ABN 73 122 948 805

FINANCIAL REPORT 2012

CONTENTS

CORPORATE GOVERNANCE STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER 2012

The Board of Directors of Island Sky Australia Limited has established corporate governance policies and procedures, where practicable, consistent with the revised Corporate Governance Principles and Recommendations issued by the ASX Corporate Governance Council (**ASX Recommendations**).

The following statement sets out a summary of the Company's corporate governance practices that were in place during the financial year and how those practices relate to the revised Corporate Governance Principles and Recommendations issued by the Australian Securities Exchange Corporate Governance Council (**ASX Recommendations**).

In ensuring ethical behaviour and accountability, the Board has included in its corporate governance policies those matters contained in the ASX Recommendations where applicable. However, the Board also recognises that full adoption of the ASX Recommendations may not be practical nor provide the optimal result given the particular circumstances and structure of the Company. The Board is, nevertheless, committed to ensuring that appropriate Corporate Governance practices are in place for the proper direction and management of the Company. This statement outlines the main Corporate Governance practices of the Company disclosed under the ASX Recommendations, including those that comply with best practice and which unless otherwise disclosed, were in place during the whole year ended 31 December 2012.

PRINCIPLE 1
Lay solid foundations for management and oversight

Recommendation 1.1 – Recommendation followed
The Board is governed by the Corporations Act 2001, ASX Listing Rules and a formal constitution adopted by the Company in 2007.

The role of the Board is to provide leadership and direction to management and to agree with management the aims, strategies and policies of the Company for the protection and enhancement of long-term shareholder value.

The Board takes responsibility for the overall Corporate Governance of the Company including its strategic direction, management goal setting and monitoring, internal control, risk management and financial reporting.

The Board has an established framework for the management of the entity including a system of internal control, a business risk management process and appropriate ethical standards. In fulfilling its responsibilities, the Board is supported by an Audit & Risk Committee to deal with internal control, ethical standards and financial reporting.

The Board had a Managing Director responsible for the day to day management of the Company including management of financial, physical and human resources, development and implementation of risk management, internal control and regulatory compliance policies and procedures, recommending strategic direction and planning for the operations of the business and the provision of relevant information to the Board. After Island Sky Corporation was partly disposed, Mr Groden stepped down as Managing Director, but remained being a Director of the Company.

The Board has adopted a formal statement of matters reserved to it in a board charter that details its functions and responsibilities.

Recommendation 1.2 – Recommendation followed
The Board takes overall responsibility for monitoring the composition of the Board and reviewing the performance and compensation of the Company's Executive directors and senior management with the objective of motivating and appropriately rewarding performance.

A Nomination & Remuneration Committee has been established to:

- review when required, the engagement, performance and remuneration of senior executives of the Company;
- recommend to the Board appropriate terms and conditions of engagement.

The Nomination Remuneration Committee is comprised of the Board as a whole.

CORPORATE GOVERNANCE STATEMENT
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Recommendation 1.3 – Recommendation followed
During the period no performance evaluation of the senior executives was undertaken.

PRINCIPLE 2
Structure the board to add value

Recommendation 2.1 – Recommendation not followed
The composition of the Board consists of three directors. The Chairman is a non-executive director.

The Audit & Risk Committee currently consists of two directors whereby both directors are Independent directors of the Company.

Recommendation 2.2 – Recommendation not followed
The Chairman, Mr Lindh, is an Independent Director. The Chairman became an Independent Director during the year when Mr Lindh ceased being an associate of a Company that is a substantial shareholder to the Company.

Recommendation 2.3 – Recommendation not followed
The Company currently does not have someone in the role of Chief Executive Officer. Mr Groden stepped down as Managing Director after Island Sky Corporation was partly disposed

Recommendation 2.4 – Recommendation followed
A Nomination & Remuneration Committee has been established, and the Committee has a Charter that sets out its roles and responsibilities, composition and structure.

The Nomination Remuneration Committee is comprised of the Board as a whole.

Recommendation 2.5 – Recommendation followed
The performance of the Board is reviewed on an ongoing basis. The Chairman also speaks to each Director individually regarding their role as a Director.

Recommendation 2.6 – Recommendation followed
The names of the directors of the Company and terms in office at the date of this Statement together with their skills, experience, expertise and financial interests in the Company are set out in the Directors' Report section of this report.

Mr Lindh, Mr Martin and Mr Groden are considered to be independent.

The Company has no relationships with any of the independent directors which the Company believes would compromise the independence of these directors.

All directors are entitled to take such legal advice as they require at any time and from time to time on any matter concerning or in relation to their rights, duties and obligations as directors in relation to the affairs of the Company at the expense of the Company upon seeking permission and being granted it by the Chairman.

The Company's constitution specifies the number of directors must be at least three and at most ten. The Board may at any time appoint a director to fill a casual vacancy. Directors appointed by the Board are subject to election by shareholders at the following annual general meeting and thereafter directors (other than the Managing Director) are subject to re-election at least every three years. The tenure for executive directors is linked to their holding of executive office.

PRINCIPLE 3
Companies should actively promote ethical and responsible decision making

Recommendation 3.1 – Recommendation followed
The Company does have a formal code of conduct. The Company requires all its directors and employees to abide by the standards of behaviour and business ethics in accordance with the law and the code of conduct.

The following standards of behaviour apply:
- Comply with the laws that govern the Company and its operations.
- Act honestly and with integrity and fairness in all dealings with others and each other.
- Avoid or manage conflicts of interest.
- Use Company assets properly and efficiently for the Company's benefit.
- Contribute to the well being of the Company's key stakeholders.
- Seek to be an exemplary corporate citizen.

Directors are also required to provide the Company with details of all securities registered in the director's name or an entity in which the director has a relevant interest within the meaning of section 9 of the Corporations Act 2001 and details of all contracts, other than contracts to which the Company is a party to which the director is a party or under which the director is entitled to a benefit, and that confer a right to call for or deliver shares in the Company and the nature of the director's interest under the contract.

Directors are required to disclose to the Board any material contract in which they may have an interest. In accordance with Section 195 of the Corporations Act 2001, a director having a material personal interest in any matter to be dealt with by the Board, will not be present when that matter is considered by the Board and will not vote on that matter.

Recommendation 3.2 – Recommendation not followed
While the Company embraces the concept of diversity, there is no formal diversity policy as the Board believes that given the size of the Company and the stage of the entity's life, the cost of establishing and managing a formal diversity policy cannot be justified.

The Company recognises that each employee brings their own unique capabilities, experiences and characteristics to their work and that the Company values such diversity at all levels of the Company in all that it does. The Company believes in treating people with respect and dignity. The Company strives to create a supportive and understanding environment in which all individuals realise their maximum potential within the Company, regardless of their differences. The Company is committed to employing the best people to do the best job.

Recommendation 3.3 – Recommendation not followed
While the Company does not have a formal diversity policy, the Company has a strong commitment to gender diversity. Female participation is reflected in the organisation.

Gender diversity will be a strategic focus for the Company in the coming years, particularly with the introduction of recommendations on gender diversity by the ASX Corporate Governance Council.

Recommendation 3.4 – Recommendation followed
For the annual period ending 31 December 2012, the Company provides the following information in relation to employees:
- Percentage of women employees in whole organisation: 50%
- Percentage of women in senior executive positions: 0%
- Percentage of women on the board: 0%

Recommendation 3.5 – Recommendation followed
While the Company does not have a formal diversity policy, it is diverse along many dimensions. Diversity at the Company refers to all the characteristics that make individuals different from each other. It includes characteristics or factors such as religion, race, ethnicity, language, gender, sexual orientation, disability, age or any other area of potential difference. The Company believes that the wide array of perspectives that results from such diversity promotes innovation and business success.

CORPORATE GOVERNANCE STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER 2012

PRINCIPLE 4
Safeguard integrity in financial reporting

Recommendation 4.1 – Recommendation followed
An Audit & Risk Committee has been established by the Company to oversee corporate governance over internal controls, ethical standards, financial reporting, external accounting and compliance procedures.

The main responsibilities of the Audit & Risk Committee include;
- reviewing, assessing and making recommendations to the Board on the annual and half year financial reports and all other financial information published or released to the market by the Company
- overseeing establishment, maintenance and reviewing the effectiveness of the Company's internal controls and ensuring efficacy and efficiency of operations, reliability of financial reporting and compliance with applicable Accounting Standards and ASX Listing Rules
- liaising with and reviewing reports of the external auditor
- reviewing performance and independence of the external auditor and where necessary making recommendations for appointment and removal of the Company's auditor.

Recommendation 4.2 – Recommendation followed
The Audit & Risk Committee consists of two non-executive directors. Both members of the Committee are independent. The Committee is chaired by Mr Martin.

Recommendation 4.3 – Recommendation followed
The Company's Audit & Risk Committee charter can be found at
http://www.asx.com.au/asx/statistics/announcements.do?by=asxCode&asxCode=isk&timeframe=Y&year=2011

Recommendation 4.4 – Recommendation followed
Details of the Audit & Risk Committee members qualifications and attendance at meetings are set out in the Directors' Report section of this report.

The Committee meets at least twice per annum and reports to the Board. The Managing Director, Company Secretary and external auditor may by invitation attend meetings at the discretion of the Committee.

PRINCIPLE 5
Make timely and balanced disclosure

Recommendation 5.1 and 5.2 – Recommendations followed
The Company operates under the continuous disclosure requirements of the ASX Listing Rules and ensures that all information which may be expected to affect the value of the Company's securities or influence investment decisions is released to the market in order that all investors have equal and timely access to material information concerning the Company. The information is made publicly available on the Company's website following release to the ASX.

The Company's formal policy for continuous disclosure can be found at
http://www.asx.com.au/asx/statistics/announcements.do?by=asxCode&asxCode=isk&timeframe=Y&year=2011

The Company's Managing Director has the responsibility for ensuring that all relevant information is released to the market in a timely manner in consultation with the Board. The Company considers this to be a satisfactory protocol given the size and stage of the Company's development.

PRINCIPLE 6
Respect the rights of shareholders

Recommendation 6.1 and 6.2 – Recommendations followed
The Board aims to ensure that shareholders are informed of all major developments affecting the Company's state of affairs. In accordance with the ASX Recommendations, information is communicated to shareholders as follows:

- the annual financial report which includes relevant information about the operations of the Company during the year, changes in the state of affairs of the entity and details of future developments, in addition to the other disclosures required by the Corporations Act
- the half yearly financial report lodged with the Australian Stock Exchange and Australian Securities and Investments Commission and sent to all shareholders who request it
- notifications relating to any proposed major changes in the Company which may impact on share ownership rights that are submitted to a vote of shareholders
- notices of all meetings of shareholders
- publicly released documents including full text of notices of meetings and explanatory material made available on the Company's web-site
- disclosure of the Company's corporate governance practices and communications strategy on the entity's web-site.

The Board encourages full participation of shareholders at the Annual General Meeting to ensure a high level of accountability and identification with the Company's strategy and goals. Important issues are presented to the shareholders as single resolutions. The external auditor of the Company is also invited to the Annual General Meeting and is available to answer any questions concerning the conduct, preparation and content of the auditor's report. Pursuant to section 249K of the Corporations Act 2001 the external auditor is provided with a copy of the notice of meeting and related communications received by shareholders.

The Company's policy for shareholder communication is posted on the Company's website, at http://www.asx.com.au/asx/statistics/announcements.do?by=asxCode&asxCode=isk&timeframe=Y&year=2011

PRINCIPLE 7
Recognise and manage risk

Recommendation 7.1, 7.2 and 7.4 – Recommendations not followed
The Board will regularly review and approve the risk management and oversight of policies of the Company. The risk management and internal control system to manage the Company's material business risks is a responsibility of the Audit and Risk Committee.

Recommendation 7.3 – Recommendation followed
In accordance with ASX Recommendation 7.3 the Managing Director and Chief Financial Officer have provided an assurance that the written declarations under s295A of the Corporations Act are founded on a sound system or risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks. The Managing Director and Chief Financial Officer gave that assurance at the time the s295A declarations were provided to the Board.

PRINCIPLE 8
Remunerate fairly and responsibly

Recommendation 8.1 – Recommendation followed
The Board has established a Nomination and Remuneration Committee.

Recommendation 8.2 and 8.3 – Recommendations followed
The Remuneration Policy, which sets the terms and conditions of the Chief Executive Officer and other senior executives, has been approved by the board. Details of that Policy are set out in the Remuneration Report section of the Directors' Report.

These Corporate Governance Policies can be found at
http://www.asx.com.au/asx/statistics/announcements.do?by=asxCode&asxCode=isk&timeframe=Y&year=2011

DIRECTORS' REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2012

Your Directors present their report on the Company and its controlled entity ("group" or "consolidated group") for the financial year ended 31st December 2012.

Directors

The names of Directors in office at any time during or since the end of the year are:

David John Lindh

Richard Jay Groden

Neville Wayne Martin

Michael Murphy Paragon (resigned 10 April 2012)

Directors have been in office since the start of the financial year to the date of this Report unless otherwise stated.

Company Secretary

The following person held the position of Company Secretary at the end of the financial year:

Ms Rajita Alwis.

Principal Activities

The previous principal activities of the consolidated group was the marketing and development of a USA Patented, high capacity, energy efficient air-to-water making machine which draws water vapour from the air and converts it into drinking water. During the year, the Company signed a Stock Purchase Agreement under which the Company sold 75% of its shares of common stock in Island Sky Corporation. The Agreement which was, subject to shareholder approval, was approved at the Annual General Meeting held on 31 July 2012. The Company retains a 25% interest in Island Sky Corporation.

There were no other significant changes in the nature of the consolidated group's principal activities during the financial year.

Operating Results

The consolidated profit of the group including continuing and discontinuing operations after providing for income tax amounted to $2,823,583 (2011 loss $3,174,799). This is a significant change from previous results reported due to the inclusion of a once off gain from the sale of its subsidiary and the deconsolidation of that entity from the Group.

Dividends Paid or Recommended

No dividends were paid or declared for payment in the financial year.

Review of Operations

During 2012, the Company entered into a Share Purchase Agreement pursuant to which it sold 75% of its investment in Island Sky Corporation. The Company has recognised a gain due to the retained losses of Island Sky Corporation being de-consolidated from the 2012 reported results.

DIRECTORS' REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2012

Financial Position

The net assets of the Consolidated Group have increased by $1,839,915 since 31 December 2011 to $676,483 at 31 December 2012. This increase has resulted from the deconsolidation of the net liability position of Island Sky Corporation from the Consolidated Group.

The group's working capital, being current assets less current liabilities, has increased $927,770 since 31 December 2011 to $278,321 at 31 December 2012.

The financial position of the Company shows that the Company will require additional capital to continue its operation.

The Directors have been considering additional avenues for investment in an effort to produce better value for shareholders in the medium term.

Significant Changes in State of Affairs

The following significant changes in the state of affairs occurred during the financial year:

i. On 18 June 2012, the Company signed a Stock Purchase Agreement with Mr Richard Groden to which the Company sold 75% of its common stock in its wholly-owned subsidiary (Island Sky Corporation). The Agreement was approved by shareholders at the Annual General Meeting on 31 July 2012. The stock was sold to the purchaser for $1,154,929. A deposit of $100,000 was received during the year.

Ii The Company entered into a Stock Pledge and Security Agreement with Mr Richard Groden to secure the remaining payment of $1,054,929 to the Company by granting a first priority senior lien and security interest in the 933,077 shares in Island Sky Corporation.

Matters Subsequent to the End of the Financial Year

No events have occurred subsequent to the financial statement that would materially affect the financial report.

Likely Development and Expected Results of Operations

The Directors are considering additional avenues for investment in an effort to produce better value for shareholders in the medium term.

Environmental Issues

The Consolidated Group's operations are not subject to significant environmental regulations.

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

Key Management Personnel	Position
David John Lindh	Independent Non-Executive Chairman
Richard Jay Groden	Independent Non-Executive Director
Neville Wayne Martin	Independent Non-Executive Director
Michael Murphy Paragon	Executive Director (ceased 10 April 2012)
Rajita Alwis	Company Secretary

DIRECTORS' REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2012

David John Lindh - LLB (University of Adelaide), OAM - Chairman
Member of Audit & Risk Committee and Chairman of Nomination & Remuneration Committee

Mr Lindh is a consultant in corporate and commercial matters, with over 30 years experience both as a lawyer and a company director. Mr Lindh was Chairman of ASX listed Centrex Metals Limited (appointed 23 March 2001 and resigned 21 January 2010) and was a non-executive director of ASX listed Enterprise Energy Ltd from 5 February 2004 to 3 October 2008 and ASX listed Primary Resources Ltd from 9 November 2005 to 13 June 2008. Mr Lindh is also a director of various private companies and is a consultant with the Adelaide law firm, Minter Ellison. Mr Lindh has been a director of listed public companies over a long period of time and has significant experience with initial public offerings.

Mr Lindh is an Australian citizen and is aged 67 years.

Richard Jay Groden - B. Arts (University of Florida) - Independent Non-Executive Director
Member of Nomination & Remuneration Committee

Mr Groden is one of the two founders of Island Sky and has played an integral part in the development of the Island Sky technology, products and business plan. He is the former president and CEO of Groden-Stamp Construction Inc. a specialist construction company involved with historic renovations of hotels and office buildings. Mr Groden has served on the Miami Shores Code Enforcement Board and the Metro Dade County Historic Preservation Board, is a former President and Chairman for the Dade Heritage Trust, and a member of the National Trust for Historic Preservation. Mr Groden has been involved in the development of the Island Sky technology since 1998.

Mr Groden is a citizen of the USA and is aged 59 years.

Michael Murphy Paragon - Executive Director – ceased 10 April 2012
Member of Nomination & Remuneration Committee

Mr Paragon joined Island Sky in 2004 and has laid the cornerstone for Island Sky's marketing, sales organisation and business plans. As the director of marketing and sales for Island Sky, he has played a key role in the development and promotion of Island Sky products and has represented Island Sky at various international trade shows which resulted in establishing many distribution arrangements. During his career Mr Paragon built worldwide recognition of Paragona products as a leading brand name among fine art materials. Mr Paragon has over 25 years of business experience and has developed and launched hundreds of new consumer products and product line extensions.

Mr Paragon is a citizen of the USA and is aged 60 years.

Neville Wayne Martin - LLB (University of Adelaide) - Independent Non-executive Director
Chairman of Audit & Risk Committee and Member of Nomination & Remuneration Committee

Neville Martin is a consultant with the law firm Minter Ellison and has over 40 years' experience in corporate and commercial law. He is a former director of Stuart Petroleum Limited and Austin Exploration Limited (both listed at the time on the ASX), and was also Chairman of Adelaide Energy Limited (also ASX listed) from September 2005 to November 2011. He is currently a non-executive director of ASX listed companies Island Sky Australia Limited and Sundance Energy Australia Limited and he is also a director of several unlisted public companies.

Mr Martin is an Australian citizen and aged 63 years.

Rajita Shamani Alwis B.Com CA – Company Secretary

Ms Alwis is a chartered accountant with over 10 years experience in public practice and commerce. Ms Alwis is also company secretary for other ASX Listed entities as well as a company secretary and chief financial officer for numerous private companies.

Ms Alwis is an Australian citizen and is aged 34 years.

DIRECTORS' REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2012

Since December 2012, 3 meetings of Directors were held. Attendances by each Director during the year were as follows:

Meetings of Directors

	Number eligible to attend	Number attended
David Lindh	3	3
Richard Groden	3	3
Neville Martin	3	3
Michael Paragon	-	-

Audit & Risk Committee meetings

	Number eligible to attend	Number attended
Neville Martin	4	4
David Lindh	4	4
Richard Groden	4	4

There were no Nomination Committee and Remuneration Committee meetings during the year.

REMUNERATION REPORT – AUDITED

This Report details the nature and amount of remuneration for each key management person of Island Sky Australia Limited.

Remuneration policy

(a) Principles used to determine the nature and amount of remuneration

The remuneration policy of Island Sky Australia Limited has been designed to align Director and executive objectives with shareholder and business objectives by providing a fixed remuneration component and offering specific long-term incentives based on key performance areas affecting the consolidated group's financial results. The Board of Island Sky Australia Limited believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best executives and directors to run and manage the consolidated group, as well as create goal congruence between Directors, Executives and Shareholders.

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

- The remuneration policy, setting the terms and conditions for the Executive Directors and other Senior Executives, was approved by the Board. The Nomination & Remuneration Committee may seek professional advice from independent external consultants.
- All Executives receive a base salary (which is based on factors such as length of service and experience), superannuation, fringe benefits, options and performance incentives.
- The Nomination & Remuneration Committee reviews executive packages annually by reference to the consolidated group's performance, executive performance and comparable information from industry sectors. Due to the partial disposal of Island Sky Corporation during the year, the Nomination & Remuneration Committee's did not meet.

REMUNERATION REPORT – CONT

The performance of Executive Directors is measured against criteria agreed annually and is based predominantly on the forecast growth of the consolidated group's profits and shareholders' value. The Board may exercise its discretion in relation to approving incentives, bonuses and options and can recommend changes to the committee's recommendations. Any changes must be justified by reference to measurable performance criteria. The policy is designed to attract the highest calibre of executives and reward them for performance that results in long-term growth in shareholder wealth.

Key management personnel and Directors are also entitled to participate in the employee option arrangements.

The key management personnel and Directors receive a superannuation guarantee contribution required by the government, which is currently 9% in Australia and 7.5% in the USA, and do not receive any other retirement benefits. The key management personnel have the option to sacrifice part of their salary to increase payments towards superannuation.

All remuneration paid to Directors and key management personnel is valued at the cost to the company and expensed. Shares given to Directors and executives are valued as the difference between the market price of those shares and the amount paid by the Director or key management personnel. Options are valued using the Black-Scholes methodology.

The Board policy is to remunerate non-executive Directors at market rates for time, commitment and responsibilities. The Nomination & Remuneration Committee determines payments to the non-executive Directors and reviews their remuneration annually, based on market practice, duties and accountability. Independent external advice is sought when required. The current maximum aggregate remuneration of Non Executive Directors has been set at $500,000 per annum. Directors may apportion any amount up to this maximum amount amongst the non executive Directors as they determine. Directors are also entitled to be paid reasonable travelling, accommodation and other expenses incurred in performing their duties as Directors. The maximum aggregate amount of fees can only be increased with prior approval by shareholders at the Annual General Meeting. Fees for non-executive Directors are not linked to the performance of the consolidated group. However, to align Directors' interests with Shareholder interests, the Directors are encouraged to hold shares in the company and are able to participate in the employee option plan.

Performance-based remuneration

As part of the Managing Director's remuneration package there was a performance-based component, consisting of key performance indicators (KPIs). The intention of this program is to facilitate goal congruence between Managing Director with that of the business and Shareholders. The KPIs are set annually by the Nomination & Remuneration Committee, with a certain level of consultation with Managing Director to ensure buy-in. The KPIs target areas the Board believes hold greater potential for group expansion and profit, covering financial and non-financial as well as short- and long-term goals. The level set for each KPI is based on budgeted figures for the group and respective industry standards.

Performance in relation to the KPIs is assessed annually with bonuses being awarded depending on the number and deemed difficulty of the KPIs achieved. Following the assessment the KPIs are reviewed by the Nomination and Remuneration Committee in light of the desired and actual outcomes and their efficiency is assessed in relation to the group's goals and shareholder wealth before the KPIs are set for the following year.

In determining whether or not a KPI has been achieved Island Sky Australia Limited bases the assessment on audited figures.

Company performance, Shareholder wealth and Director and key management personnel remuneration

The remuneration policy has been tailored to increase goal congruence between Shareholders, Directors and key management personnel. There have been two methods applied in achieving this aim; a performance based bonus based on key performance indicators and the issue of options to the majority of Directors and key management personnel to encourage the alignment of personal and Shareholder interests. The company believes this policy will be effective in increasing shareholder wealth.

REMUNERATION REPORT – CONT

Remuneration for key management personnel is not linked to the performance of the consolidated group. However to align key management personnel interests with shareholder interests they are able to participate in the employee option plan.

(b) Details of Remuneration

	Appointed as Director of Parent	Appointed as Directors or Personnel of Subsidiary	Appointed as key management Personnel of Parent & Subsidiary
David Lindh (Chairman)	12 April 2007	n/a	n/a
Richard Groden	17 January 2007	1 April 2004	n/a
Michael Paragon	21 March 2007 – 10 April 2012	1 April 2004 – 10 April 2012	n/a
Neville Martin	17 January 2007	n/a	n/a

(c) Remuneration

Directors	**Short-term Benefits**	**Share-based payment**	**Post-employment Benefits**	**Total**	**Performance Related**
	Salary & fees	**Options**	**Superannuation**		
2012	**$**	**$**	**$**	**$**	**%**
David Lindh [(1)]	-	-	-	-	-
Richard Groden	-	-	-	-	-
Neville Martin[(2)]	-	-	-	-	-
	-	-	**-**	**-**	**-**

(1) No director fees were accrued during the 2012 year and Mr Lindh did not receive any payment for 2012 director fees during the year. Mr Lindh had outstanding director fees for the 2011 and 2010 year which Mr Lindh has loaned to the company. The company paid a portion of these outstanding fees during the year totaling $73,575.

(2) No director fees were accrued during the 2012 year and Mr Martin did not receive any payment for 2012 director fees during the year. Mr Martin had outstanding director fees for the 2011 and 2010 year which Mr Martin has loaned to the company. The company paid a portion of these outstanding fees during the year totaling $24,996.

REMUNERATION REPORT – CONT

Directors	Short-term Benefits	Share-based payment	Post-employment Benefits	Total	Performance Related
	Salary & fees	Options	Superannuation		
2011	**$**	**$**	**$**	**$**	**%**
David Lindh [(3)]	80,000	-	7,200	87,200	-
Richard Groden[(4)]	96,492	-	-	96,492	-
Michael Paragon[(5)]	66,107	-	-	66,107	-
Neville Martin[(6)]	40,000	-	-	40,000	-
	282,599	-	**7,200**	**289,799**	**-**

(3) Mr Lindh's fees were accrued during the 2011 year but not paid.

(4) Mr. Groden received a cash payment of $11,171 during the 2011 year. The above amount also includes $85,321 for fees accrued in the 2011 year but not paid.

(5) Mr. Paragon received a cash payment of $9,645 during the 2011 year. The above amount also includes $56,462 for fees accrued in the 2011 year but not paid.

(6) Mr. Martin fees were accrued during the 2011 year but not paid.

Shareholdings

Number of Shares held by Key Management Personnel

	Balance on 1.1.2012	Received as Compensation	Options Exercised	Net Change Other	Balance 31.12.2012
David John Lindh*	40,041,604	-	-	(27,322,004)	12,719,600
Richard Jay Groden**	13,096,913	-	-	-	13,096,913
Neville Wayne Martin***	9,519,758	-	-	-	9,519,758
Total	62,658,275	-	-	(27,322,004)	35,336,271

Number of Shares held by Key Management Personnel

*12,519,600 of the shares are held by Davan Nominees Pty Ltd. Mr Lindh is a Director and shareholder of Davan Nominees Pty Ltd. The net change of 27,322,004 related to shares held by Chesser Nominees Pty Ltd, a company that Mr Lindh was formerly but no longer an associate of.

**Included in the above are 12,000,000 share held in joint names of Richard Jay Groden and Susan Groden. Also included are 794,391 shares held in Rhythm & Blues Holdings Inc, a company associated with Richard Groden.

***8,902,308 of the shares are held by Houmar Nominees Pty Ltd as trustee for the Martin Superannuation Fund. Mr Martin is a Director and shareholder of Houmar Nominees Pty Ltd and a beneficiary of the Martin Superannuation Trust. Mr Martin is a potential beneficiary of Chaffey Consulting Pty Ltd, which as trustee for Minter Ellison Investment Trust holds 32,450 shares on behalf of Mr Martin. Stansbury Petroleum Investments Pty Ltd, a company associated with Mr Martin holds 20,000 shares.

(d) Service Agreements

There were no service agreements in place during the 2012 year.

The Nomination and Remuneration committee determines the proportion of fixed and variable compensation for each key management personnel.

DIRECTORS' REPORT
FOR THE YEAR ENDED 31ST DECEMBER 2012

REMUNERATION REPORT – CONT

Indemnifying Officers or Auditor

During or since the end of the financial year the company has given an indemnity or entered into an agreement to indemnify, or paid or agreed to pay insurance premiums as follows:

The company has paid premiums to insure each of the Directors against liability for costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in the capacity of Director of the company, other than conduct involving a wilful breach of duty in relation to the company.

Options

At the date of this Report the unissued ordinary shares of Island Sky Australia Limited under option are as follows:

Grant Date	Date of Expiry	Exercise Price	Number under Option
5 May 2011	30 April 2014	$0.40	300,000
4 August 2011	4 August 2014	$0.005	5,000,000
			5,300,000

Proceedings on Behalf of Company

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

The company was not a party to any such proceedings during the year.

Non-audit Services

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

- all non-audit services are reviewed and approved by the Audit Committee prior to commencement to ensure they do not adversely affect the integrity and objectivity of the Auditor
- the nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

The following fees for non-audit services were paid/payable to the External Auditors during the year ended 31 December 2012:

	$
Taxation services	2,790
	2,790

Auditor's Independence Declaration

The lead Auditor's Independence Declaration for the year ended 31 December 2012 has been received and can be found on the following page of the Directors' Report.

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

David Lindh, Director

Dated this 28th day of March 2013

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**AUDITOR'S INDEPENDENCE DECLARATION
TO THE DIRECTORS OF ISLAND SKY AUSTRALIA LIMITED**

In accordance with the requirements of section 307C of the Corporations Act 2001, as lead auditor for the audit of Island Sky Australia Limited for the year ended 31 December 2012, I declare that, to the best of my knowledge and belief, there have been:

a no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

b no contraventions of any applicable code of professional conduct in relation to the audit.

Grant Thornton

GRANT THORNTON AUDIT PTY LTD
Chartered Accountants

J L Humphrey
Director – Audit & Assurance

Adelaide, 28 March 2013

Island Sky Australia Limited and Controlled entity

ABN 73 122 948 805

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Consolidated Group	
		2012 $	2011 $
Other income	2	29,219	5,123
Marketing		-	(14,773)
Occupancy	2	(27,923)	(28,575)
Administration	2	(66,778)	(78,355)
Professional fees	2	(140,504)	(193,523)
Other expenses	2	(12,971)	(148,053)
Impairment in investment in associate	2	(116,800)	-
Finance costs	2	(496)	(740)
Profit /(Loss) before income tax		(336,253)	(458,896)
Income tax expense	4	-	(12,857)
Profit/(Loss) for the year from continuing operations		(336,253)	(471,753)
Profit/(Loss) from discontinued operation	3	3,159,836	(2,703,046)
Profit/(Loss) for the year		2,823,583	(3,174,799)
Other comprehensive income			
Foreign Currency Translation Adjustment (loss)		(5,989)	(47,960)
Total comprehensive income for the year		2,817,594	(3,222,759)
Profit attributable to:			
Members of the parent entity		2,823,583	(3,174,799)
Total comprehensive income attributable to members of the parent entity:			
Continuing operations		(342,242)	(519,713)
Discontinuing operations		3,159,836	(2,703,046)
		2,817,594	(3,222,759)
Earnings per share for loss from continuing operations attributable to the ordinary equity holders of the company:			
Basic earnings per share from continuing operations (cents per share)	7	**(0.118)**	**(0.173)**
Diluted earnings per share from continuing operations (cents per share)	7	**(0.118)**	**(0.173)**
Earnings per share for loss from discontinued operations attributable to the ordinary equity holders of the company:			
Basic earnings per share from discontinued operations (cents per share)	7	**1.106**	**(0.992)**
Diluted earnings per share from discontinued operations (cents per share)	7	**1.106**	**(0.9918)**

The accompanying notes form part of these financial statements.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2012

	Note	Consolidated Group	
		2012 $	2011 $
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	9	43,888	289,017
Trade and other receivables	10	3,274	19,427
Inventories	14	-	911,892
Other current assets	15	-	20,746
TOTAL CURRENT ASSETS		47,162	1,241,082
NON-CURRENT ASSETS			
Trade and other receivables	10	954,804	-
Investment in associate	11	-	-
Plant and equipment	13	-	30,814
Other non-current assets	15	-	11,845
TOTAL NON-CURRENT ASSETS		954,804	42,659
TOTAL ASSETS		1,001,966	1,283,741
CURRENT LIABILITIES			
Trade and other payables	16	325,483	2,444,404
Provisions	17	-	2,769
TOTAL CURRENT LIABILITIES		325,483	2,447,173
TOTAL LIABILITIES		325,483	2,447,173
NET ASSETS/(LIABILITIES)		676,483	(1,163,432)
EQUITY			
Issued capital	18	12,315,716	14,448,739
Reserves	19	82,626	(1,066,729)
Retained losses		(11,721,859)	(14,545,442)
TOTAL EQUITY		676,483	(1,163,432)

The accompanying notes form part of these financial statements.

Island Sky Australia Limited and Controlled entity
ABN 73 122 948 805

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Share Capital Ordinary	Foreign Currency Translation Reserve	Share Based Payment Reserve	Retained Losses	Total
		$	$	$	$	$
CONSOLIDATED GROUP						
Balance at 1 January 2011		**13,777,803**	**(1,101,395)**	**69,305**	**(11,370,643)**	**1,375,070**
Shares issued during the year	18	714,255	-	-	-	714,255
Share issue costs	18	(56,175)	-	-	-	(56,175)
Option issue costs		-	-	13,321	-	13,321
Deferred tax benefit associated with the share issue costs	18	12,857	-	-	-	12,857
Total comprehensive income for the year		-	(47,960)	-	(3,174,799)	(3,222,759)
Balance at 31 December 2011		**14,448,739**	**(1,149,355)**	**82,626**	**(14,545,442)**	**(1,163,432)**
Derecognition of foreign currency translation reserve upon sale of subsidiary	19	-	1,155,344	-	-	1,155,344
Sale of subsidiary previously accounted for as a reverse acquisition	18	(2,133,023)	-	-	-	(2,133,023)
Total comprehensive income for the year		-	(5,989)	-	2,823,583	2,817,594
Balance at 31 December 2012		**12,315,716**	**-**	**82,626**	**(11,721,859)**	**676,483**

The accompanying notes form part of these financial statements.

Island Sky Australia Limited and Controlled entity
ABN 73 122 948 805

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Consolidated Group	
		2012 $	2011 $
CASH FLOWS FROM OPERATING ACTIVITIES			
Payments to suppliers and employees		(186,848)	(340,445)
Interest received		7,813	5,123
Finance costs		(1,385)	(740)
Net cash (used in) continuing operations		(180,420)	(336,062)
Net cash (used in) discontinued operations	5(c)	(149,443)	(329,506)
Net Cash used in operating activities	21	(329,863)	(665,568)
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of subsidiaries, net of cash disposed	5(b)	90,923	-
Net cash provided by continuing operations		90,923	-
Net cash provided by discontinued operations	5(c)	-	23,838
Net cash provided by investing activities		90,923	23,838
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares		-	714,255
Payment of share issue costs		-	(42,855)
Net cash provided by continuing operations		-	671,400
Net cash provided by discontinued operations		-	242,290
Net cash provided by financing activities		-	913,690
Net (decrease)/increase in cash held		(238,940)	271,960
Cash at beginning of financial year		289,017	66,480
Effect of exchange rates on cash holdings in foreign currencies		(6,189)	(49,423)
Cash at end of financial year	9	43,888	289,017

The accompanying notes form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

This financial report includes the consolidated financial statements and notes of Island Sky Australia Ltd and controlled entity ('consolidated group' or 'Group').

The financial statements were authorised for issued by the board of directors on 28th March 2013.

Basis of Preparation

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Australian Accounting Interpretations, other authoritative pronouncements of Australian Accounting Standards Board and the Corporations Act 2001.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards. Material accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated. Island Sky Australia Ltd is a for-profit company for the purpose of preparing financial statements.

The financial report has been prepared on an accruals basis and is based on historical costs, modified, where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities.

Accounting Policies

Principles of Consolidation

A controlled entity is any entity Island Sky Australia Limited has the power to control the financial and operating policies of so as to obtain benefits from its activities.

Details of the controlled entity are contained in Note 12 to the financial statements. The controlled entity has a December financial year-end.

As at reporting date, the assets and liabilities of all controlled entity has been incorporated into the consolidated financial statements as well as their results for the year then ended.

All inter-company balances and transactions between entities in the consolidated group, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the parent entity.

Where controlled entities have entered or left the consolidated group during the year, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

Income Tax

The income tax expense (revenue) for the year comprises of current income tax expense (income) and deferred tax expense (income).

Current income tax expense charges to the profit and loss is the tax payable on taxable income calculated using applicable income tax rates enacted, or substantially enacted, as at reporting date. Current tax liabilities (assets) are therefore measured at the amounts expected to be paid to (recovered from) the relevant taxation authority.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES - CONT

Income Tax –Cont

Deferred income tax expense reflects movements in deferred tax asset and deferred tax liability balances during the year as well as unused tax losses.

Current and deferred income tax expense (income) is charged or credited directly to equity instead of the profit or loss when the tax relates to items that are credited or charged directly to equity.

Deferred tax assets and liabilities are ascertained based on temporary differences arising between the bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets also result where amounts have been fully expensed but future tax deductions are available. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax assets and liabilities are calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates enacted or substantively enacted at reporting date. Their measurement also reflects the manner in which management expects to recover or settle the carrying amount of the related asset or liability.

Deferred tax assets relating to temporary differences and unused tax losses are recognised only to the extent that it is probable that future taxable profit will be available against which the benefits of the deferred tax asset can be utilised.

Where temporary differences exist in relation to investments in subsidiaries, branches, associates, and joint ventures, deferred tax assets and liabilities are not recognised where the timing of the reversal of the temporary difference can be controlled and it is not probable that the reversal will occur in the foreseeable future.

Current tax assets and liabilities are offset where a legally enforceable right of set-off exists, the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where it is intended that net settlement or simultaneous realisation and settlement of the respective asset and liability will occur in future periods in which significant amounts of deferred tax assets or liabilities are expected to be recovered or settled.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost, less provision for doubtful debts.

Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for doubtful receivables is established where there is objective evidence that the consolidated group will not be able to collect all amounts due according to the original terms of receivables.

Inventories

Inventories are measured at the lower cost and net realisable value. The cost of manufactured products includes direct materials, direct labour and an appropriate portion of variable and fixed overheads. Overheads are applied on the basis of normal operating capacity. Costs are assigned on the basis of weighted average costs.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Plant and Equipment

Each class of plant and equipment is carried at historical cost or fair value less, where applicable, any accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Trade and Other Payables

These amounts represent liabilities for goods and services provided to the consolidated group prior to the period end, which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

Financial Instruments

Recognition and Initial Measurement

Financial instruments, incorporating financial assets and financial liabilities, are recognised when the entity becomes a party to the contractual provisions of the instrument. Trade date accounting is adopted for financial assets that are delivered within timeframes established by marketplace convention.

Financial instruments are initially measured at fair value plus transaction costs where the instrument is not classified as at fair value through profit and loss. Transactions costs related to instruments classified as at fair value through profit and loss are expensed to profit or loss immediately. Financial instruments are classified and measured as set out below.

Derecognition

Financial assets are derecognised where the contractual rights to receipt of cash flows expires or the asset is transferred to another party whereby the entity no longer has any significant continuing involvement in the risks and benefits, associated with the asset. Financial liabilities are derecognised where the related obligations are either discharged, cancelled or expire. The difference between the carrying value of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in the statement of comprehensive income.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Financial Instruments - Cont

Classification and Subsequent Measurement

(i) *Financial assets at fair value through profit or loss*
Financial assets are classified at fair value through profit or loss when they are held for trading for the purpose of short term profit taking, where they are derivatives not held for hedging purposes, or designated as such to avoid an accounting mismatch or to enable performance evaluation where a group of financial assets is managed by key management personnel on a fair value basis in accordance with documented risk management or investment strategy. Realised and unrealised gains and losses arising from changes in fair value are included in profit or loss in the period in which they arise.

(ii) *Loans Receivables*
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are subsequently measured at amortised cost using the effective interest rate method.

(iii) *Held-to-maturity investments*
Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and it is the group's intention to hold those investments to maturity. They are subsequently measured at amortised cost using the effective interest rate method.

(iv) *Available-for-sale financial assets*
Available-for-sale financial assets are non-derivative financial assets that are either designated as such or that are not classified in any of the other categories. They comprise investments in the equity of other entity where there is neither a fixed maturity nor fixed or determinable payments.

(v) *Financial Liabilities*
Non-derivative financial liabilities (excluding financial guarantees) are subsequently measured at amortised cost using the effective interest rate method.

Fair Value
Fair value is determined based on the current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

Impairment
At each reporting date, the group assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether impairment has arisen. Impairment losses are recognised in the statement of comprehensive income.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Impairment of Non-financial Assets

At each reporting date, the group reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the statement of comprehensive income.

Impairment testing is performed annually with intangible assets having an indefinite life.

Where it is not possible to estimate the recoverable amount of an individual asset, the group estimates the recoverable amount of the cash generating unit to which the asset belongs.

Contributed Equity

Ordinary Shares are classified as equity with incremental costs directly attributable to the issue of new shares and options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options for the acquisition of a business are included in the cost of the acquisition as part of the purchase consideration.

Provisions

Provisions are recognised when the group has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

Revenue

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, trade allowances and amounts collected on behalf of third parties.

Revenue from the sale of goods is recognised upon the delivery of goods to customers.

Interest revenue is recognised on a proportional basis taking into account the interest rates applicable to the financial assets.

Revenue from the rendering of a service is recognised upon the delivery of the service to the customers.

All revenue is stated net of the amount of goods and services tax (GST).

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the statement of financial position are shown inclusive of GST.

Cash flows are presented in the statement of cash flows on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

Comparative Figures

When required by accounting standards comparative figures have been adjusted to conform to changes in presentation for the current financial year.

Critical Accounting Estimates and Judgments

The Directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the consolidated group.

Key Estimates — Impairment

The consolidated group assesses impairment at each reporting date by evaluating conditions specific to the consolidated group that may lead to impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates.

Earnings per Share

(i) Basic Earnings per Share

Basic earning per share is calculated by dividing the profit attributable to equity holders of the company excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

(ii) Diluted Earnings per Share

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

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Investments in associates and joint ventures

Associates are those entities over which the Group is able to exert significant influence but which are neither subsidiaries nor joint ventures. Investments in associates are initially recognised at cost and subsequently accounted for using the equity method. Any goodwill or fair value adjustment attributable to the Group's share in the associate is not recognised separately and is included in the amount recognised and subsequently accounted for using the equity method. Any goodwill or fair value adjustment attributable to the Group's share in the associate is not recognised separately and is included in the amount recognised as investment in associates.

The carrying amount of the of the investments in associates is increased or decreased to recognise the Group's share of the profit or loss and other comprehensive income of the associate, adjusted where necessary to ensure consistency with the accounting policies of the Group.

Unrealised gains and losses on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in those entities. Where unrealised losses are eliminated, the underlying asset is also tested for impairment.

Functional and presentation currency translation

The consolidated financial statements are presented in Australian dollars (AUD), which is also the functional currency of the parent company.

Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency of the respective Group entity, using the exchange rates prevailing at the dates of the transactions (spot exchange rate).

Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at year end exchange rates are recognised in profit or loss.

Non-monetary items are not retranslated at year-end and are measured at historical cost (translated using the exchange rates at the date of the transaction), except for non-monetary items measured at fair value which are translated using the exchange rates at the date when fair value was determined.

Foreign operations

In the Group's financial statements, all assets, liabilities and transactions of Group entities with a functional currency of the entity in the Group have remained unchanged during the reporting period.

On consolidation, assets and liabilities have been translated into AUD at the closing rate at the reporting date. Goodwill and fair value adjustments arising on the acquisition of a foreign entity have been treated as assets and liabilities of the foreign entity and translated into AUD at the closing rate. Income and expenses have been translated into AUD at the average rate over the reporting period. Exchange differences are charged/credited to other comprehensive income and recognised in the currency translation reserve in equity are reclassified to profit or loss and recognised as part of the gain or loss disposal.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Loss from discontinued operations

A discontinued operation is a component of the entity that either has been disposed of, or is classified as held for sale, and:

Represents a separate major line of business or geographical area of operations;

- Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- Is a subsidiary acquired exclusively with a view to resale

Profit or loss from discontinued operations in the prior year relate to all operations that have been discontinued by the reporting date for the latest period presented.

Changes in accounting policies

The AASB has issued new, revised and amended standards and interpretations that have mandatory application dates for future reporting periods.

Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the group:

The accounting standards that have not been early adopted for the year ended 31 December 2012, but will be applicable to the group in future reporting periods, are detailed below. Apart from these standards, other accounting standards that will be applicable in future periods have been reviewed, however they have been considered to be insignificant to the group.

At the date of these financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective, and have not been adopted early by the group.

Management anticipates that all of the relevant pronouncements will be adopted in the group's accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the group's financial statements is provided below.

Certain other new standards and interpretations have been issued but are not expected to have a material impact on the group's financial statements.

(i) AASB 9 Financial Instruments (effective from 1 January 2013)

The AASB aims to replace AASB 139 Financial Instruments: Recognition and Measurement in its entirety. The replacement standard (AASB 9) is being issued in phases. To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities have been issued. These chapters are effective for annual periods beginning 1 January 2013. Further chapters dealing with impairment methodology and hedge accounting are still being developed.

Management have yet to assess the impact that this amendment is likely to have on the financial statements of the Group. However, they do not expect to implement the amendments until all chapters of AASB 9 have been published and they can comprehensively assess the impact of all changes.

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

Consolidation Standards

A package of consolidation standards are effective for annual periods beginning or after 1 January 2013. Information on these new standards is presented below. The group's management have yet to assess the impact of these new and revised standards on the group's consolidated financial statements.

(ii) AASB 10 Consolidated Financial Statements (AASB 10)

AASB 10 supersedes the consolidation requirements in AASB 127 Consolidated and Separate Financial Statements (AASB 127) and Interpretation 112 Consolidation – Special Purpose Entities. It revised the definition of control together with accompanying guidance to identify an interest in a subsidiary. However, the requirements and mechanics of consolidation and the accounting for any non-controlling interests and changes in control remain the same.

(iii) AASB 11 Joint Arrangements (AASB 11)

AASB 11 supersedes AASB 131 Interests in Joint Ventures (AASB 131). It aligns more closely the accounting by the investors with their rights and obligations relating to the joint arrangement. It introduces two accounting categories (joint operations and joint ventures) whose applicability is determined based on the substance of the joint arrangement. In addition, AASB 131's option of using proportionate consolidation for joint ventures has been eliminated. AASB 11 now requires the use of the equity accounting method for joint ventures, which is currently used for investments in associates.

(iv) AASB 12 Disclosure of Interests in Other Entities (AASB 12)

AASB 12 integrates and makes consistent the disclosure requirements for various types of investments, including unconsolidated structured entities. It introduces new disclosure requirements about the risks to which an entity is exposed from its involvement with structured entities.

(v) Consequential amendments to AASB 127 Separate Financial Statements (AASB 127) and AASB 128 Investments in Associates and Joint Ventures (AASB 128)

AASB 127 Consolidated and Separate Financial Statements was amended to AASB 127 Separate Financial Statements which now deals only with separate financial statements. AASB 128 brings investments in joint ventures into its scope. However, AASB 128's equity accounting methodology remains unchanged.

(vi) AASB 13 Fair Value Measurement (AASB 13)

AASB 13 does not affect which items are required to be fair-valued, but clarifies the definition of fair value and provides related guidance and enhanced disclosures about fair value measurements. It is applicable for annual periods beginning on or after 1 January 2013. The group's management have yet to assess the impact of this new standard.

(vii) AASB 2011-9 Amendments to Australian Accounting Standards Presentation of Items of Other Comprehensive Income (AASB 101 Amendments)

NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES – CONT

The AASB 101 Amendments require an entity to group items presented in other comprehensive income into those that, in accordance with other IFRSs: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. It is applicable for annual periods beginning on or after 1 July 2012. The group's management expects this will change the current presentation of items in other comprehensive income; however, it will not affect the measurement or recognition of such items.

(viii) AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements (AASB 124 Amendments)

AASB 2011-4 makes amendments to AASB 124 Related Party Disclosures to remove individual key management personnel disclosure requirements, to achieve consistency with the international equivalent (which includes requirements to disclose aggregate (rather than individual) amounts of KMP compensation), and remove duplication with the Corporations Act 2011. The amendments are applicable for annual periods beginning on or after 1 July 2013. The group's management have yet to assess the impact of these amendments.

These new accounting standards are not expected to materially impact the group's financial results upon adoption.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2: PROFIT/(LOSS) FOR THE PERIOD FROM CONTINUING OPERATIONS

	Consolidated Group	
	2012	2011
	$	$
The following revenue and expense items are relevant in explaining the financial performance for the annual period from continuing operations:		
Other income		
Interest from Bank deposits	2,194	5,123
Interest from long term receivable	26,349	-
Other	676	-
Total interest revenue	29,219	5,123

	Consolidated Group	
	2012	2011
	$	$
Finance costs:		
— Bank charges and fees	496	740
Total finance costs	496	740
— Occupancy costs:		
— Rental expense for sublease	27,923	28,575
Total occupancy costs	27,923	28,575
Administration		
— Travel, accommodation and entertaining	-	8
— Office expenses	66,778	78,347
Total administration costs	66,778	78,355
Professional Fees:		
— Accounting and audit fees	30,290	52,000
— Legal	11,575	37,039
— Corporate advisory fees	55,000	60,000
— Other consulting fees	43,639	44,484
Total professional fees	140,504	193,523

NOTE 2: PROFIT/(LOSS) FOR THE PERIOD FROM CONTINUING OPERATIONS - CONT

	Consolidated Group	
	2012	**2011**
	$	**$**
Other Expenses		
— Salaries, director fees and other related costs	12,971	148,053
	12,971	148,053
Impairment		
— Investment in associate – Island Sky Corporation	116,800	-
Total Impairment	116,800	-

NOTE 3: LOSS FOR THE PERIOD FROM DISCONTINUED OPERATIONS

On 15 June 2012 the Company signed a Stock Purchase Agreement (SPA) with Mr Richard Groden pursuant to which the Company sold 75% of its shares of common stock held in its wholly owned subsidiary, Island Sky Corporation. The Agreement, subject to shareholder approval, was approved at the Annual General Meeting held on 31 July 2012. As a result of this transaction, the net liabilities of Island Sky Corporation have been deconsolidated from the Statement of Financial Position. In addition, the performance of Island Sky Corporation has been removed from the continuing "operations" within the Statement of Comprehensive Income for the year ended 31 December 2012 and the comparative period.

NOTE 3: LOSS FOR THE PERIOD FROM DISCONTINUED OPERATIONS - CONT

	Consolidated Group	
	2012	**2011**
	$	**$**
The following revenue and expense items are relevant in explaining the financial performance for the period of the discontinued operation:		
Revenue		
Sales Income	51,480	195,389
Gain on sale of assets	-	6,150
Interest Income	5,620	13,575
	57,100	215,114
Cost of sales	(25,423)	(715,741)
Expenses		
Distribution	(555)	(1,592)
Marketing	(826)	(1,362)
Occupancy	(34,712)	(94,535)
Administration	(23,397)	(54,606)
Employee expenses	(136,748)	(838,819)
Professional fees	(13,967)	(98,939)
Depreciation	(16,810)	(26,420)
Travel, accommodation and entertainment	(249)	(3,680)
Finance costs	(20,518)	(20,947)
Impairment	-	(1,006,729)
Other expenses	(396)	(53,789)
	(248,178)	(2,201,418)
Income tax expense		
Company taxation	(145)	(1,001)
	(145)	(1,001)
Gain on disposal of subsidiary	3,376,482	-
(Loss)/profit from discontinued operation	3,159,836	(2,703,046)

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 4: INCOME TAX EXPENSE

	Consolidated Group	
	2012 **$**	**2011** **$**
The components of tax expense comprise:		
Current tax	-	-
Deferred tax	-	12,857
	-	12,857
The prima facie tax on profit/(loss) from ordinary activities before income tax is reconciled to the income tax as follows:		
Prima facie tax payable on profit/(loss) from ordinary activities before income tax at 30% (2011: 30%)	(100,876)	(137,669)
Add/(Less):		
Tax effect of:		
— Other non-allowable items	-	38,160
	(100,876)	38,160
Deferred tax assets recognised direct to equity and not meeting the recognition criteria of AASB 112	-	12,857
Tax effect of tax losses not brought into accounts as they do not meet the recognition criteria	100,876	99,509
Income tax attributable to entity	-	12,857

NOTE 5: DISPOSAL OF ISLAND SKY CORPORATION

As outlined in Note 3, Island Sky Australia Limited disposed of 75% of its holding in Island Sky Corporation for a total consideration of $1,154,929. ($1,028,488 after discounting).

(a) Effect of the disposal on the financial position of the Group:

The assets and liabilities of Island Sky Corporation at the date of disposal were:

Cash and cash equivalents	9,077
Trade and other receivables	42,385
Plant and Equipment	13,744
Inventories	897,298
Trade and other payables	(2,155,187)
Net Liabilities	(1,192,683)
De-recognition of foreign currency translation reserve	(1,155,344)
	(2,348,027)
Total consideration received or receivable (after discount)	1,028,455
Gain on disposal of subsidiary	3,376,482

(b) Proceeds from sale net of cash disposed

Total consideration received in cash	100,000
Cash and cash equivalents disposed of	(9,077)
Net cash received	**90,923**

(c) Cashflows from discontinued operations

Cashflows generated by Island Sky Corporation for the reporting period until the disposal are as follows:

	2012	2011
Operating activities	(149,443)	(329,506)
Investing activities	-	23,838

NOTE 6: AUDITORS' REMUNERATION

	Consolidated Group	
	2012 $	2011 $
Remuneration of the auditor of the parent entity for:		
— auditing or reviewing the financial report	27,500	50,000
— taxation services	2,790	2,000
	30,290	52,000
Amounts paid for audit services to a practice related to the parent entity auditor:		
— auditing or reviewing the financial report	-	40,000
— taxation services	-	2,000
	-	42,000

NOTE 7: EARNINGS PER SHARE

	Consolidated Group	
	2012 $	2011 $
Reconciliation of earnings to profit or loss from continuing operations		
Profit/(Loss)	(336,253)	(471,753)
Earnings used in the calculation of basic and diluted EPS from continued operations	(336,253)	(471,753)
Earnings used in the calculation of basic and diluted EPS from discontinued operations	3,159,836	(2,703,046)
Weighted average number of ordinary shares outstanding during the period used in calculating basic EPS	285,701,996	272,547,535
Weighted average number of shares used in diluted EPS. In accordance with AASB 133 there were no dilutive securities for the 2012 year.	285,701,996	272,547,535

NOTE 8: KEY MANAGEMENT PERSONNEL REMUNERATION

Remuneration

Directors	Short-term Benefits	Share-based payment	Post-employment Benefits	Total	Performance Related
	Salary & fees	Options	Superannuation		
2012	**$**	**$**	**$**	**$**	**%**
David Lindh [(1)]	-	-	-	-	-
Richard Groden	-	-	-	-	-
Neville Martin[(2)]	-	-	-	-	-
	-	-	**-**	**-**	**-**

(1) No director fees were accrued during the 2012 year. Mr Lindh did not receive any payment for 2012 director fees during the year. Mr Lindh had outstanding director fees for the 2011 and 2010 year which Mr Lindh loaned to the company. The company paid a portion of these outstanding fees during the year totaling $73,575.

(2) No director fees were accrued during the 2012 year. Mr Martin did not receive any payment for 2012 director fees during the year. Mr Martin had outstanding director fees for the 2011 and 2010 year which Mr Martin loaned to the company. The company paid a portion of these outstanding fees during the year totaling $24,996.

Directors	Short-term Benefits	Share-based payment	Post-employment Benefits	Total	Performance Related
	Salary & fees	Options	Superannuation		
2011	**$**	**$**	**$**	**$**	**%**
David Lindh [(3)]	80,000	-	7,200	87,200	-
Richard Groden[(4)]	96,492	-	-	96,492	-
Michael Paragon[(5)]	66,107	-	-	66,107	-
Neville Martin[(6)]	40,000	-	-	40,000	-
	282,599	-	**7,200**	**289,799**	**-**

(3) Mr Lindh's fees were accrued during the 2011 year but not paid.

(4) Mr. Groden received a cash payment of $11,171 during the 2011 year. The above amount also includes $85,321 for fees accrued in the 2011 year but not paid.

(5) Mr. Paragon received a cash payment of $9,645 during the 2011 year. The above amount also includes $56,462 for fees accrued in the 2011 year but not paid.

(6) Mr. Martin fees were accrued during the 2011 year but not paid.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 8: KEY MANAGEMENT PERSONNEL REMUNERATION - CONT

Shareholdings

Number of Shares held by Key Management Personnel

	Balance on 1.1.2012	Received as Compensation	Options Exercised	Net Change Other	Balance 31.12.2012
David John Lindh*	40,041,604	-	-	(27,322,004)	12,719,600
Richard Jay Groden**	13,096,913	-	-	-	13,096,913
Neville Wayne Martin***	9,519,758	-	-	-	9,519,758
Total	62,658,275	-	-	(27,322,004)	35,336,271

Number of Shares held by Key Management Personnel

*12,519,600 of the shares are held by Davan Nominees Pty Ltd. Mr Lindh is a Director and shareholder of Davan Nominees Pty Ltd. The net change of 27,322,004 related to shares held by Chesser Nominees Pty Ltd, a company that Mr Lindh was formerly but no longer an associate of.

**Included in the above are 12,000,000 share held in joint names of Richard Jay Groden and Susan Groden. Also included are 794,391 shares held in Rhythm & Blues Holdings Inc, a company associated with Richard Groden.

***8,902,308 of the shares are held by Houmar Nominees Pty Ltd as trustee for the Martin Superannuation Fund. Mr Martin is a Director and shareholder of Houmar Nominees Pty Ltd and a beneficiary of the Martin Superannuation Trust. Mr Martin is a potential beneficiary of Chaffey Consulting Pty Ltd, which as trustee for Minter Ellison Investment Trust holds 32,450 shares on behalf of Mr Martin. Stansbury Petroleum Investments Pty Ltd, a company associated with Mr Martin holds 20,000 of the shares.

NOTE 9: CASH AND CASH EQUIVALENTS

	Consolidated Group	
	2012 $	2011 $
Cash at bank and in hand	43,888	289,017
	43,888	289,017

The effective interest rate on short-term bank deposits was 2.5% (2011: 4.7%); these deposits have an average maturity of 30 days.

Reconciliation of cash

Cash at the end of the financial period as shown in the statement of cash flows is reconciled to items in the statement of financial position as follows:

	2012 $	2011 $
Cash and cash equivalents	43,888	289,017
	43,888	289,017

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 10: TRADE AND OTHER RECEIVABLES

	Consolidated Group	
	2012	**2011**
	$	**$**
CURRENT		
Trade receivables	-	120,202
Provision for Doubtful Debts	-	(100,100)
GST Receivable	3,274	(675)
Total Receivables	3,274	19,427
NON-CURRENT		
Receivable from related party (a)	954,803	-
	954,803	-

Provision for Impairment of Receivables

Current trade and term receivables are non-interest bearing loans and generally on 30 day terms. Non-current trade and term receivables are assessed for recoverability based on the underlying terms of the contract. A provision for impairment is recognised when there is objective evidence that an individual trade or term receivable is impaired.

There are no significant balances within trade and other receivables that contain assets that are impaired or past due. It is expected these balances will be received when due. Impaired assets are provided for in full.

(a) On 15 June 2012 the Company signed a Stock Purchase Agreement (SPA) with Mr Richard Groden to sell 933,077 shares in Island Sky Corporation for $1,154,929. $100,000 was due once shareholders approved the SPA, with the balance $1,054,929 payable within 2 years after the SPA was approved. As the receivable is interest free a discount of 6.6% has been applied against the balance to reflect the time value of money. This discount will unwind over the term of the receivable.

A breakdown of the receivable as at 31 December 2012 from the related party is as follows:

Consideration for 933,077 shares:	1,154,929
Less: Deposit paid	(100,000)
Less: Discount	(100 126)
	954,803

The Company entered into a Stock Pledge and Security Agreement with Mr Richard Groden to secure the remaining payment of $1,054,929 to the Company by granting a first priority senior lien and security interest in the 933,077 shares in Island Sky Corporation.

NOTE 11: INVESTMENT IN ASSOCIATE

	Consolidated Group	
	2012 **$**	**2011** **$**
Investment in associate		
Unlisted investments		
NON - CURRENT		
— Shares – Island Sky Corporation	116,800	-
— Provision for Impairment	(116,800)	-
Investment in associate	-	-

Investments in associates

The group holds a 25% voting power and equity interest in Island Sky Corporation which manufactures and distributes water-making machines. The investment is accounted for under the equity method. The associate has a reporting date of 31 December.

The shares are not publicly listed on a stock exchange and hence published price quotes are not available.

NOTE 12: CONTROLLED ENTITY

Controlled entity Consolidated

	Country of Incorporation	Percentage Owned (%)*	
Parent Entity and Ultimate Parent Entity:		**2012**	**2011**
Island Sky Australia Limited	Australia		
Subsidiaries of **Island Sky Australia Limited**:			
Island Sky Corporation Inc	United States of America	-	100%

** Percentage of voting power is in proportion to ownership*

NOTE 13: PLANT AND EQUIPMENT

	Consolidated Group	
	2012 $	2011 $
PLANT AND EQUIPMENT		
At cost	-	333,367
Accumulated depreciation	-	(303,617)
Total plant and equipment	-	29,750
LEASEHOLD IMPROVEMENTS		
At cost	-	184,672
Accumulated depreciation	-	(183,608)
Total Leasehold Improvements	-	1,064
PLANT AND EQUIPMENT		
At cost	-	518,039
Accumulated depreciation	-	(487,225)
Total property, plant and equipment	-	30,814
Movements in carrying amounts		
PLANT AND EQUIPMENT		
Opening Balance	29,750	75,967
Additions	-	2,009
Depreciation expense	(15,746)	(38,437)
Disposal of wholly-owned subsidiary	(14,004)	-
Adjustments from translation of foreign controlled entity	-	(9,789)
Closing Balance	-	29,750
LEASEHOLD IMPROVEMENTS		
Opening Balance	1,064	20,582
Depreciation expense	(1,064)	(9,609)
Disposals	-	(6,150)
Adjustments from translation of foreign controlled entity	-	(3,759)
Closing Balance	-	1,064

NOTE 14: INVENTORIES

	Consolidated Group	
	2012 $	2011 $
CURRENT		
Inventories	-	911,892
	-	911,892

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 15: OTHER ASSETS

	Consolidated Group	
	2012 $	2011 $
CURRENT		
Prepayments	-	20,746
	-	20,746
NON-CURRENT		
Customer deposits	-	11,845
	-	11,845

NOTE 16: TRADE AND OTHER PAYABLES

	Consolidated Group	
	2012 $	2011 $
CURRENT		
Trade payables	239,404	565,447
Sundry payables and accrued expenses	86,079	1,878,957
	325,483	2,444,404

All amounts are short-term in nature. The carrying values are considered to be a reasonable approximation of fair value.

Details of trade and other payables to related parties are outlined in Note 24.

NOTE 17: PROVISIONS

	Consolidated Group	
	2012 $	2011 $
CURRENT		
Employee entitlements	-	2,769
	-	2,769

The above employee entitlement provision relate to the annual leave entitlement on the Managing Director's Service Agreement for Richard Groden, which was extinguished during the year.

NOTE 18: ISSUED CAPITAL

	Consolidated Group	
	2012	**2011**
a. Ordinary Shares	**$**	**$**
At the beginning of the year	14,448,739	13,777,803
Total shares issued during the year	-	-
Sale of subsidiary – previously accounted for as a reverse acquisition	(2,133,023)	-
Shares issued during the prior year		
2 August 2011	-	138,890
4 August 2011	-	575,365
Total shares issued during the prior year	-	714,255
Share issue costs	-	(56,175)
Tax effect of transaction costs	-	12,857
At the end of the year	12,315,716	14,448,739

	Consolidated Group	
	2012	**2011**
Ordinary shares	**No.**	**No.**
At the beginning of the year	285,701,996	142,850,998
Shares issued during the year	-	-
Total shares issued during the year	-	-
Shares issued during the prior year		
— 2 August 2011	-	27,777,921
— 4 August 2011	-	115,073,077
Total shares issued during the prior year	-	142,850,998
At the end of the year	285,701,996	285,701,996

At the shareholders' meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

NOTE 18: ISSUED CAPITAL - CONT

b. Listed Options

	2011 Listed Options	
	2012	**2011**
	No.	**No.**
At the beginning of the year	-	1,629,003
Options issued during the year		
Island Sky Australia Limited	-	-
Total Options issued during the year	-	-
Options expired during the prior year		
- 30 November 2011 (i)	-	1,629,003
Total options expired during the prior year	-	1,629,003
At the end of the year	-	-

(i) 2011 Listed Options had an exercise price of $0.25 and expired on 30 November 2011.

c. Unlisted Options

	2014 Unlisted Options	
	2012	**2011**
	No.	**No.**
At the beginning of the year	5,000,000	-
Options issued during the year		
Island Sky Australia Limited	-	-
Total Options issued during the year	-	-
Options issued during the prior year		
- 4 August 2011	-	5,000,000
Total options issued during the prior year	-	5,000,000
At the end of the reporting period	5,000,000	5,000,000

(i) The unlisted options have an exercise price of $0.005 and expire on 4 August 2014.

NOTE 18: ISSUED CAPITAL - CONT

d. Unlisted Options	2014 A Class Options	
	2012	**2011**
	No.	**No.**
At the beginning of the year	300,000	-
Options issued during the year		
Island Sky Australia Limited	-	-
Total Options issued during the year	-	-
Options issued during the prior year		
- 5 May 2011	-	300,000
Total options issued during the prior year	-	300,000
At the end of the reporting period	300,000	300,000

(i) The unlisted options have an exercise price of $0.40 and expire on 30 April 2014

Capital Management

Management effectively manages the groups capital by assessing the group's financial risks and adjusting its capital structure in response to changes in these risks and in the market. These responses include the management of debt levels, distributions to shareholders and share issues.

NOTE 19: RESERVES

Share Based Payment Reserve

The share based payments reserve records items recognised as expenses on valuation of employee share options.

Foreign currency translation reserve

The consolidated financial statements are presented in Australian dollars (AUD), which is also the functional currency of the continuing operation.

In the group's financial statements, all assets, liabilities and transactions of Group entities with a functional currency other than the AUD are translated into AUD upon consolidation. The functional currency of the entity in the Group has remained unchanged during the reporting year.

On consolidation, assets and liabilities have been translated into AUD at the closing rate at the reporting date. Income and expenses have been translated into AUD at the average rate over the reporting year. Exchange differences are charged/credited to other comprehensive income and recognised in the foreign currency translation reserve in equity. On 15th June Island Sky Australia Ltd entered into an agreement to dispose of the foreign operation. The cumulative translation differences recognised in equity have been reclassified to profit or loss and recognised as part of the gain or loss on disposal.

NOTE 20: OPERATING SEGMENTS

Identification of reportable segments

The group has identified its operating segments based on the internal reports that are reviewed and used by the board of directors (chief operating decision makers) in assessing performance and determining the allocation of resources.

The Consolidated Group's operations were the marketing and development of USA Patented, high capacity, energy efficient air-to-water making machines which draws water vapour from the air and converts it into drinking water. The Consolidated Group's business segments previously were located in Australia with the manufacturing and development subsidiary being located in United States of America. The Skywater14 units were manufactured at Protel Pacific Corporation, a full service contract manufacturer with two manufacturing facilities in China and engineering facilities in USA.

Following the disposal of the groups operating subsidiary Island Sky Corporation (based in the USA) as outlined in Note 3, the directors are of the view that there is no longer distinguishable operating segments which require disclosure.

NOTE 21: CASH FLOW INFORMATION

	Consolidated Group	
	2012	**2011**
	$	**$**
Reconciliation of Cash Flow from Operations with Profit/(Loss) after Income Tax		
Profit/(Loss) after income tax from continuing operations	(336,253)	(471,753)
Loss after income tax from discontinued operations	3,159,836	(2,703,046)
Non-cash flows adjustments		
Gain on disposal of subsidiary	(3,376,482)	-
Depreciation	-	48,046
Impairment of investment in associate	116,800	-
Amortisation and impairment	-	1,006,938
Income tax expense	-	13,858
Interest expense on loans	-	17,922
Changes in assets and liabilities, net of the effects of purchase and disposal of subsidiaries		
Decrease/(Increase) in trade and term receivables	234	(4,037)
(Increase)/Decrease in other assets	(25,960)	89,054
Increase/(Decrease) in trade payables and accruals	134,731	483,593
(Decrease)/Increase in provisions	(2,769)	853,857
Cashflow from operating activities	(329,863)	(665,568)

NOTE 22: SHARE-BASED PAYMENTS

There were no share based payments during the 2012 year.

5,000,000 unlisted options were issued on 4 August 2011 to underwriters of the non-renounceable rights issue. There were no other share based payments during the 2012 or 2011 year.

The following share base payments existed at 31 December 2012;

- 5,000,000 2014 options granted to underwriters with an exercise price of $0.005 and an expiry date of 4 August 2014.
- 300,000 2014 A Class options granted to employees of Island Sky Florida with an exercise price of $0.4 and an expiry date of 30 April 2014.

Island Sky Australia Employee Option Plan
The Company has established a Share Option Plan (the 'Plan') with the following key features:

(a) Eligibility
The Board may issue Options under the Plan to any officer or employee of the Company (Eligible Employee).

(b) General Terms of the Options
Options will be issued free of charge. Each Option is to subscribe for one Share and, when issued, the Shares will rank equally with other Shares. The Options are not transferable. Quotation of the Options on the ASX will not be sought but the Company will apply to the ASX for official quotation of Shares issued on the exercise of Options. Options may be granted subject to conditions specified by the Board, which must be satisfied, before the Option can be exercised.

(c) Exercise of Options
Subject to satisfaction of the Conditions of Exercise of Options, Options may be exercised at any time within 5 years of the date of grant (provided however that the number of Options the Eligible Employee may exercise during any period of 12 consecutive months shall not exceed that number of Options that equals one third of the total number of Options issued to the Eligible Employee under the Plan [whether or not exercised prior to the time of calculation]). Options lapse upon termination of the Eligible Employee's employment by the Company and, unless the terms of the offer of the Option specified otherwise each Option lapses 5 years after the date upon which it was granted.

(d) Exercise Price
The exercise price per Share for an option will be the amount determined by the Board at the time of the grant of the Option.

(e) New Issue of Securities
Option holders will not be entitled to participate in any new issue of securities in the Company unless they exercise their Options prior to the record date for the determination of entitlements to the new issue.

(f) Bonus Issues
If the Company makes a bonus issue of securities to ordinary shareholders, each unexercised Option will, on exercise, entitle its holder to receive the bonus securities as if the Option had been exercised before the record date for the bonus issue.

(g) Rights Issues
If the Company makes a pro-rata rights issue of Shares for cash to its ordinary shareholders, the exercise price of the unexercised Options will be adjusted to reflect the diluting effect of the issue.

(h) Capital Reorganisations
If there is any reorganisation of the capital of the Company, the number of Options and their exercise price will be adjusted in accordance with the Listings Rules.

(i) Limit on Number of Options
The maximum number of Options on issue under the Plan must not at any time exceed 5% of the total number of Shares on issue at that time.

NOTE 22: SHARE-BASED PAYMENTS - CONT

Options granted to key management personnel are as follows:	**Grant Date**	**Number**
	Number	**Weighted average exercise price**
Options outstanding at 31 December 2010	9,000,000	$0.93
Granted	5,300,000	$0.03
Forfeited	-	-
Exercised	-	-
Expired	9,000,000	-
Options outstanding as at 31 December 2011	5,300,000	$0.03
Options exercisable as at 31 December 2011	5,300,000	$0.03
Granted	-	-
Forfeited	-	-
Exercised	-	-
Expired	-	-
Options outstanding as at 31 December 2012	5,300,000	$0.03
Options exercisable as at 31 December 2012	5,300,000	$0.03

The fair values of options granted were determined using a variation of the binomial option pricing model that takes into account factors specific to share incentive plans, such as the vesting period. The following period assumptions were used in the valuation

	2014 A Class Options	2014 Options
Grant Date	5 May 2011	4 August 2011
Vesting period ends	30 April 2014	4 August 2014
Share price at date of grant	0.004	0.007
Volatility	7.9%	7.9%
Option life	3 Years	3 Years
Risk free investment rate	4.75%	4.75%
Fair value at grant date	$nil	$13,321
Exercise price at date of grant	$0.40	$0.005

NOTE 23: EVENTS AFTER THE BALANCE DATE

No adjusting or significant non-adjusting events have occurred between the reporting date and the date of this report.

NOTE 24: RELATED PARTY TRANSACTIONS

	Consolidated Group	
	2012 **$**	**2011** **$**
Transactions between related parties are on normal commercial terms and conditions no more favourable than those available to other parties unless otherwise stated.		
Transactions with related parties:		
Other Related Parties transaction (net of GST)		
Ms Groden, a related party of Mr Groden loaned Island Sky funds. Interest is payable on this loan within one year at a rate of ten percent.	-	30,438
During the year the entity used the services of AE Administrative Services Pty Ltd for the provision of Company Secretarial, Accounting and Administration Services. Mr Lindh is an associate of this company.	51,773	56,843
Rhythm & Blues Holdings Inc, a company associated with Mr Groden loaned Island Sky funds. Interest is payable on this loan within one year at a rate of 10 percent.	-	51,644
Groden & Stamp Construction Inc, a company associated with Mr Richard Groden loaned Island Sky funds. Interest is payable on this loan within one year at a rate of 10 percent	-	31,758
Rent, occupancy costs and reimbursable expenses to Adelaide Equity Partners Limited. Mr Lindh is a Director of Adelaide Equity Partners.	27,923	28,248
During the year the entity used the services of Adelaide Equity Partners Limited for the provision of Corporate Advisory Services. Mr Lindh is a Director of Adelaide Equity Partners Limited.	55,000	60,000
During the year, the Company used the services of Minter Ellison for the provision of legal services. Mr Martin is a partner and Mr Lindh is a consultant of Minter Ellison.	2,940	56,935
During the year the Company recognised an amount payable to Mr Martin for unpaid director’s fees.	24,996	-
During the year the Company recognised an amount payable to Mr Lindh for unpaid director’s fees.	35,425	-
During the year the company disposed of 75% of its subsidiary to Mr Groden (refer Note 5).	100,000	-

NOTE 24: RELATED PARTY TRANSACTIONS - CONT

Other Related Parties balances (including GST)

Amount payable to Minter Ellison, of which, Mr Martin is a partner and Mr Lindh is a consultant.	-	6,409
Amount payable to Adelaide Equity Partners Limited, of which, Mr Lindh is a Director and shareholder.	184,010	92,717
Amount payable to AE Administrative Services Pty Ltd, of which, Mr Lindh is an associate of this company.	45,767	21,384
Amount receivable from Mr Groden for disposal of subsidiary (refer Note 10).	954,803	-

NOTE 25: FINANCIAL INSTRUMENTS

Financial Risk Management Policies

The Group's financial instruments consist mainly of deposits with banks, short term investments, accounts receivable and payable. The main risks the group is exposed to through its financial instruments are interest rate risk, foreign currency risk, liquidity risk and credit risk.

Treasury Risk Management

The Board of the group meet on a regular basis to analyse financial risk exposure and to evaluate treasury management strategies. The Board of the company regularly analyse interest rate exposure and evaluate treasury management strategies in the context of the most recent economic conditions and forecasts.

Foreign Currency Risk

The consolidated group will be exposed to fluctuations in foreign currencies arising from sales and purchase of goods and services in currencies other than the group's functional currency. The consolidated entity potentially may have sales in foreign locations which will require risk management policies to be implemented to minimise the foreign currency risk.

Interest Rate Risk

The group had no long term financial assets or liabilities upon which it earns or pays interest. Cash is held in an interest yielding cheque account and on short-term call deposits where the interest rate can vary from day to day.

Interest rate risk is managed with a mixture of fixed and floating rate cash deposits. It is the policy of the group to keep surplus cash in high yielding deposits. For further details on interest rate risk refer below.

Liquidity Risk

Liquidity risk arises from the possibility that the group might encounter difficulty in settling its debts or otherwise meeting its obligations related to financial liabilities. The group manages liquidity risk by monitoring forecast cash flows.

Credit Risk

Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to customers, including outstanding receivables and committed transactions, and represents the potential financial loss if counterparties fail to perform as contracted. Management monitors credit risk on an ongoing basis by maintenance of procedures. Such procedures include the utilisation of systems for the approval, granting and renewal of credit limits, regular monitoring of exposures against such limits and monitoring of the financial stability of significant customers and counterparties.

NOTE 25: FINANCIAL INSTRUMENTS - CONT

Interest Rate Risk

The consolidated group's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial assets and financial liabilities, is as follows:

	Fixed Interest Rate Maturing			
	Weighted Average Effective Interest Rate		Total	
	2012	2011	2012 $	2011 $
Financial Assets:				
Cash and cash equivalents	2.5%	4.7%	43,888	289,017
Total Financial Assets			43,888	289,017

	Floating Interest Rate Within 1 Year		Non Interest Bearing	
	2012 $	2011 $	2012 $	2011 $
Financial Assets				
Cash and cash equivalents	43,888	289,017	-	-
Receivables	-	-	954,803	19,427
Total Financial Assets	43,888	289,017	954,803	19,427
Financial Liabilities				
Trade and sundry payables	-	410,631	325,483	2,033,773
Total Financial Liabilities	-	410,631	325,483	2,033,773

Net Fair Values

Aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the financial statements at balance date. Fair values are materially in line with carrying values.

	2012		2011	
	Carrying Amount $	Net Fair Value $	Carrying Amount $	Net Fair Value $
Financial Assets				
Cash and cash equivalents	43,888	43,888	289,017	289,017
Receivables	954,803	954,803	19,427	19,427
	998,691	998,691	308,444	308,444
Financial Liabilities				
Other liabilities and payables	325,483	325,483	2,444,404	2,444,404
	325,483	325,483	2,444,404	2,444,404
Net financial assets	673,208	673,208	(2,135,960)	(2,135,960)

NOTE 25: FINANCIAL INSTRUMENTS - CONT

Sensitivity analysis

Interest rate sensitivity analysis

At 31 December 2012, the effect on profit/loss and equity as a result of changes in the interest rate, with all other variables remaining constant is immaterial to the group's operations.

Financial Instrument Composition and maturity analysis

The table below reflects the undiscounted contracted settlement terms for financial instruments of a fixed period of maturity, as well as management's expectations of the settlement period for all other financial instruments. As such, the amounts may not reconcile to the statement of financial position.

Trade and sundry payables are expected to be paid as follows:

	Consolidated	
	2012	**2011**
	$	**$**
Less than 6 months	325,483	2,444,404
6 months to 1 year	-	-
1 to 5 years	-	-
Over 5 years	-	-
	325,483	2,444,404

NOTE 26: CONTINGENT LIABILITIES AND CONTINGENT ASSETS

The Company had no contingent assets or liabilities at 31 December 2011 or 31 December 2012.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 27: GOING CONCERN BASIS OF ACCOUNTING

The financial report has been prepared on the basis of going concern.

The company incurred a loss from continuing operations of $336,253. As at 31 December 2012 the company's current liabilities exceeded its current assets by $278,321. The financial position of the holding company indicates the need for additional capital.

The company remains reliant upon further capital raisings to continue as a going concern. If additional funds are not raised, the going concern basis may not be appropriate, with the result that the Company may have to realise its assets and extinguish is liabilities, other than in the ordinary course of business and in amounts different from those stated in the financial report. No allowance for such circumstance has been made in the financial report.

NOTE 28: PARENT ENTITY FINANCIAL INFORMATION

Statement of Financial Position

	Parent	
	2012	2011
	$	$
Current Assets	47,162	286,900
Non-current Assets	954,804	-
Total Assets	1,001,966	286,900
Current Liabilities	325,483	345,875
Total Liabilities	325,483	345,875
Net Assets	676,483	(58,975)
Shareholder's Equity		
Contributed Equity	12,315,716	12,315,716
Reserves	82,626	82,626
Retained Losses	(11,721,859)	(12,339,367)
Capital and reserves attributable to owners	676,483	(58,975)

NOTE 29: COMPANY DETAILS

The registered office of the company is:

Island Sky Australia Limited
Level 3
100 Pirie Street
Adelaide SA 5000
Telephone (08) 8232 2550
Facsimile (08) 8232 2540

Island Sky Australia Limited and Controlled entity
ABN 73 122 948 805

DIRECTORS' DECLARATION

The Directors of the company declare that:

1. the financial statements and notes, as set out on pages 17 to 54, are in accordance with the *Corporations Act 2001* and:
    a. comply with Accounting Standards and the Corporations Regulations 2001; and
    b. give a true and fair view of the financial position as at 31 December 2012 and of the performance for the period ended on that date of the consolidated group;
2. A declaration as required by Section 295A of the Corporations Act has been received.
3. in the Directors' opinion there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors.

David Lindh OAM

Chairman

Dated this 28th day of March 2013

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INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF ISLAND SKY AUSTRALIA LIMITED

Report on the financial report

We have audited the accompanying financial report of Island Sky Australia Limited (the "Company"), which comprises the consolidated statement of financial position as at 31 December 2012, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the consolidated entity comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The Directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 the Directors' responsibility also includes such internal control as the Directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error. The Directors also state, in the notes to the financial report, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the Company's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial report.

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

Independence
In conducting our audit, we have complied with the independence requirements of the Corporations Act 2001.

Auditor's opinion
In our opinion:

a the financial report of Island Sky Australia Limited is in accordance with the Corporations Act 2001, including:

  i giving a true and fair view of the consolidated entity's financial position as at 31 December 2012 and of its performance for the year ended on that date; and

  ii complying with Australian Accounting Standards and the Corporations Regulations 2001; and

b the financial report also complies with International Financial Reporting Standards as disclosed in the notes to the financial statements.

Material uncertainty regarding continuation as a going concern
Without qualifying our opinion, we draw attention to Note 27 in the financial report which indicates that the company incurred a net loss from continuing operations of $336,253. As at 31 December 2012 the company's current liabilities exceeded its current assets by $278,321. These conditions, along with other matters as set forth in Note 27, indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern and therefore, the company may be unable to realise its assets and discharge its liabilities in the normal course of business, and at the amounts stated in the financial report.

Report on the remuneration report

We have audited the remuneration report included in the directors' report for the year ended 31 December 2012. The Directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with section 300A of the Corporations Act 2001. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's opinion on the remuneration report

In our opinion, the remuneration report of Island Sky Australia Limited for the year ended 31 December 2012, complies with section 300A of the Corporations Act 2001.

Grant Thornton

GRANT THORNTON AUDIT PTY LTD
Chartered Accountants

J L Humphrey
Director – Audit & Assurance

Adelaide, 28 March 2013