporation	Ownership Interest % 2006	2005
Parent Entity			
iiNet Limited			
Controlled Entities			
Held by iiNet Limited			
Chime Communications Pty Ltd	Australia	100%	100%
ihug Pty Ltd	Australia	100%	100%
Connect West Pty Ltd	Australia	100%	100%
Netscapade Pty Ltd	Australia	100%	100%
iiNet New Zealand Limited	New Zealand	100%	100%
iiNet (OzEmail) Pty Ltd	Australia	100%	100%
Held by iiNet New Zealand Limited			
ihug Limited	New Zealand	100%	100%

Entities subject to class order relief

Pursuant to Class Order 98/1418, relief has been granted to Chime Communications Pty Ltd, iHug Pty Ltd, Netscapade Pty Ltd, Connect West Pty Ltd and iiNet (OzEmail) Pty Ltd from the Corporations Act 2001 requirements for preparation, audit and lodgement of their financial reports.

As a condition of the Class Order, iiNet Limited, Chime Communications Pty Ltd, iHug Pty Ltd, Connect West Pty Ltd and iiNet (OzEmail) Pty Ltd (the Closed Group) entered into a Deed of Cross Guarantee on 29 June 2005. The effect of the deed is that iiNet Limited has guaranteed to pay any deficiency in the event of the winding up of either controlled entity. The controlled entities have also given a similar guarantee in the event that iiNet Limited is wound up.

The consolidated income statement and balance sheet of the entities which are members of the closed group are as follows:

10. Other Financial Assets – Non-current (Continued)

	Closed Group 2006 $	Closed Group 2005 $
(i) Consolidated Income Statement		
Profit before income tax	(37,153,557)	7,357,275
Income tax expense /(benefit)	(8,300,222)	(5,795,658)
Net profit	(45,453,779)	1,561,617
Retained profits at the beginning of the financial year	(1,807,606)	1,878,879
Dividends provided for or paid	(5,460,594)	(5,248,102)
Retained profits/(accumulated losses) at the end of the financial year	(52,721,979)	(1,807,606)
(ii) Balance Sheet		
Current Assets		
Cash and cash equivalents	5,110,113	22,146,182
Trade and Other receivables	21,783,772	19,162,671
Inventories	426,925	269,883
Other	3,966,484	4,995,752
Total Current Assets	31,287,294	46,574,488
Non-Current Assets		
Receivables	46,539,193	52,478,013
Property, plant and equipment	54,204,324	28,256,552
Intangible assets	109,110,019	161,035,053
Deferred income tax asset	3,806,886	3,704,385
Other	3,620,570	2,333,946
Total Non-Current Assets	217,280,992	247,807,949
Total Assets	248,568,286	294,382,437
Current Liabilities		
Trade and other payables	36,397,782	28,314,115
Unearned revenue	18,163,788	15,428,059
Interest-bearing loans and borrowings	4,102,353	11,994,823
Income tax payable	(3,935,324)	1,637,375
Provisions	3,185,094	5,467,640
Total Current Liabilities	57,913,693	62,842,012
Non-Current Liabilities		
Interest-bearing loans and borrowings	53,805,986	53,804,061
Deferred income tax liabilities	6,602,820	8,159,249
Provisions	35,818	128,328
Total Non-Current Liabilities	60,444,624	62,091,638
Total Liabilities	118,358,317	124,933,650
Net Assets	130,209,969	169,448,787
Equity		
Issued capital	180,800,726	170,195,672
Accumulated losses	(52,721,979)	(1,807,606)
Other reserves	2,131,222	1,060,721
Total Equity	130,209,969	169,448,787

11. Plant and Equipment

Consolidated - at cost

	Equipment Under Finance Lease	Plant and Equipment	Leasehold Improvements	Total
	$	$	$	$
Gross Carrying Amount				
Balance as at 30 June 2005	11,005,051	42,838,601	2,390,410	56,234,062
Additions	1,456,340	33,189,991	69,008	34,715,339
Disposals	-	-	-	-
Balance as at 30 June 2006	12,461,391	76,028,592	2,459,418	90,949,401
Accumulated Depreciation/Amortisation				
Balance as at 30 June 2005	(4,135,040)	(21,018,257)	(1,375,107)	(26,528,404)
Depreciation Expense	(1,944,321)	(10,477,468)	(220,542)	(12,642,331)
Impairment (i)	-	(1,054,640)	-	(1,054,640)
Disposals	-	-	-	-
Balance as at 30 June 2006	(6,079,361)	(32,550,365)	(1,595,649)	(40,225,375)
Net Book Value				
As at 30 June 2005	6,870,011	21,820,344	1,015,303	29,705,658
As at 30 June 2006	6,382,030	43,478,227	863,769	50,724,026
Company - at cost				
Gross Carrying Amount				
Balance as at 30 June 2005	7,842,110	28,786,745	2,414,068	39,042,923
Additions	1,456,340	25,400,954	77,247	26,934,541
Disposals	-	-	-	-
Balance as at 30 June 2006	9,298,450	54,187,699	2,491,315	65,977,464
Accumulated Depreciation/Amortisation				
Balance as at 30 June 2005	(1,338,099)	(14,056,927)	(1,230,807)	(16,625,833)
Depreciation Expense	(1,615,872)	(6,541,113)	(108,087)	(8,265,072)
Disposals	-	-	-	-
Balance as at 30 June 2006	(2,953,971)	(20,598,040)	(1,338,894)	(24,890,905)
Net Book Value				
As at 30 June 2005	6,504,011	14,729,818	1,183,261	22,417,090
As at 30 June 2006	6,344,479	33,589,659	1,152,421	41,086,559

Assets pledged as security
Assets under lease are pledged as security for the associated lease liabilities.
Under the terms of the debt facility (Note 25 (e)), the Westpac Banking Corporation has a fixed and floating charge over the plant and equipment of the iiNet Group.
(i) As a result of the strategic evaluation of the business it was decided to fully write down unproductive assets.

11. Plant and Equipment (Continued)

Consolidated - at cost	Equipment Under Finance Lease $	Plant and Equipment $	Leasehold Improvements $	Total $
Gross Carrying Amount				
Balance as at 30 June 2004	5,253,283	27,578,910	1,961,346	34,793,539
Net foreign currency movements	-	(152,931)	276	(152,655)
Additions	5,751,768	13,606,523	428,788	19,787,079
Disposals	-	(294,729)	-	(294,729)
Acquired through acquisitions	-	2,100,828	-	2,100,828
Balance as at 30 June 2005	11,005,051	42,838,601	2,390,410	56,234,062
Accumulated Depreciation/Amortisation				
Balance as at 30 June 2004	(2,248,085)	(14,505,971)	(963,628)	(17,717,684)
Net foreign currency movements	-	200,663	117	200,780
Depreciation Expense	(1,886,955)	(6,839,313)	(411,596)	(9,137,864)
Disposals	-	126,364	-	126,364
Balance as at 30 June 2005	(4,135,040)	(21,018,257)	(1,375,107)	(26,528,404)
Net Book Value				
As at 30 June 2004	3,005,198	13,072,939	997,718	17,075,855
As at 30 June 2005	6,870,011	21,820,344	1,015,303	29,705,658
Company - at cost				
Gross Carrying Amount				
Balance as at 30 June 2004	2,090,342	18,023,597	1,917,638	22,031,577
Additions	5,751,768	10,763,148	496,430	17,011,346
Disposals	-	-	-	-
Balance as at 30 June 2005	7,842,110	28,786,745	2,414,068	39,042,923
Accumulated Depreciation/Amortisation				
Balance as at 30 June 2004	(69,948)	(10,778,718)	(954,690)	(11,803,356)
Depreciation Expense	(1,268,151)	(3,278,209)	(276,117)	(4,822,477)
Disposals	-	-	-	-
Balance as at 30 June 2005	(1,338,099)	(14,056,927)	(1,230,807)	(16,625,833)
Net Book Value				
As at 30 June 2004	2,020,394	7,244,879	962,948	10,228,221
As at 30 June 2005	6,504,011	14,729,818	1,183,261	22,417,090

12. Intangible Assets and Goodwill

Consolidated	Subscriber Acquistion costs $	Development costs $	Subscriber bases $	Goodwill[1] $	Patents and trademarks $	Total $
At 1 July 2005						
Cost (gross carrying amount)	3,305,305	4,169,493	53,864,146	175,770,854	77,633	237,187,431
Accumulated amortisation and impairment	(786,940)	(1,580,870)	(21,509,447)	-	(6,634)	(23,883,891)
Net carrying amount	2,518,365	2,588,623	32,354,699	175,770,854	70,999	213,303,540
Year ended 30 June 2006						
At 1 July 2005, net of accumulated amortisation and impairment	2,518,365	2,588,623	32,354,699	175,770,854	70,999	213,303,540
Additions - external cost	5,987,431	-	756,778	-	-	6,744,209
Additions – internal cost	-	2,174,594	-	-	25,386	2,199,980
Impairment	-	-	(22,463,611)	(41,504,866)	-	(63,968,477)
Foreign currency translation difference	-	-	104,302	(144,186)	-	(39,884)
Amortisation	(3,158,676)	(1,142,646)	(9,423,292)	-	(4,726)	(13,729,340)
At 30 June 2006, net of accumulated amortisation and impairment	5,347,120	3,620,571	1,328,876	134,121,802	91,659	144,510,028
At 30 June 2006						
Cost (gross carrying amount)	9,292,736	6,344,087	54,620,924	175,770,854	103,019	246,131,620
Accumulated amortisation and impairment	(3,945,616)	(2,723,516)	(53,292,048)	(41,649,052)	(11,360)	(101,621,592)
Net carrying amount	5,347,120	3,620,571	1,328,876	134,121,802	91,659	144,510,028
[1]purchased as part of business combinations						
Company						
At 1 July 2005						
Cost (gross carrying amount)	1,884,325	3,091,374	12,685,212	-	75,179	17,736,090
Accumulated amortisation and impairment	(304,535)	(811,009)	(10,250,220)	-	(6,522)	(11,372,286)
Net carrying amount	1,579,790	2,280,365	2,434,992	-	68,657	6,363,804
Year ended 30 June 2006						
At 1 July 2005, net of accumulated amortisation and impairment	1,579,790	2,280,365	2,434,992	-	68,657	6,363,804
Additions	5,899,587	1,909,905	-	21,811	25,386	7,856,689
Impairment	-	-	(1,598,298)	(21,811)	-	(1,620,109)
Amortisation	(2,411,160)	(1,057,674)	(836,694)	-	(4,602)	(4,310,130)
At 30 June 2006, net of accumulated amortisation and impairment	5,068,217	3,132,596	-	-	89,441	8,290,254
At 30 June 2006						
Cost (gross carrying amount)	7,783,912	5,001,279	12,685,212	21,811	100,565	25,592,779
Accumulated amortisation and impairment	(2,715,695)	(1,868,683)	(12,685,212)	(21,811)	(11,124)	(17,302,525)
Net carrying amount	5,068,217	3,132,596	-	-	89,441	8,290,254

12. Intangible Assets and Goodwill (Continued)

	Subscriber Acquistion costs	Development Costs	Subscriber bases	Goodwill[1]	Patents and Trademarks	Total
Consolidated	$	$	$	$	$	$
At 1 July 2004						
Cost (gross carrying amount)	-	3,476,851	42,414,958	56,544,387	39,523	102,475,719
Accumulated amortisation and impairment	-	(938,934)	(13,509,426)	-	(3,379)	(14,451,739)
Net carrying amount	-	2,537,917	28,905,532	56,544,387	36,144	88,023,980
Year ended 30 June 2005						
At 1 July 2004, net of accumulated amortisation and impairment	-	2,537,917	28,905,532	56,544,387	36,144	88,023,980
Addition arising from business combination	-	-	11,449,188	119,226,467	-	130,675,655
Additions	3,305,305	692,642	-	-	38,110	4,036,057
Amortisation	(786,940)	(641,936)	(8,000,021)	-	(3,255)	(9,432,152)
At 1 July 2005, net of accumulated amortisation and impairment	2,518,365	2,588,623	32,354,699	175,770,854	70,999	213,303,540
At 30 June 2005						
Cost (gross carrying amount)	3,305,305	4,169,493	53,864,146	175,770,854	77,633	237,187,431
Accumulated amortisation and impairment	(786,940)	(1,580,870)	(21,509,447)	-	(6,634)	(23,883,891)
Net carrying amount	2,518,365	2,588,623	32,354,699	175,770,854	70,999	213,303,540

[1] purchased as part of business combinations

	Subscriber Acquistion costs	Development Costs	Subscriber bases	Goodwill[1]	Patents and Trademarks	Total
Company						
At 1 July 2004						
Cost (gross carrying amount)	-	2,401,072	12,632,810	-	37,065	15,070,947
Accumulated amortisation and impairment	-	(473,510)	(9,353,496)	-	(3,367)	(9,830,373)
Net carrying amount	-	1,927,562	3,279,314	-	33,698	5,240,574
Year ended 30 June 2005						
At 1 July 2004, net of accumulated amortisation and impairment	-	1,927,562	3,279,314	-	33,698	5,240,574
Impairment	-	-	-	-	-	-
Additions	1,884,325	690,302	52,402	-	38,114	2,665,143
Amortisation	(304,535)	(337,499)	(896,724)	-	(3,155)	(1,541,913)
At 30 June 2005, net of accumulated amortisation and impairment	1,579,790	2,280,365	2,434,992	-	68,657	6,363,804
At 30 June 2005						
Cost (gross carrying amount)	1,884,325	3,091,374	12,685,212	-	75,179	17,736,090
Accumulated amortisation and impairment	(304,535)	(811,009)	(10,250,220)	-	(6,522)	(11,372,286)
Net carrying amount	1,579,790	2,280,365	2,434,992	-	68,657	6,363,804

Development costs, subscriber bases and patents and trademarks have been capitalised at cost. These intangible assets have been assessed as having a finite life and are amortised using the straight-line method over the periods disclosed in note 2. If an impairment indication arises, the recoverable amount is estimated and an impairment loss is recognised to the extent that the recoverable amount is lower than the carrying amount.

Goodwill is not amortised but is subject to annual impairment testing (see note 13).

For the years ended 30 June 2006 and 30 June 2005:

- Developments costs have been amortised over their useful life of 2 to 5 years.
- Subscriber bases have been amortised over their useful life of 5 years.
- Patents and trademarks have been amortised over their useful life of 20 years.

Write-down of Subscriber Bases

iiNet has reviewed the carrying value of the subscriber bases relating to its Australian operations. Prior to the write-down these assets had a total carrying value of $23,792,487.

Following the integration of the subscriber bases onto iiNet's billing system, the Company is not able to separately identify and reliably measure the future profitability of certain acquired subscriber bases. As a result, a write-off of $22,463,611 has been recognised.

13. Impairment Testing of Goodwill

Goodwill acquired through business combinations has been allocated to two individual cash-generating units for impairment testing as follows:

- Australia
- New Zealand

Write-down of Australian Operations

iiNet has reviewed the carrying value of the assets relating to its Australian operations (which is a reportable segment). Prior to the write-down these assets had a total carrying value of $168,994,331, including $126,494,295 of goodwill. The recoverable amount for iiNet's Australian operations was assessed on a value in use basis.

In previous periods the recoverable amount had been determined to exceed carrying value. However in the June 2006 assessment it was determined that the recoverable amount was lower than the carrying value and hence impairments have occurred. In determining the recoverable amount a pre-tax discount rate of 15.0% was applied in the June 2006 assessment and 15.9% in the June 2005 assessment.

The decline in the recoverable amount was a consequence of:

- A significant increase in wholesale prices and terms with Telstra Corporation Limited (the principal supplier to iiNet's Australian operations); and
- The migration of high margin dial customers to lower margin ADSL products particularly where the customer is on the Telstra Wholesale network. The rate of this migration accelerated during the year ended 30 June 2006.

These fundamental changes within Australian operations, have led to the recognition of an impairment charge of $27,826,429 at 30 June 2006.

13. Impairment Testing of Goodwill (Continued)

Write-down of New Zealand Operations

iiNet has reviewed the carrying value of the assets relating to its New Zealand operations (which is a reportable segment). Prior to the write-down these assets had a total carrying value of $46,484,892, including $38,781,879 of goodwill. The recoverable amount for iiNet's New Zealand operations was assessed on a fair value less costs to sell basis.

In previous periods the recoverable amount had been determined to exceed carrying value. However in the June 2006 assessment it was determined that the recoverable amount was lower than the carrying value and hence impairment has occurred. In determining the recoverable amount the mid point of the non-binding indicative offers received by iiNet from interested parties less transaction costs was used to assess the recoverable amount.

The decline in the recoverable amount was a consequence of the change in product mix sold and the regulatory environment in New Zealand.

These fundamental changes within New Zealand operations, have led to the recognition of an impairment charge of $12,526,010 at 30 June 2006.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
14. Other Non-current Assets					
Intercompany loans		-	-	-	220,524
15. Trade And Other Payables - Current					
Trade creditors	(i)	41,044,448	32,241,615	29,735,782	10,651,621
Other creditors	(ii)	351,287	159,495	310,346	381,944
		41,395,735	32,401,110	30,046,128	11,033,565
Terms and Conditions:					
(i) Trade creditors and GST payable are non-interest bearing and generally on 30 day terms.					
(ii) Other creditors are non-interest bearing and have repayment terms between 30 and 180 days.					
16. Unearned Revenue - Current					
Unearned revenue		14,649,011	16,529,856	6,657,231	11,303,545
17. Interest - bearing Loans and Borrowings - Current					
Bank facility	17(i)	10,000,000	10,000,000	10,000,000	10,000,000
Finance lease liabilities	26(b), 17(ii)	3,536,323	1,994,823	3,533,699	1,947,802
		13,536,323	11,994,823	13,533,699	11,947,802

Terms and Conditions

(i) Amounts drawn-down under the bank facility held with the Westpac Banking Corporation are repayable on a quarterly basis with the facility expiring on February 2008. Interest is recognised at an average rate of 7.29% (2005: 7.33%). The facility has been secured by a fixed and floating charge over the assets of the iiNet group. On 21 September 2006 Westpac increased iiNet's facility by $10 million.

(ii) Finance leases have lease terms of between 1 and 5 years with the option to purchase the assets at the completion of the leases. The average discount rate implicit in the leases is 6.33% (2005: 6.3%). Lease liabilities are secured by a charge over the leased assets. A restriction also exists requiring notification to the lessor of any further finance leases entered into.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
18. Provisions - Current					
Employee entitlements	30	2,536,545	2,198,993	2,175,620	1,342,973
Surplus leased space	a	548,049	65,428	210,236	-
Non-beneficial Contracts	b	-	2,815,821	-	-
Make Good	c	449,998	400,000	150,000	-
Other		42,994	395,649	-	40,086
		3,577,586	5,875,891	2,535,856	1,383,059
Movements in provisions:					
(a) Surplus Leased Space					
Balance as at beginning of the year		65,428	526,661	-	21,438
Additional provisions		503,958	-	210,236	-
Reductions arising from payments/other sacrifices of future economic benefits		(21,337)	(461,233)	-	(21,438)
Balance at year end		548,049	65,428	210,236	-

The provision for surplus leased space represents the future lease payments that the consolidated entity is presently obliged to make in respect of surplus lease space under non-cancellable operating lease operations, less estimated future sub-lease revenue where applicable. The estimate may vary as a result of changes in utilisation of the leased premises and the sub lease arrangements where applicable.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
(b) Non-beneficial Contracts					
Balance as at beginning of the year		2,815,821	-	-	-
Additional provisions arising from acquisition of OzEmail and Virtual Communities		-	5,440,161	-	-
Reductions arising from payments/other sacrifices of future economic benefits		(2,815,821)	(2,624,340)	-	-
Balance at year end		-	2,815,821	-	-

The provision for non-beneficial contracts is a fair value adjustment identified as part of the acquisition of the OzEmail business.

(c) Make Good					
Balance as at beginning of the year		400,000	-	-	-
Arising during the year		449,998	400,000	150,000	-
Reductions arising from payments/other sacrifices of future economic benefits		(400,000)	-	-	-
Balance at year end		449,998	400,000	150,000	-

The provision for make good is a fair value adjustment identified as part of the acquisition of businesses.

18. Provisions - Current (Continued)

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
(d) Other					
Balance as at beginning of the year		395,649	150,613	40,086	93,534
Additional provisions		42,994	355,563	-	-
Reductions arising from payments/other sacrifices of future economic benefits		(395,649)	(110,527)	(40,086)	(53,448)
Balance at year end		42,994	395,649	-	40,086

Other provisions raised include provisions for lease incentives and dial utilisation.

19. Interest Bearing Loans and Borrowings – Non-current

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Bank facility	17(i)	38,000,000	49,000,000	38,000,000	49,000,000
Finance lease liabilities	26(b),17(ii)	6,372,016	4,804,061	6,372,016	4,800,555
		44,372,016	53,804,061	44,372,016	53,800,555

20. Provisions – Non-current

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Employee entitlements	30	35,818	128,328	35,818	61,554
Surplus leased space	(i)	-	-	-	-
		35,818	128,328	35,818	61,554
(i) Surplus leased space					
Balance as at beginning of the year		-	449,497	-	-
Additional provisions		-	-	-	-
Reductions arising from payments/other sacrifices of future economic benefits		-	(449,497)	-	-
Balance at year end		-	-	-	-

21. Issued Capital

	Consolidated and Company			
	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	79,594,416	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	109,126,616	170,195,672

Effective 1 July 1998, the Corporations legislation in place abolished the concepts of authorised capital and par value shares. Accordingly, the Parent does not have authorised capital nor par value in respect of its issued shares.

(b) Terms and conditions of contributed equity

Ordinary shares carry one vote per share and carry the right to dividends.

(c) Share options

Options to take up ordinary shares in the capital of the Company as at 30 June 2006 are:

Exercise Period	Exercise Price	Opening Balance 1 July 2005	Options Granted during 2005/ 2006	Options Exercised during 2005/2006	Options Cancelled/ Expired during 2005/2006	Closing Balance 30 June 2006
	Price $	Number	Number	Number	Number	Number
Granted to Key Management Personnel						
4 November 2004 to 3 May 2008	$1.42	31,500	-	-	31,500	-
1 June 2005 to 1 June 2006 (1st Tranche)	$3.30	150,000	-	-	150,000	-
1 Dec 2006 to 1 Dec 2007 (2nd Tranche)	$4.00	150,000	-	-	-	150,000
2 Jan 2006 to 2 July 2009	$2.88	80,000	-	-	-	80,000
2 Jan 2006 to 2 July 2009	$4.00	200,000	-	-	-	200,000
2 Jan 2006 to 2 July 2009	$5.00	200,000	-	-	-	200,000
29 Jan 2006 to 29 July 2009	$2.80	250,000	-	-	250,000	-
31 July 2007 to 31 Jan 2011	$1.74	-	495,000	-	-	495,000
Granted under employee share option plans (includes employees who are also key management personnel)						
9 Oct 2002 to 9 Apr 2006	$0.61	95,500	-	82,000	13,500	-
6 June 2003 to 6 Dec 2006	$0.48	21,300	-	-	-	21,300
4 May 2006 to 3 May 2008 (non-discretionary)	$1.42	302,000	-	3,500	-	298,500
4 Nov 2004 to 3 May 2008 (discretionary)	$1.42	208,000	-	22,500	44,000	141,500
12 Feb 2007 to 12 Feb 2009 (non-discretionary)	$3.01	927,400	-	6,400	-	921,000
12 Aug 2005 to 12 Feb 2009 (discretionary)	$3.01	381,700	-	-	42,800	338,900
2 Jan 2006 to 2 July 2009	$2.88	165,000	-	-	-	165,000
29 Jan 2006 to 29 July 2009	$2.80	250,000	-	-	250,000	-
31 July 2007 to 31 Jan 2011	$1.74	-	1,471,700	-	-	1,471,700
		3,412,400	1,966,700	114,400	781,800	4,482,900

Consideration received on the exercise of options is recognised in contributed equity. During the financial year $109,254 (2005: $2,133,015) was recognised in contributed equity arising from the exercise of director, executive and employee options.

Further details of the director and specified director options are provided in note 29, and further details of employee share option plans are contained in note 30 to the financial statements.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
22. Reserves and Retained Profits /(Accumulated Losses)					
Retained Profits/(Accumulated Losses)					
Balance at the beginning of the financial year		(2,917,300)	(8,081,768)	4,190,813	1,844,735
Net profit attributable to members of the parent entity		(62,550,911)	10,412,570	(70,064,486)	7,594,180
Dividends provided for or paid from available profits at the time		(5,460,594)	(5,248,102)	(5,460,594)	(5,248,102)
Balance at year end		(70,928,805)	(2,917,300)	(71,334,267)	4,190,813
Other Reserves					
(i) Employee Equity Benefits Reserve					
This reserve is used to record the value of equity benefits provided to employees and directors as part of their remuneration.					
Opening Balance		1,436,248	455,911	1,436,248	455,911
Share based payments		694,974	980,337	694,974	980,337
Balance at year end		2,131,222	1,436,248	2,131,222	1,436,248
(ii) Foreign Currency Translation Reserve					
The foreign currency translation reserve is used to record exchange differences arising from the translation of financial statements of foreign subsidiaries.					
Opening Balance		530,738	543,393	-	-
Loss on transactions of overseas controlled entities		(936,201)	(12,655)	-	-
Balance at year end		(405,463)	530,738	-	-
Total Other Reserves		1,725,759	1,966,986	2,131,222	1,436,248

23. Earnings Per Share

	2006 $	2005 $
The following reflects the income and share data used in the calculation of basic and diluted earnings per share:		
Earnings as per Income Statement	(62,550,911)	10,412,570
	Number	Number
Weighted average number of ordinary shares used to calculate basic earnings per share	110,010,998	88,595,660
Add effect of dilutive securities - employee options	-	390,130
Weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share	110,010,998	88,985,790

The Group had 332,080 non dilutive potential ordinary shares at 30 June 2006.

	2006		2005	
	Cents per share	Total $	Cents per share	Total $
24. Dividends Provided for or Paid				
(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	4.0	4,366,891	4.0	3,217,278
	5.0	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%)	4,303,785	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
	4,303,785	6,951,013

The tax rate at which paid dividends have been franked is 30 percent (2005: 30%). Dividends proposed will be paid at the rate of 30 percent (2005: 30%).

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
25. Notes to the Statement of Cash Flows					
(a) Reconciliation of cash					
Cash balance comprises					
- cash at bank		7,219,326	4,605,145	4,383,468	280,957
- short term deposits - at call		171,209	20,782,228	440,887	19,814,091
		7,390,535	25,387,373	4,824,355	20,095,048
- short term deposits included in receivables		876,298	1,397,888	432,289	637,850
		8,266,833	26,785,261	5,256,644	20,732,898

(b) Cash balances not available for use

As at the end of the financial year $876,298 was held in term deposits as security for bank guarantees and is not available for use (2005: $1,397,888)

25. Notes to the Statement of Cash Flows (Continued)

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
(c) Reconciliation of net profit /(loss) after tax to net cash flows from operations					
Net profit/(loss) after income tax		(62,550,911)	10,412,570	(70,064,486)	7,594,180
Depreciation and amortisation		26,371,672	18,570,016	12,575,202	6,364,390
Net gain on sale of non current assets		(586,056)	(14,023)	(228,054)	(918)
Share-based payment		694,974	980,337	694,974	980,337
Impairment of assets		65,023,117	-	-	-
Impairment of intercompany investment		-	-	51,672,709	-
Changes in net assets and liabilities net of effects from acquisition of businesses:					
(Increase)/decrease in assets:					
- Receivables		(1,971,880)	(13,323,978)	(2,811,763)	(6,320,391)
- Inventory		16,736	(99,629)	(249,167)	(38,540)
Increase/(decrease) in liabilities:					
- Payables		3,115,729	10,496,672	19,012,522	4,562,244
- Provision for employee entitlements		(2,390,815)	939,011	806,910	642,986
- Provision - other		883,254	1,984,947	320,150	(84,463)
- Income tax payable		851,406	(6,070,993)	(282,676)	(1,870,151)
- Other tax balances		(8,561,504)	(1,705,444)	(2,152,722)	(2,048,612)
Net cash flow from operating activities		20,895,722	22,169,486	9,293,599	9,781,062

(d) Non-Cash Financing and Investing Activities

(i) During the year, the Group acquired plant and equipment with an aggregate fair value of $1,456,340 (2005: $5,751,768) by means of finance leases.

(e) Financing Facilities

During the 2005 financial year the consolidated entity entered into a debt facility with Westpac Banking Corporation. This facility will expire on 25 February 2008.

	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
- amounts drawn down	91,500,000	91,500,000	91,500,000	91,500,000
- amounts repaid	(43,500,000)	(32,500,000)	(43,500,000)	(32,500,000)
- amount used as at year end	48,000,000	59,000,000	48,000,000	59,000,000
- amount unused as at year end	-	-	-	-
	48,000,000	59,000,000	48,000,000	59,000,000

26. Expenditure Commitments

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
(a) Capital expenditure commitments					
Plant and equipment					
Not later than 1 year		4,132,443	13,080,639	304,003	12,354,797

(b) Lease Commitments

(i) Finance lease liabilities

The Group has finance leases for various items of plant and equipment. These contracts have options to purchase the leased asset at a nominal amount at the conclusion of the lease agreements. There are no renewal or escalation clauses.
Future minimum lease payments under hire purchase contracts together with the present value of the net minimum lease payments are as follows:

Consolidated	2006 Minimum Lease Payments $	2005 Minimum Lease Payments $
Not later than 1 year	4,121,056	2,413,328
Later than 1 year and not later than 5 years	6,724,033	5,143,062
Later than 5 years	-	-
Minimum lease payments	10,845,089	7,556,390
Less: Future finance charges	(936,631)	(757,506)
	9,908,458	6,798,884
Parent		
Not later than 1 year	4,121,133	2,362,579
Later than 1 year and not later than 5 years	6,724,033	5,139,556
Later than 5 years	-	-
Minimum lease payments	10,845,166	7,502,135
Less: Future finance charges	(936,631)	(753,778)
	9,908,535	6,748,357

The weighted average interest rate impact in the finance leases for both the Group and the Parent is 6.33% (2005: 6.33%).

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
(ii) Non cancellable operating leases					
Not later than 1 year		2,976,408	2,189,454	893,573	651,001
Later than 1 year and not later than 5 years		2,150,260	1,053,083	1,727,951	-
Later than 5 years		597,093	187,520	-	-
		5,723,761	3,430,057	2,621,524	651,001
Operating leases relate to premises with lease terms remaining between 1 and 12 years. The consolidated entity does not have an option to purchase the leased asset at the expiry of the lease term.					
(c) Other Expenditure					
Other Committed Operating Expenditure					
Not later than 1 year		24,586,577	9,323,065	-	-
Later than 1 year and not later than 5 years		25,800,357	3,184,248	-	-
Later than 5 years		155,139	-	-	-
		50,542,073	12,507,313	-	-

27. Contingent Liabilities

Under the self assessment provisions and following the receipt of professional advice, certain costs relating to the acquisition of subscriber bases were claimed as deductions for income tax purposes for the years ended 30 June 1998 to 2001. The Australian Tax Office (ATO) has disputed the deductibility of these costs but has confirmed iiNet has a reasonable arguable case. However, as at the date of this report the issue remains unresolved and there is a potential liability for associated general interest charges payable, which has been fully provided for.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
28. Auditor's Remuneration					
Amounts received or due and receivable by					
Ernst & Young for:					
Auditing the financial report		375,000	439,788	315,000	354,237
Other services - tax compliance and corporate advisory		994,899	1,121,576	944,451	1,031,801
Total auditor's remuneration		1,369,899	1,561,364	1,259,451	1,386,038

29. Director and Executive Disclosures

Key Management Personnel

Directors

P. C. Harley	Chairman (Executive)
M. M. Malone	Managing Director
K. N. Goodall	Director (Non-Executive)
P. R. James	Director (Non-Executive)
A.L. Milner	Director (Non-Executive)
P. A. Broad	Director (Non-Executive) (appointed 6 June 2006)
A. J. Grist	Director (Non-Executive) (appointed 26 July 2006)

Executives

C. W. Hollingsworth	Chief Financial Officer/ Company Secretary (resigned November 2005)
S. R. Fewster	Chief Financial Officer/ Company Secretary (appointed November 2005)
G. Bader	Chief Technology Officer
D. J. Dans	Chief Information Officer (appointed December 2005)
L. G. French	General Manager – Marketing
S. Dalby	General Manager – Regulatory, Australia
D. Diprose	General Manager – Regulatory, New Zealand
M. Pienaar	General Manager – Human Resources
M. Rushworth	General Manager – New Zealand (appointed August 2005)
M. White	Chief Operating Officer (appointed September 2006)

(a) Remuneration of Key Management Personnel (KMP)

The Company has applied the exemption under Corporations Amendments Regulation 2006 which exempts listed companies from providing remuneration disclosures in relation to their key management personnel in their annual financial reports by Accounting Standard AASB 124 "Related Party Disclosures". These remuneration disclosures are provided in the Remuneration Report of the Directors' Report designated as audited.

Compensation by Category	Consolidated		Parent Entity	
	2006 $	2005 $	2006 $	2005 $
Short-term	1,720,380	1,384,858	1,484,693	1,271,416
Post Employment	85,820	93,287	85,820	93,287
Other Long-term	-	-	-	-
Termination Benefits	-	-	-	-
Share-based Payment	318,024	596,443	289,051	579,150
	2,124,224	2,074,588	1,859,564	1,943,853

29. Director and Executive Disclosures (Continued)

Option Holdings of Key Management Personnel (Consolidated)
30 June 2006 (Numbers of Options)

	Balance at beginning of period 1 July 2005	Granted as remuneration	Options exercised	Net change other	Balance at end of period 30 June 2006	Exercisable at 30 June 2006
Directors						
K. N. Goodall	100,000	-	-	(50,000)	50,000	-
P. R. James	100,000	-	-	(50,000)	50,000	-
A. L. Milner	100,000	-	-	(50,000)	50,000	-
Executives						
C. W. Hollingsworth	296,200	-	-	(281,500)	14,700	6,500
S. R. Fewster	50,000	75,000	-	-	125,000	25,000
G. Bader	450,000	75,000	-	-	525,000	223,400
D. J. Dans	-	75,000	-	-	75,000	-
L. G. French	80,000	75,000	-	-	155,000	40,000
S. Dalby	35,000	45,000	-	-	80,000	16,050
M. Pienaar	35,500	75,000	-	-	110,500	13,400
M. Rushworth	-	75,000	-	-	75,000	-

Compensation of Key Management Personnel (Continued)
Option Holdings of Key Management Personnel (Consolidated) continued
30 June 2005 (Numbers of Options)

	Balance at beginning of period 1 July 2004	Granted as remuneration	Options exercised	Net change other	Balance at end of period 30 June 2005	Exercisable at 30 June 2005
Directors						
P. C. Harley	160,000	-	(160,000)	-	-	-
M. M. Malone	500,000	-	(500,000)	-	-	-
K. N. Goodall	100,000	-	-	-	100,000	100,000
P. R. James	100,000	-	-	-	100,000	100,000
A. L. Milner	100,000	-	-	-	100,000	100,000
A. L. Fergusson (resigned 2004)	-	-	-	-	-	-
Executives						
C. W. Hollingsworth	677,700	250,000	(631,500)	-	296,200	-
S. R. Fewster	-	50,000	-	-	50,000	-
G. Bader	50,000	400,000	-	-	450,000	-
L. G. French	-	80,000	-	-	80,000	-
S. Dalby	35,000	-	-	-	35,000	-
M. Pienaar	35,500	-	-	-	35,500	-

Share Holdings of Key Management Personnel (Consolidated)
30 June 2006 (Numbers of Shares)

	Balance at beginning of period 1 July 2005	Granted as remuneration	Options exercised	Shares sold during the year	Other changes during the year	Balance at end of period 30 June 2006
Directors						
P. C. Harley	140,000	-	-	-	-	140,000
M. M. Malone	18,078,167	-	-	-	6,250,000	24,328,167
K. N. Goodall	40,000	-	-	-	-	40,000
P. R. James	15,000	-	-	-	-	15,000
A. L. Milner	2,300,000	-	-	-	-	2,300,000
Executives						
G. Bader	-	-	-	(115,000)	225,000	110,000
S. Dalby	4,000	-	-	-	6,000	10,000

Share Holdings of Key Management Personnel (Consolidated) continued
30 June 2005 (Numbers of Shares)

	Balance at beginning of period 1 July 2004	Granted as remuneration	Options exercised	Shares sold during the year	Other changes during the year	Balance at end of period 30 June 2005
Directors						
P. C. Harley	120,000	-	160,000	(140,000)	-	140,000
M. M. Malone	18,078,167	-	500,000	(500,000)	-	18,078,167
K. N. Goodall	40,000	-	-	-	-	40,000
P. R. James	15,000	-	-	-	-	15,000
A. L. Milner	2,300,000	-	-	-	-	2,300,000
Executives						
C. W. Hollingsworth	800,000	-	631,500	(631,500)	300,000	1,100,000

At the date of this report no loans have been entered into between the company and any of its directors.

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $

30. Employee Benefits

	Note	Consolidated 2006 $	Consolidated 2005 $	Company 2006 $	Company 2005 $
Employee Benefit Liabilities/Assets					
The aggregate employee entitlement liability recognised and included in the financial statements is as follows:					
Included in payables - accrued wages, salaries and on-costs		522,607	370,138	309,452	383,828
Provisions – current	(i)	2,536,545	2,198,993	2,175,620	1,342,973
Provisions – non-current	(i)	35,818	128,328	35,818	61,554
Aggregate employee benefit liability		3,094,970	2,697,459	2,520,890	1,788,355
(i) Employee entitlements					
Balance as at beginning of the year		2,327,321	1,688,309	1,404,527	761,541
Arising during the year		3,362,933	2,562,102	3,258,656	2,013,678
Reductions arising from payments/other sacrifices of future economic benefits		(3,117,891)	(1,923,090)	(2,451,745)	(1,370,692)
Balance at year end		2,572,363	2,327,321	2,211,438	1,404,527

	2006 Number	2005 Number	2006 Number	2005 Number
Number of full time equivalent employees at end of financial year	767	721	632	419

iiNet Employee Share Option Plan pre 2002

The Company has issued options under an established employee share option plan, to persons determined by a committee of at least three directors as eligible persons. Those persons included employees, directors, managers, and part-time staff members of the Company. Each option is convertible into one ordinary share, with holders entitled to exercise half their options 18 months after the issue date, with the remaining half exercisable three years after the date of issue.

Options lapse if:
(a) the eligible person ceases to work for iiNet or an associated company, or in the case of directors, ceases to be a director; or
(b) they are not exercised within 5 years.

In the event of a takeover bid where the offeror acquires at least 50 percent of the company's shares the option holders will be able to exercise their options earlier.

No new issues of options will be made from the iiNet Employee Share Option Plan as it has been superseded by the 2002 iiNet Employee Share Option Plan, which has been superseded by the 2006 iiNet Employee Option Plan.

30. Employee Benefits (Continued)

2002 iiNet Employee Share Option Plan

At the 2002 Annual General Meeting, shareholders approved the adoption of the 2002 iiNet Employee Share Option Plan. The directors may issue options to eligible persons, being employees (other than directors) as either or both of discretionary options or non-discriminatory options, in accordance with the terms of the Plan.

The terms of each of type of option, being discretionary and non-discriminatory, are detailed below.

The maximum number of options capable of being issued under the plan will not exceed 5 percent of the issued capital of the Company at any point in time.

In the event of a takeover bid where the offeror acquires at least 50 percent of the company's shares, the option holders will be able to exercise their options earlier.
(i) Discretionary Options
Directors may determine from time to time to issue any number of options to eligible persons. Eligible persons are determined at the discretion of the directors.

Each discretionary option is convertible into one ordinary share, with holders entitled to exercise half their options 18 months after the issue date, with the remaining half exercisable three years after the date of issue.

Options lapse if:
(a) the eligible person ceases to work for iiNet or an associated company;
(b) they are not exercised within five years.

(ii) Non-discriminatory Plan
Directors may determine from time to time to issue options to eligible persons. The directors must offer to eligible persons on a non-discriminatory basis to at least 75 percent of permanent employees (including part time employees).

Each non-discriminatory option is convertible into one ordinary share, with holders entitled to exercise their options 36 months after the issue date.

Options will only lapse if they are not exercised within five years after the issue date

2006 iiNet Employee Option Plan

In January 2006 the company made an offer of options to employees utilising exemptions available to it under ASIC Class Order 03/184 and the Securities Act 2002 (NZ).

The options offered to eligible employees under the 2006 EOP vest to the employee in two equal tranches on the 18 month and 36 month anniversary of the date of issue. The options expire on the day before the last working day that is the 5 year anniversary of the date of issue. Should an employee cease to be an eligible person for any reason other than redundancy, retirement, permanent disability or death the options lapse. The directors reserve the right to exercise their discretion with regards to the options held by employees who cease to be eligible people by virtue of redundancy, retirement, permanent disability or death, enabling such employees to exercise their options within 90 days of ceasing to be an eligible person.

Director & Executive Option Issues

At the Annual General Meeting of the company held on 28 November 2003 shareholders agreed to the issue of options to specified directors, on the following terms and conditions.

The options were exercisable in two equal tranches, 18 and 36 months from the date of issue. Those options not exercised within 12 months of first becoming exercisable lapsed. Each options when exercised, at $3.30 and $4.00 respectively, entitles the holder to one ordinary share which ranks equally in all respects with existing shares. Should the director cease to be a director of the Company, all unexercised options at that date lapse.

On 2 July 2004, the Company relied upon ASIC Class Order 03/184 exercising relief available from the preparation of a prospectus, and granted 400,000 options to a specified executive with the following terms and conditions.

The options were exercisable in two equal tranches, 18 and 36 months from the date of issue. Each option when exercised, at $4.00 and $5.00 respectively, entitles the holder to one ordinary share which ranks equally in all respects with existing shares. Should the director cease to be a director of the Company, all unexercised options at that date lapse.

The following table summarises the number (No), weighted average exercise prices (WAEP) of and movements in all share options on issue during the year, including those issued under the above plans and executive options:

	2006		2005	
	No	WAEP	No	WAEP
Outstanding at the beginning of the year	3,050,900	288.5	4,131,200	208.4
Granted during the year	1,471,700	174.0	865,000	359.8
Forfeited during the year	350,300	256.8	283,100	273.2
Exercised during the year	114,400	76.0	1,662,200	128.7
Expired during the year	150,000	330.0	-	-
Outstanding at the end of the year	3,907,900	252.4	3,050,900	288.5
Exercisable at the end of the year	913,250	250.0	370,800	191.8

The outstanding balance at 30 June 2006 is represented by:

iiNet Employee Share Plan pre 2002

- 21,300 options over ordinary shares with an exercise price of $0.48 each, exercisable upon meeting the above conditions and until 6 December 2006

2002 iiNet Employee Share Option Plan

- 298,500 options over ordinary shares with an exercise price of $1.42 each, exercisable upon meeting the above conditions and until 3 May 2008
- 141,500 options over ordinary shares with an exercise price of $1.42 each, exercisable upon meeting the above conditions and until 3 May 2008
- 921,000 options over ordinary shares with an exercise price of $3.01 each, exercisable upon meeting the above conditions and until 12 February 2009
- 338,900 options over ordinary shares with an exercise price of $3.01 each, exercisable upon meeting the above conditions and until 12 February 2009
- 165,000 options over ordinary shares with an exercise price of $2.88 each, exercisable upon meeting the above conditions, and 50% from 2 January 2006, 50% from 3 July 2007, until expiration on 2 July 2009

2006 iiNet Employee Option Plan

- 1,471,700 options over ordinary shares with an exercise price of $1.74 each, exercisable upon meeting the above conditions and until 31 January 2011

30. Employee Benefits (Continued)

Executive Options on Issue

For the purposes of clarity and ease of reconciliation, the number of options on issue that were issued as executive options, that is options that have been issued outside the above plans, is presented summarily in the above table and in detail as follows:

- 200,000 options over ordinary shares with an exercise price of $4.00 each, forfeited on cessation of employment, exercisable 50% from 2 January 2006, 50% from 3 July 2007, until expiration on 2 July 2009
- 200,000 options over ordinary shares with an exercise price of $5.00 each, forfeited on cessation of employment, exercisable 50% from 2 January 2006, 50% from 3 July 2007, until expiration on 2 July 2009

The volume weighted average share price at the reporting date was $0.64 (2005: $2.80)

The weighted average remaining contractual life for the share options outstanding at 30 June 2006 is 39.2 months (2005: 39.6 months).

The range of exercise prices for options outstanding at the end of the year was $0.48 to $5.00 (2005: $0.48 to $5.00). The average weighted fair value of options granted during the year was $1,374,918 (2005: $182,130).

The fair value of the equity-settled share options granted under the option plan is estimated at the date of grant using a Black-Scholes model taking into account a 0% dividend yield and the terms and conditions upon which the options were granted.

The following table lists, for those options outstanding at the reporting date, the inputs to the model used to calculate the fair value of the options at issue date:

Option series	On issue at reporting date	Expected volatility (%)	Risk-free interest rate (%)	Expected life of options (months)	Option exercise price ($)	Share price at grant date ($)
Pre-2002 ESOP	21,300	35.2	5.7	54	0.48	3.18
2002 ESOP OPT8	298,500	41.5	5.21	60	1.42	1.49
2002 ESOP OPT9	141,500	41.5	5.21	60	1.42	1.49
Executive options OPT11	150,000	36.0	5.99	48	4.00	3.29
2002 ESOP OPT12	921,000	50.0	5.55	60	3.01	3.05
2002 ESOP OPT13	338,900	25.7	5.55	60	3.01	3.05
Executive options OPT14	165,000	35.8	5.91	60	2.88	2.85
Executive options OPT15	200,000	35.8	5.91	60	4.00	2.85
Executive options OPT16	200,000	35.8	5.91	60	5.00	2.85
2006 EOP	1,471,700	45.0	5.29	60	1.74	1.54

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. No other features of options granted were incorporated into the measurement of fair value.

31. Related Party Disclosures

(a) Wholly-owned group

The ultimate parent of the wholly-owned group is iiNet Limited.

(b) Wholly-owned group transactions

Loans

During the financial year, $137.9 million (2005: $137.9 million) of the loans issued to wholly-owned controlled entities bears interest charged at 7.43 percent (2005: 8.25 percent). These loans were specific transactions to facilitate the acquisition of subscriber bases and controlled entities. These loans have no set date of repayment. The remaining inter group loans bear no interest and have no set date of repayment.

During the year, iiNet Limited provided accounting and administrative services, at no cost, to entities in the wholly-owned group. Other transactions that occurred during the financial year between entities in the wholly-owned group were sale and purchases of services at cost.

(c) Associates

The consolidated group provides Internet services to certain of the director related entities, these transactions are all executed on a commercial basis.

Sales to and purchases from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms.

Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

(d) Other Related Parties

The Company provides Internet services to the Directors and other related parties. These services are provided at commercial and arms length terms.

32. Segment Reporting

The consolidated entity operates principally in one business segment being the telecommunications industry, and two geographical segments, being Australia and New Zealand based upon the location of both customers and assets.

Segment accounting policies are the same as the consolidated entity's policies described in note 2. Unallocated revenue and expenses include foreign exchange gains and losses, and borrowing expenses. Unallocated assets and liabilities include tax assets, liabilities and borrowings.

32. Segment Reporting (Continued)

Geographic segments -Primary reporting Consolidated	Australia 2006 $	Australia 2005 $	New Zealand 2006 $	New Zealand 2005 $	Eliminations 2006 $	Eliminations 2005 $	Consolidated 2006 $	Consolidated 2005 $
Revenue								
Segment revenue								
Rendering of services	206,263,665	121,967,207	33,860,676	31,689,849	-	-	240,124,341	153,657,056
Sale of goods	7,544,590	2,612,103	-	-	-	-	7,544,590	2,612,103
Rental revenue	-	20,228	92,601	243,746	-	-	92,601	263,974
Non-segment revenue								
Interest revenue	-	-	-	-	-	-	784,029	626,905
Total consolidated revenue	-	-	-	-	-	-	248,545,561	157,160,038
Result								
Profit before finance charges and tax	(48,785,891)	16,324,447	(17,202,408)	705,439	-	-	(65,968,299)	17,029,886
Finance costs							(4,955,884)	(2,671,164)
Net profit before tax							(70,924,183)	14,358,722
Tax expense							8,373,272	(3,946,152)
Net profit							(62,550,911)	10,412,570
Assets and Liabilities:								
Segment assets	233,635,075	296,397,590	34,575,058	56,536,586	(38,547,758)	(51,287,632)	229,662,375	301,646,544
Segment liabilities	(115,511,263)	(127,264,692)	(40,698,384)	(56,424,128)	38,144,952	51,287,634	(118,064,695)	(132,401,186)
Other segment information:								
Capital expenditure	34,226,379	140,477,948	2,235,367	2,414,625	-	-	36,461,746	142,892,573
Impairment losses	(46,253,304)	-	(18,769,813)	-	-	-	(65,023,117)	-
Depreciation	(8,936,441)	(4,767,352)	(1,541,027)	(2,071,961)	-	-	(10,477,468)	(6,839,313)
Amortisation	(12,210,400)	(8,720,235)	(3,683,803)	(3,010,468)	-	-	(15,894,203)	(11,730,703)
Cash flow information:								
Net cash flow from operating activities	13,762,941	19,405,334	7,132,778	2,764,152	-	-	20,895,719	22,169,486
Net cash flow from investing activities	(34,283,169)	(140,208,493)	(2,384,896)	(2,175,917)	-	-	(36,668,065)	(142,384,410)
Net cash flow from financing activities	(3,416,506)	141,101,896	670,421	(330,741)	-	-	(2,746,085)	140,771,155

33. Financial Instruments

The Group's principal financial instruments are cash and short term deposits, loans and finance leases. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The Group does not enter into derivative transactions. The main risks arising from the Group's financial instruments are interest rate risk and credit risk.

The Board reviews and agrees policies for managing each of these risks.
The Group's policy is that no trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk and credit risk. The Board reviews and agrees policies for managing each of these risks which are summarised below.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 2 to the financial statements.

Cash flow interest rate risk
The Group's exposure to the changes in market interest rates relates primarily to the Group's long-term debt obligations with a floating interest rate.

The Group's policy is to manage its interest rate cost using a mix of fixed and variable rate debt. The Group's policy is to keep 70% of its borrowings at a fixed rates of interest.

Foreign currency risk
As a result of the Group's operations in New Zealand the Group's balance sheet can be affected by movements in the NZ$/A$ exchange rates. The Group does not seek to hedge this exposure. It is the Group's policy to not enter into forward currency contracts.

The Group also has transactional currency exposures. Such exposures arises from sales or purchases by an operating unit in currencies other than the unit's functional currency.

Approximately 14% of the Group's sales are denominated in currencies other than the functional currency of the operating unit making the sale, whilst almost 12.4% of costs are denominated in the unit's functional currency.

Credit risk
The Group trades only with recognised, creditworthy third parties.

It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures.

In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

There are no significant concentrations of credit risk within the Group.

Since the Group trades only recognised parties, there is no requirement for collateral.

Liquidity risk
The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts, bank loans, debentures, preference shares, finance leases and hire purchase contracts.

33. Financial Instruments (Continued)

Net fair value

The carrying amount of financial assets and financial liabilities recorded in the financial statements represent their respective net fair values, determined in accordance with the accounting policies disclosed in note 2 to the financial statements. As the Group's financial instruments are all entered at market rates and are readily transferable the carrying values equate to the fair values.

Interest rate risk

The consolidated entity's exposure to interest rate risk for classes of financial assets and financial liabilities is set out below:

2006	Maturing						Total	Weighted Average Effective Interest Rate
Consolidated	< 1 Year	>1 to <2 Years	>2 to <3 Years	>3 to <4 Years	>4 to <5 Years	>5 Years		%
Financial Assets								
Fixed Rate								
Term deposits	876,298	-	-	-	-	-	876,298	5.14
Floating Rate								
Cash	7,390,535	-	-	-	-	-	7,390,535	1.38
Financial Liabilities								
Fixed Rate								
Bank facility	7,000,000	26,600,000	-	-	-	-	33,600,000	7.29
Finance lease liability	3,536,323	5,809,252	562,883	-	-	-	9,908,458	6.33
Floating Rate	3,000,000	11,400,000	-	-	-	-	14,400,000	

2005		Non-interest bearing	Floating interest rate	Fixed interest maturing in:		Total	Weighted average interest rate
Consolidated				1 year or less	1 to 5 years		Floating
	Note		$	$	$	$	%
Financial Assets							
Cash		855,049	24,280,324	252,000	-	25,387,373	3.2
Trade receivables		21,835,649	-	-	-	21,835,649	-
		22,690,698	24,280,324	252,000	-	47,223,022	-
Financial Liabilities							
Trade payables		31,211,105	-	-	-	31,211,105	-
Bank facility		-	-	10,000,000	49,000,000	59,000,000	7.3
Lease liability		-	-	1,994,823	4,804,061	6,798,884	6.3
Total		31,211,105	-	11,994,823	53,804,061	97,009,989	-

Credit Risk

The consolidated entity does not have any significant credit risk exposure to any single counter-party or any group of counter-parties having similar characteristics. The carrying amount of financial assets recorded in the financial statements, net of any provisions for losses, represent the consolidated entity's maximum exposure to credit risk without taking into account the value of any collateral or other security obtained.

34. Business Combinations

Acquisition of Quik

On 10 February 2006 ihug Limited acquired the Internet business Quik from Quik Internet Limited which is based in New Zealand. Under the terms of the Agreement ihug Limited paid cash and assumed ownership of the client database, debtors, fixed assets and bank accounts.

Recognition of income and expenditure will be accounted for from the specified date of 1 January 2006.

At the date of acquisition Quik Internet Limited was an Internet service provider, as part of the purchase negotiations it was agreed Quik Internet Limited would cease operating as an Internet service provider.

The acquisition price was $781,609.

The fair value of the assets and liabilities acquired as at the date of acquisition are:

	Consolidated	
	Recognised on Acquisition	Carrying Value
Trade Receivables	58,639	118,198
Fixed Assets	-	12,439
Client Database	756,778	684,780
	815,417	815,417
Consideration		
Cash Paid	781,609	
Costs associated with the acquisition	33,808	
Total Consideration	815,417	

35. 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.
The company issued 3,763,986 shares at 69.6 cents per share to PowerTel in August 2006, raising $2,619,734.
On 21 September 2006 Westpac increased iiNet's facility by $10 million.

36. Transition to AIFRS

For all periods up to and including the year ended 30 June 2005, the Group prepared its financial statements in accordance with Australian generally accepted accounting practice (AGAAP). These financial statements for the year ended 30 June 2006 are the first the Group is required to prepare in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS).

Accordingly, the Group has prepared financial statements that comply with AIFRS applicable for periods beginning on or after 1 July 2005 and the significant accounting policies meeting those requirements are described in note 2.
In preparing these financial statements, the Group has started from an opening balance sheet as at 1 July 2004, the Group's date of transition to AIFRS, and made those changes in accounting policies and other restatements required by AASB 1 First-time adoption of AIFRS.

This note explains the principal adjustments made by the Group in restating its AGAAP balance sheet as at 1 June 2004 and its previously published AGAAP financial statements for the year ended 30 June 2005.

Exemptions applied
AASB 1 allows first-time adopters certain exemptions from the general requirement to apply AIFRS retrospectively.

The Group has taken the following exemptions:

(i) *Exemption from the requirement to restate comparative information for AASB 132 and AASB 139*
The consolidated entity has elected to adopt this exemption and has not applied AASB 132: Financial Instruments: Disclosure and Presentation and AASB 139 Financial Instruments: Recognition and Measurement to its comparative information. Refer to the accounting policy stated in note 2 for details of the accounting policies relating to financial instruments for the comparative period.

(ii) *Exemption from requirement to expense share-based payment transactions*
The consolidated entity has adopted the share-based payments exemption and has applied AASB 2 "Share-Based Payments" only to equity instruments granted after 7 November 2002 that had not vested before 1 January 2005.

(iii) *Exemption from applying AASB 3 "Business Combinations" prior to transition date*
The consolidated entity has adopted the Business Combinations exemption and has not restated business combinations prior to 1 July 2004.

Explanation of material adjustments to the cash flow statement
There are no material differences between the cash flow statements presented under AIFRS and those presented under AGAAP.

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

	Note	CONSOLIDATED			COMPANY		
		AGAAP	AIFRS IMPACT	AIFRS	AGAAP	AIFRS IMPACT	AIFRS
		$	$	$	$	$	$
Current Assets							
Cash and cash equivalents		6,241,685	-	6,241,685	817,176	-	817,176
Trade and other receivables		4,473,138	-	4,473,138	1,263,869	-	1,263,869
Inventories		397,458	-	397,458	147,438	-	147,438
Other		803,160	-	803,160	209,521	-	209,521
Total Current Assets		11,915,441	-	11,915,441	2,438,004	-	2,438,004
Non-current Assets							
Trade and other receivables		375	-	375	89,130,476	-	89,130,476
Other financial assets		-	-	-	10,002	-	10,002
Property, plant and equipment		17,075,855	-	17,075,855	10,228,221	-	10,228,221
Intangible assets and goodwill		88,023,980	-	88,023,980	5,240,574	-	5,240,574
Deferred income tax asset	(C)	2,039,937	323,126	2,363,063	652,055	323,126	975,181
Other		-	-	-	-	-	-
Total Non-current Assets		107,140,147	323,126	107,463,273	105,261,328	323,126	105,584,454
Total Assets		119,055,588	323,126	119,378,714	107,699,332	323,126	108,022,458
Current Liabilities							
Trade and other payables		12,518,860	-	12,518,860	6,112,900	-	6,112,900
Unearned revenue		7,034,196	-	7,034,196	5,053,188	-	5,053,188
Interest bearing loans and borrowings		3,041,174	-	3,041,174	2,853,128	-	2,853,128
Income tax payable		4,208,669	-	4,208,669	3,140,087	-	3,140,087
Provisions		2,385,941	-	2,385,941	700,322	-	700,322
Total Current Liabilities		29,188,840	-	29,188,840	17,859,625	-	17,859,625
Non-current Liabilities							
Interest bearing loans and borrowings		1,512,608	-	1,512,608	1,459,708	-	1,459,708
Deferred income tax liabilities	(C)	375,061	9,970,113	10,345,174	510,841	983,794	1,494,635
Provisions		694,317	-	694,317	187,605	-	187,605
Total Non-current Liabilities		2,581,986	9,970,113	12,552,099	2,158,154	983,794	3,141,948
Total Liabilities		31,770,826	9,970,113	41,740,939	20,017,779	983,794	21,001,573
Net Assets		87,284,762	(9,646,987)	77,637,775	87,681,553	(660,668)	87,020,885
Equity							
Issued capital	(C)	84,397,113	323,126	84,720,239	84,397,113	323,126	84,720,239
Accumulated losses	(B),(C)	2,344,256	(10,426,024)	(8,081,768)	3,284,440	(1,439,705)	1,844,735
Other reserves	(B)	543,393	455,911	999,304	-	455,911	455,911
Total Equity		87,284,762	(9,646,987)	77,637,775	87,681,553	(660,668)	87,020,885

36. Transition to AIFRS (Continued)

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

	Note	CONSOLIDATED			COMPANY		
		AGAAP	AIFRS IMPACT	AIFRS	AGAAP	AIFRS IMPACT	AIFRS
		$	$	$	$	$	$
Current Assets							
Cash and cash equivalents		25,387,373	-	25,387,373	20,095,048	-	20,095,048
Trade and other receivables		21,835,649	-	21,835,649	13,146,131	-	13,146,131
Inventories		497,087	-	497,087	185,978	-	185,978
Other		5,796,119	-	5,796,119	1,881,367	-	1,881,367
Total Current Assets		53,516,228	-	53,516,228	35,308,524	-	35,308,524
Non-current Assets							
Trade and other receivables		375	-	375	200,072,367	2,444,470	202,516,837
Property, plant and equipment		29,705,658	-	29,705,658	22,417,090	-	22,417,090
Other financial assets		-	-	-	10,004	-	10,004
Intangible assets and goodwill	(A)	205,476,583	7,826,957	213,303,540	6,363,804	-	6,363,804
Deferred income tax asset	(C)	4,301,219	819,524	5,120,743	2,795,304	(1,333,198)	1,462,106
Other		-	-	-	220,524	-	220,524
Total Non-current Assets		239,483,835	8,646,481	248,130,316	231,879,093	1,111,272	232,990,365
Total Assets		293,000,063	8,646,481	301,646,544	267,187,617	1,111,272	268,298,889
Current Liabilities							
Trade and other payables		32,401,110	-	32,401,110	11,033,565	-	11,033,565
Unearned revenue		16,529,856	-	16,529,856	11,303,545	-	11,303,545
Interest bearing loans and borrowings		11,994,823	-	11,994,823	11,947,802	-	11,947,802
Income tax payable		851,405	-	851,405	1,630,557	-	1,630,557
Provisions		5,875,891	-	5,875,891	1,383,059	-	1,383,059
Total Current Liabilities		67,653,085	-	67,653,085	37,298,528	-	37,298,528
Non-current Liabilities							
Interest bearing loans and borrowings		53,804,061	-	53,804,061	53,800,555	-	53,800,555
Deferred income tax liabilities	(C)	930,899	9,884,813	10,815,712	605,478	710,041	1,315,519
Provisions		128,328	-	128,328	61,554	-	61,554
Total Non-current Liabilities		54,863,288	9,884,813	64,748,101	54,467,587	710,041	55,177,628
Total Liabilities		122,516,373	9,884,813	132,401,186	91,766,115	710,041	92,476,156
Net Assets		170,483,690	(1,238,332)	169,245,358	175,421,502	401,231	175,822,733
Equity							
Issued capital	(C)	169,171,268	1,024,404	170,195,672	169,171,268	1,024,404	170,195,672
Accumulated losses	(A),(B),(C),(D)	781,684	(3,698,984)	(2,917,300)	6,250,234	(2,059,421)	4,190,813
Other reserves	(B)	530,738	1,436,248	1,966,986	-	1,436,248	1,436,248
Total Equity		170,483,690	(1,238,332)	169,245,358	175,421,502	401,231	175,822,733

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

	Note	CONSOLIDATED			COMPANY		
		AGAAP	AIFRS IMPACT	AIFRS	AGAAP	AIFRS IMPACT	AIFRS
		$	$	$	$	$	$
Revenue							
Rendering of services		153,657,056	-	153,657,056	72,788,766	-	72,788,766
Sale of goods		2,612,103	-	2,612,103	2,612,103	-	2,612,103
Intercompany Dividends		-	-	-	11,922,785	-	11,922,785
Other revenue	(E)	1,399,042	(508,163)	890,879	2,265,033	(918)	2,264,115
Total Revenue		157,668,201	(508,163)	157,160,038	89,588,687	(918)	89,587,769
Cost of sales and services rendered		(71,518,857)	-	(71,518,857)	(45,405,815)	-	(45,405,815)
Gross Profit		86,149,344	(508,163)	85,641,181	44,182,872	(918)	44,181,954
Other income	(E)	-	14,023	14,023	-	918	918
Employee Expenses	(B),(D)	(30,410,195)	(980,337)	(31,390,532)	(19,499,079)	(688,589)	(20,187,668)
Depreciation and amortisation expense	(A)	(23,458,233)	4,888,217	(18,570,016)	(6,364,390)	-	(6,364,390)
Impairment losses		-	-	-	-	-	-
Marketing expenses		(3,008,411)	-	(3,008,411)	(912,666)	-	(912,666)
Office costs		(9,684,541)	-	(9,684,541)	(4,384,670)	-	(4,384,670)
Other Expenses	(E)	(5,882,317)	(89,501)	(5,971,818)	(3,199,729)	-	(3,199,729)
Profit from Continuing Operations Before Tax and Finance Costs		13,705,647	3,324,239	17,029,886	9,822,338	(688,589)	9,133,749
Financing costs		(2,671,164)	-	(2,671,164)	(2,594,250)	-	(2,594,250)
Profit from Continuing Operations before Income Tax		11,034,483	3,324,239	14,358,722	7,228,088	(688,589)	6,539,499
Income tax (expense)/benefits	(C)	(7,348,953)	3,402,801	(3,946,152)	985,808	68,873	1,054,681
Profit attributable to members of iiNet Limited		3,685,530	6,727,040	10,412,570	8,213,896	(619,716)	7,594,180

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

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.

36. Transition to AIFRS (Continued)

Notes (continued)

(C) Deferred tax (continued)

AASB 112 “Income Taxes” requires the recognition of a deferred tax asset in respect of capital raising costs.

(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”.

37. Adjustment to Preliminary Financial Statement

The consolidated results of the consolidated entity for the year ended 30 June 2006 differed from those announced in the un-audited preliminary final statement (Appendix 4E) made to the Australian Stock Exchange, as follows:

	Preliminary Financial Statements 2006 $'000's	Consolidated Financial Statements 2006 $'000's
Profit /(Loss) from Ordinary Activities	(70,924)	(70,924)
Income Tax Benefit Relating to Ordinary Activities	10,843	8,373
Profit /(Loss) from Ordinary Actitivities after Income Tax Expense	(60,081)	(62,551)

The Preliminary Final Report contained a deferred tax asset relating to the subscriber bases. In finalising the Annual Report it was considered appropriate that this asset be booked as a tax expense due to the full impairment of the subscriber bases.

stock exchange information as at 19 September 2006

Additional information required by the Australian Stock Exchange Limited and not shown elsewhere in this report is as follows. This information is current as at 19 September 2006.

(a) Distribution of equity securities

i. Ordinary share capital

- 125,605,002 fully paid ordinary shares are held by 4,184 individual shareholders. All issued shares carry one vote per share and carry the rights to dividends.

ii. Options

- 3,907,900 options are held by 348 individual optionholders. Options do not carry the right to vote.

The number of shareholders by size of holding in each class is:

	Fully paid ordinary shares	Options
1 – 1,000	835	12
1,001 – 5,000	1,903	195
5,001 – 10,000	667	70
10,001 – 100,000	730	67
100,001 and over	49	4
	4,184	**348**
Holding less than a marketable parcel	410	-

(b) Substantial shareholders

	Number of fully paid ordinary shares	Percentage of total issued fully paid ordinary shares
Perth Internet Pty Ltd	24,328,168	19.37%
PowerTel Limited	21,850,901	17.40%
Amcom Telecommunications Limited	24,300,000	19.35%
	70,479,069	56.12%

(c) Twenty largest shareholders

	Number of fully paid ordinary shares	Percentage of total issued fully paid ordinary shares
PowerTel Limited	21,850,901	17.40%
Perth Internet Pty Ltd	18,012,162	14.34%
Colbern Fiduciary Nominees Pty Ltd	12,343,915	9.83%
Bell Potter Nominees Pty Ltd	11,906,407	9.48%
BT Portfolio Services Limited	6,250,000	4.98%
Citicorp Nominees Pty Ltd	3,549,092	2.83%
JP Morgan Nominees Australia Limited	3,454,337	2.75%
Alcotrack Pty Ltd	2,300,000	1.83%
RBC Dexia Investor Services Australia Nominees Pty Ltd	2,119,851	1.69%
Westpac Custodian Nominees Limited	1,239,918	0.99%
Amcom Telecommunications Limited	1,000,000	0.80%
Nicholas John Wood and Timothy Scott Wood	581,250	0.46%
Caveo Communications Pty Ltd	500,000	0.40%
Timothy Scott Wood	447,798	0.36%
Dennis John Banks	407,349	0.32%
Comsec Nominees Pty Ltd	384,499	0.31%
D&D Nominees Pty Ltd	350,000	0.28%
Emin Pty Ltd	350,000	0.28%
Nash Investments (WA) Pty Ltd	350,000	0.28%
Gasmere Pty Ltd	307,000	0.24%

Company Secretary

Mr S. Fewster

Principal Place of Business and Registered Office

iiNet Limited
Level 6, Durack Centre
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Stock Exchange Listings

iiNet Limited's ordinary shares are quoted by the Australian Stock Exchange Limited.

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directory

iiNet Limited
ACN 068 628 937

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P. C. Harley
Executive Chairman

M. M. Malone
Managing Director

Directors
K. N. Goodall
A. L. Milner
P. R. James
P. A. Broad
A. J. Grist

Company Secretary
S. Fewster

Audit Committee
K. N. Goodall
Chairman

A. L. Milner
P. R. James
P. A. Broad
A. J. Grist

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ABN 48 068 628 937

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