pieNETWORKS Limited

ABN 27 078 661 444

Annual report
30 June 2012

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Chairman's' Review

Dear Shareholder,

The year to June 2012 proved a very difficult year for the company. The company had invested heavily in further development of the Hotspot Webphone in expectation of a substantial order from Telstra.

However, it became clear in early 2012 that capital expenditure constraints within Telstra would limit the budget available for expansion of Webphone deployments. The board approached Telstra at the highest levels to seek confirmation of an intention to order more Webphones, but was unable to obtain any firm commitment. The board then took the necessary decision to substantially reduce expenditure, which necessitated substantial reduction in staff numbers and cancellation of a range of supply contracts. The company's principal place of business was relocated to reduce accommodation costs to a minimal level.

The structural changes were designed to minimize costs while preserving the company's intellectual property in the Webphone and related products; and to maintain services to and revenue from existing clients, including Telstra. The company continues to provide support services to Telstra to maintain the existing deployment of Webphones.

Given the delays and uncertainty in future potential revenues from sales of Webphones to Telstra, the board determined that it was necessary to seek alternative business strategies for the company, as announced to the ASX in the announcement dated 19th March, 2012. Subsequently, the board has reviewed a number of opportunities and has initiated a capital raising to enable the company to pursue alternative strategies. The opportunities being considered include an expansion of the Company's business in the communications field, including potential acquisitions. One opportunity under consideration is the acquisition of a telecommunications company in South East Asia. The potential acquisition is still subject to due diligence and no agreement has been reached in relation to key commercial terms.

The board will continue to pursue this opportunity and others in the interests of preserving and improving shareholder value.

In closing I want to thank our shareholders for their continued support during this difficult period of the Company's history.

For and on behalf of the board,

Peter Gunzburg
Chairman

pieNETWORKS Limited
Directors' report
For the year ended 30 June 2012

The directors present their report together with the financial statements of the Group comprising of pieNETWORKS Limited (the Company) and its subsidiaries for the financial year ended 30 June 2012 and the auditor's report thereon.

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pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

1. Directors
The directors of the Company at any time during or since the end of the financial year are:

Name, qualifications and independence status	***Age***	***Experience, special responsibilities and other directorships***
Peter L Gunzburg BComm, ASIA Chairman Non-Executive Director	60	Over 20 years experience as a stockbroker. Currently the Chairman of Eurogold Limited (director since 2001), Brinkley Mining PLC and a director of Fleetwood Corporation Limited (director since 2002). Past Director of Resolute Limited, The Australian Securities Exchange Limited, Eyers Reed Limited, CIBC World Markets Australia Limited, AIM listed Matra Petroleum PLC and Strike Oil Limited. Chairman of the Audit and Compliance Committee (since 30 January 2012, previously member) and Chairman of the Remuneration and Nomination Committee. Appointed 29 April 2002. Held the role of Chairman from 30 July 2002 to 10 August 2010. Reappointed Chairman on 6 February 2012.
Bill Zikou BEng, MBA Independent Non-Executive Director	61	Over 35 years experience in the telecommunications industry with 25 years in senior management and executive roles. His previous recent roles include CEO of Ericsson South East Europe (consisting of 9 countries) and CEO of Ericsson Australia, New Zealand and the Pacific islands. Member of the Audit and Compliance Committee and Remuneration and Nomination Committee. Appointed 10 August 2010.
Mark Pitts BBus, FCA Independent Non-Executive Director/Company Secretary	50	Over 25 years experience in statutory reporting and business administration. He has been directly involved with, and consulted to, a number of public companies holding senior financial management positions. He is a partner in corporate advisory firm Endeavour Corporate. Member of the Audit and Compliance Committee and Remuneration and Nomination Committee. Appointed Company Secretary 12 March 2008. Appointed Director on 6 February 2012.
Justin T. Milne B.A. Chairman Independent Non-Executive Director	59	Justin has had a distinguished career in the Internet and Media arenas. He was CEO of The Microsoft Network, of OzEmail and of Telstra BigPond. He also ran Telstra's considerable media businesses in Australia and China. He is a director of Tabcorp Ltd, Basketball Australia Ltd, and the Sydney Children's Hospital Network. He is active in Chinese Media where he consults to a number of organisations. He is a past board member of the SA Economic Development Board and a past President of the Internet Industry Association. Member of the Audit and Compliance Committee and Remuneration and Nomination Committee. Appointed 1 March 2011 as independent Non-Executive Director. Appointed as Chairman on 26 July 2011. Resigned as Chairman and Director on 6 February 2012.

pieNETWORKS Limited
Directors' report (continued)

For the year ended 30 June 2012

1. Directors (Continued)

Name, qualifications and independence status	*Age*	*Experience, special responsibilities and other directorships*
Campbell Smith Non-Executive Director	47	Over 20 years experience in finance and sales and marketing. Co-founder and first Managing Director of the Company. Appointed 23 May 1997. Managing Director/Chief Executive Officer 23 May 1997 to 28 September 2011. Resigned as Non-Executive Director on 11 November 2011.
Peter Abery M.Sc (Elec.Eng), MBA Chairman Independent Non-Executive Director	64	Over 20 years extensive management experience at MD / CEO level. Previous recent roles include CEO of HPM Industries, CEO of Crown Castle UK Ltd and Crown Castle Australia Pty Ltd, and Managing Director of Vodafone Network in Australia and senior roles in Telstra Corporation. He is a director of Nomad Building Solutions Limited (director since 28 July 2008) and a former non-executive director of the Norfolk Group Limited (From 31 May 2007 to 4 August 2010). Member of the Audit and Compliance Committee and Remuneration and Nomination Committee. Appointed 8 May 2007 as Independent Non-Executive Director. Appointed as Chairman on 10 August 2010. Resigned as Chairman and non-executive director on 26 July 2011.
Craig Ferrier BBus, CPA Non-Executive Director	50	Craig has over 20 years experience in the corporate and financial management of public companies gained as an executive and in advisory roles. He has worked within a broad range of sectors including mining and exploration, venture capital, manufacturing and information technology, including roles within the BHP and Ansett groups. Immediate past positions include the role of CFO with Grange Resources Limited and immediately prior to that, as CFO of Aurox Resources Limited. Craig led the development and successful merger of that entity with ASX 100 Company, Atlas Iron Limited. Company Secretary from May 2001 until 12 March 2008. Appointed 10 September 2003. Resigned on 30 January 2012.

2. Company secretary

Mark Pitts BBus, FCA Independent Non-Executive Director/ Company Secretary	50	Over 25 years experience in statutory reporting and business administration. He has been directly involved with, and consulted to, a number of public companies holding senior financial management positions. He is a partner in corporate advisory firm Endeavour Corporate. Appointed 12 March 2008.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

3. Directors' meetings
The number of directors' meetings (including meetings of committees of directors) and number of meetings attended by each of the directors of the Company during the financial year are:

Director	Board Meetings		Audit and Compliance Committee Meetings		Remuneration & Nomination Committee Meetings [1]	
	A	**B**	**A**	**B**	**A**	**B**
Peter L Gunzburg	10	10	1	1	-	-
Bill Zikou	10	10	1	1	-	-
Mark Pitts	3	3	-	-	-	-
Justin Milne	6	6	1	1	-	-
Campbell Smith	4	4	1	1	-	-
Peter Abery	-	-	-	-	-	-
Craig Ferrier	6	6	1	1	-	-

A – Number of meetings attended
B – Number of meetings held during the time the director held office during the year
[1] - Committee exists but did not meet during the year

4. Corporate governance statement
The directors of pieNETWORKS Limited ("pie" or the "Company") have established a framework of corporate governance, which they review on a regular basis.

The Company operates in accordance with the principles of corporate governance as set out by the ASX Corporate Governance Council (CGC) and as required by the ASX Listing Rules, The directors have implemented policies and practices which they believe will focus their attention and that of their Senior Executives on accountability, risk management and ethical conduct.

The CGC Principles, in conjunction with the ASX Listing Rules, require companies to disclose whether their corporate governance practices follow the revised CGC Principles on an "if not, why not" basis. This statement outlines the main corporate governance practices in place throughout the year, which comply with the CGC Principles and Best Practice Recommendations, unless otherwise stated.

4.1 Board of Directors
The roles of the Board and management
The role of the Board is to oversee and guide the management of the Company and its business with the aim of protecting and enhancing the interests of its shareholders and taking into account the interests of all stakeholders.

Details of the background, experience and professional skills of each director are set out on page 5 and 6 of this Directors' Report.

In summary the Board is responsible for:
- setting the strategic direction of the Company;
- appointing and removing the managing director;
- ratifying the appointment and/or removal of the Chief Financial Officer and the Company Secretary;
- reviewing and ratifying the systems of risk management, internal control and compliance;
- approving operating budgets;
- approving and monitoring progress of major capital expenditure, capital management, acquisitions and divestments;
- approving the form of and monitoring financial and other reporting; and
- establishing goals for management and monitoring the achievement of those goals.

pieNETWORKS Limited
Directors’ report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.1 Board of Directors (continued)

The Chief Operating Officer is responsible to the Board for the day-to-day management of the Company. The role of management is to support the Chief Operating Officer in the implementation of the agreed strategy in accordance with the delegated authority of the Board. The Chairman liaises regularly with the Chief Operating Officer, at least monthly, to discuss the general performance of the Company and any issues arising.

Board structure and independence

The Company recognises the importance of having a Board comprising of directors with an appropriate range of backgrounds, skills and experience to suit the Company’s current and future strategies and requirements. The composition of the board is determined by the application of the following principles:

- persons nominated as non-executive directors shall be expected to have qualifications, experience and expertise of benefit to the Company and to bring an independent view to the Board’s deliberations. Persons nominated as executive directors must be of sufficient stature and security of employment to express independent views on any matter;
- the Chairman should ideally be independent, but in any case be non-executive and be elected by the Board based on his suitability for the position;
- all non-executive directors are expected voluntarily to review their membership of the Board from time-to-time taking into account length of service, age, qualifications and expertise relevant to the Company’s then current policy and programme, together with the other criteria considered desirable for composition of a balanced Board and the overall interests of the Company; and
- executive directors shall be expected to retire from the Board on the relinquishment of their executive responsibilities.

The Company considers that the Board should have at least three directors and will aim to have a majority of independent directors (as required) but acknowledges that this may not be possible at all times due to the size of the Company.

Directors are expected to bring independent views and judgement to the Board’s deliberations. In determining each director’s independence the Board will use the guiding principle that an independent director is independent of management and free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the exercise of their unfettered and independent judgement. In applying the guiding principle, the Board will take into consideration the definition in the revised CGC Principles and Recommendations and appropriate materiality.

During the year, the Board comprised of up to six non-executive directors, including the Chairman, and one Executive Director, namely, the Managing Director. The current Board comprises three non-executive directors one of whom would not be regarded as independent against the CGC criteria. Mr Peter Gunzburg, the current Chairman and a Non-Executive Director, is a substantial shareholder of the Company as therefore would not be regarded as independent.

Mr. Bill Zikou and Mr Mark PItts, both Non-Executive Directors of the Company during the financial year, are regarded to be independent based on the criteria set out above.

Under the Company's Constitution, the minimum number of directors is three. At each Annual General Meeting, one third of the directors (excluding the Managing Director) must resign, with directors resigning by rotation based on the date of their appointment. Directors resigning by rotation may offer themselves for re-election.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.1 Board of Directors (continued)

Meetings of the board
The Board meets formally at least six times a year and on other occasions, as required. The agenda for meetings is prepared by the Company Secretary in consultation with the Chairman. Standard items include the operations report, financial reports, strategic matters and governance and compliance matters. Executives are available to participate in Board discussions as required.

Board access to information and independent advice
All directors have unrestricted access to all employees of the Group and, subject to the law and the terms of Deeds of Access, Insurance and Indemnity, access to all Company records.

Consistent with CGC Principle 2, each director may, with the prior written approval of the Chairman, obtain independent professional advice to assist the director in the proper exercise of powers and discharge of duties as a director or as a member of a Board Committee. The Company will reimburse the director for the reasonable expense of obtaining that advice.

4.2 Business Ethics
Code of conduct
The Board has adopted a Company Code of Conduct to promote ethical and responsible decision-making by all employees (including directors). The Code embraces the values of honesty, integrity, accountability and equality and to strive to enhance the reputation and performance of the Company. In summary, the overriding principles are:
- All employees must conduct their duties honestly and in the best interests of the Company as a whole;
- Treat other stakeholders fairly and without discrimination;
- Respect confidentiality and do not misuse Company information or assets;
- Conduct themselves in accordance with both the letter and spirit of the law; and
- Maintain a safe working environment.

Diversity Policy
The Board has implemented a Diversity Policy in accordance with best practice and governance guidelines. The Company believes that the promotion of diversity on its Boards, in senior management and within the organisation generally is good practice and strengthens its decision making.

The Diversity Policy operates to confirm existing employment practices which seek to attract and retain people by promoting an environment where employees are treated with fairness and respect and have equal access to opportunities as they arise. Diversity within the workforce includes such factors as religion, race, ethnicity, language, gender, disability and age.

The Company employs new employees and promotes current employees on the basis of performance, ability and attitude. The Board is continually reviewing its practices with a focus on ensuring that the selection process at all levels within the organisation is formal and transparent and that the workplace environment is open, fair and tolerant.

Gender Diversity
The Company, in keeping with the recommendations of the Corporate Governance Council provides the following information regarding the proportion of gender diversity in the organisation as at 30 June 2012:

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.2 Business ethics (continued)

	Male	Female	Total	Proportion female
PIE Board	3	-	3	0%
Senior Management	2	-	2	0%
Balance of Employees	1	2	3	67%
	6	2	8	25%

The recommendations of the Corporate Governance Council relating to reporting require a Board to set measurable objectives for achieving diversity within the organisation, and to report against them on an annual basis. The Company has implemented measurable objectives as follows:

Measurable Objective	Objective Satisified	Comment
Adoption and promotion of a Formal Diversity Policy	Yes	The Company has adopted a formal diversity policy which has been made publicly available via the ASX and the Company's website.
To ensure Company policies are consistent with and aligned with the goals of the Diversity Policy	Yes	The Company's selection, remuneration and promotion practices are merit based and as such are consistent with the goals of the Company's Diversity Policy.
To provide flexible work and salary arrangements to accommodate family commitments, study and self-improvement goals, cultural traditions and other personal choices of current and potential employees.	Yes	The Company does, where considered reasonable, and without prejudice, accommodate requests for flexible working arrangements.
To implement clear and transparent policies governing reward and recognition practices.	Yes	The Company grants reward and promotion based on merit and responsibility as part of its annual and ongoing review processes.
To provide relevant and challenging professional development and training opportunities for all employees.	Yes	The Company seeks to continually encourage self-improvement in all employees, irrespective of seniority, ability or experience, through external and internal training courses, regular staff meetings and relevant on job mentoring.

The Company has not implemented specific measurable objectives regarding the proportion of females to be employed within the organisation or implement requirements for a proportion of female candidates for employment and Board positions. The Board considers that the setting of quantitative gender based measurable targets is not consistent with the merit and ability based policies currently implemented by the Company.

The Board will consider the future implementation of gender based diversity measurable objectives when more appropriate to the size and nature of the Company's operations.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.2 Business Ethics (continued)

Securities trading policy
The Board has adopted a policy and procedure on dealing in the Company's securities by directors, officers and employees. The policy prohibits trading by all employees and directors of the Company and its related entities at all times where the transaction is intended for short term or speculative gain or where the person is in possession of price sensitive information. All Directors and employees (including their immediate family or any entity for which they control investment decisions), must ensure that any trading in securities issued by the Company is undertaken within the framework set out in the Securities trading policy.

The Securities trading policy does not prevent Directors or employees (including their immediate family or any entity for which they control investment decisions) from participating in any share plan or share offers established or made by the Company. However, Directors or employees are prevented from trading in the securities once acquired if the individual is in possession of price sensitive information not generally available to all security holders.

In keeping with recent listing rule amendments, additional restrictions are placed on trading by Directors, Executives and other key management personnel as determined by the Chairman and Company Secretary from time to time ('Restricted Employees').

In addition to the overriding prohibition against dealing in the Company's securities when a person is in possession of inside information, Restricted Employees and their associated parties are at all times prohibited from dealing in the Company's securities during **prescribed 'closed' periods**. The Company has nominated closed periods to run from the end of the financial quarter up to the day after the release date of the quarterly report. Restricted Employees must also obtain written consent from the Chairman or Managing Director/Chief Executive Officer prior to trading in the Company's securities.

The Securities trading policy also includes a clause prohibiting Directors and Executives from entering into transactions in associated products which operate to limit the economic risk of security holdings in the Company over unvested entitlements.

Financial reporting
The Board requires the persons performing the roles of chief operating officer and financial controller to state in writing to the Board that the Company's financial reports represent a true and fair view, in all material respects, of the Company's financial condition and operational results in accordance with the relevant accounting standards.

The Board has established an Audit & Compliance Committee ("A&CC"). The role of the A&CC is set out in a charter and its responsibilities include reviewing all published accounts of the Group; reviewing the scope and independence of external audits; monitoring and assessing the systems for internal compliance and control, legal compliance and risk management; and advising on the appointment, performance and remuneration of the external auditors.

The Company's auditor is KPMG. Consistent with CGC Principle 6, KPMG attend, and are available to answer questions at, the Company's annual general meeting.

Continuous disclosure
The Company understands and respects that timely disclosure of price sensitive information is central to the efficient operation of the Australian Securities Exchange's securities market and has adopted a comprehensive policy covering announcements to the Australian Securities Exchange, prevention of selective or inadvertent disclosure, conduct of investor and analysts briefings and media communications. The Company Secretary has responsibility for coordinating disclosure of information to the Australian Securities Exchange.

The Company's continuous disclosure policy is reviewed periodically and updated as required and is consistent with ASX Principle 5.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.3 Communication with shareholders
The Company places considerable importance on effective communication with shareholders to ensure their access to timely and relevant information. The Company communicates information on its activities and financial performance through the issue of the annual and half-year financial reports, quarterly reports on activities and cash flows and through other announcements released to the Australian Securities Exchange.

The Company posts all reports, ASX announcements, media releases and copies of newspaper reports on the Company's website at www.pienetworks.com. The website contains an archive of ASX announcements and annual reports for at least the last 3 years. The Company will, wherever practicable, take advantage of new technologies that provide greater opportunities for more effective communications with shareholders.

The Company will ensure that the annual general meeting is held in a manner that enables as many shareholders as possible to attend and encourages effective participation by shareholders. The Company requires the attendance of the external auditor at the Company's annual general meeting and to be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

4.4 Risk management
Management is ultimately responsible to the Board for the Group's system of internal control and risk management. The Audit & Compliance Committee assists the Board in monitoring this role.

The Company is committed to the identification, monitoring and management of risks associated with its business activities and has established various financial and operational reporting procedures and other internal control and compliance systems in this regard. These include:
- delegated authority limits in respect of financial expenditure and other business activities;
- a comprehensive annual insurance programme;
- internal controls to safeguard the Company's assets and ensure the integrity of business processes and reporting systems;
- regular cashflow reporting and capital adequacy monitoring;
- annual budgeting and monthly reporting systems for all businesses which enable the monitoring of progress against performance targets and the evaluation of trends;
- appropriate due diligence procedures for acquisitions and divestments; and
- disaster recovery procedures and crisis management systems.

4.5 Audit & Compliance Committee
The Audit & Compliance Committee assists the Board by:
- reviewing with management the adequacy and effectiveness of internal control systems, expenditure controls and reporting systems;
- reviewing all published financial statements of the Group;
- reviewing the scope and independence of external audits;
- advising on the appointment, performance and remuneration of external auditors;
- reviewing and evaluating risk management policies in the light of the Company's business strategy, capital strength, legal compliance requirements and overall risk tolerance;
- reviewing the adequacy of its insurance policies; and
- periodically reviewing the adequacy of accounting, financial, legal and other personnel resources.

Consistent with the requirements of CGC Principles 4 and 7, the persons performing the roles of chief operating officer and financial controller must state in writing to the Board that the Company's and the Group's financial reports present a true and fair view, in all material respects, of the Company's financial condition and operational results and are in accordance with relevant accounting standards. Additionally, the persons performing the roles of chief operating officer and financial controller are required to state in writing that this is based on a sound system for risk management and internal compliance and control which implements the policies adopted by the Board and is operating efficiently and effectively in all material respects.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.5 Audit & Compliance Committee (continued)
In view of the size of the Board, the Audit & Compliance Committee comprised all directors during the year ended 30 June 2012. Mr Peter Gunzburg is chairman of the committee. The external auditors and the financial controller are invited to committee meetings at the discretion of the committee.

4.6 Remuneration and Nomination Committee
Nomination

The Board has established a Remuneration & Nomination Committee that is comprised of all Non-Executive Directors. The committee reviews its composition as required to ensure that the Board has the appropriate mix of expertise and experience. When a vacancy exists, for whatever reason, or where it is considered that the Board would benefit from the services of a new director with particular skills, candidates with the appropriate expertise and experience are considered. The Board then appoints the most suitable candidate who must stand for election at the next general meeting of shareholders. No formal meetings of the committee were held during the year.

The Chairman reviews the performance of all directors each year. Directors whose performance is unsatisfactory are counselled and encouraged to improve their performance. If the Chairman believes their performance has not adequately improved, they are asked to retire.

Remuneration

During the financial year, the Remuneration and Nomination Committee comprised Messrs Gunzburg, Zikou, Pitts, Milne, Abery and Ferrier. The role of the Remuneration & Nomination Committee is to ensure that appropriate remuneration policies are in place and that they meet the needs of the Company and enhance corporate and individual performance. No formal meetings of the committee were held during the year.

The Remuneration & Nomination Committee is responsible for reviewing:
- executive remuneration and incentive policies;
- the remuneration packages of senior management;
- the Company's recruitment, retention and termination policies and procedures for senior management;
- superannuation arrangements;
- the performance management system operating within the organisation and its effectiveness; and
- the remuneration framework for directors.

During the 2012 year, the role of the Remuneration and Nomination Committee was undertaken by the full Board.

Remuneration levels are competitively set to attract suitably qualified and experienced directors and senior executives, having regard for Company performance. Shareholders in general meeting have approved a directors' fee pool limit of $300,000 from which non-executive directors' fees may be paid.

The performance of the Chief Operating Officer and other executive directors is reviewed by the Remuneration & Nomination Committee. The performances of the other executives and staff are reviewed on an annual basis by the Chief Operating Officer.

4.7 Remuneration report - audited
4.7.1 Compensation policies
Remuneration is referred to as compensation throughout this report.

Overview of compensation policies

Compensation levels for directors of the Company are competitively set to attract and retain appropriately qualified and experienced directors.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4.7 Remuneration report - audited
4.7.1 Compensation policies (continued)

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Group. Other than the directors and executives identified in 4.7.2, no other person is concerned in, or takes part in, the management of the Company ("senior manager") or has authority and responsibility for planning, directing and controlling the activities of the entity. As such, during the financial year, the Company did not have any other persons that would meet the definition of "key management personnel" for the purposes of AASB 124 or "company executive", or "relevant group executive" for the purposes of section 300A of the Corporations Act 2001 ("Act").

Compensation packages may include a mix of fixed and variable compensation and short and long-term performance-based incentives.

The Group does not provide non-cash benefits to key management personnel other than statutory superannuation contributions.

Fixed compensation

Fixed compensation consists of base compensation (which is calculated on a total cost basis), as well as employer contributions to superannuation funds.

Compensation levels are reviewed by the Remuneration and Nomination Committee through a process that considers individual, segment and overall performance of the consolidated entity. The Remuneration and Nomination Committee has regard to compensation levels external to the Group to ensure the director's compensation is competitive in the market place.

Performance linked compensation

Performance linked compensation may include both short-term and long-term incentives and is designed to reward executive directors and senior executives for meeting or exceeding their financial and personal objectives. The short-term incentive (STI), when in place, is intended to be an "at risk" bonus provided in the form of cash, while the long-term incentive (LTI) is provided as options over ordinary shares in the Company.

Short-term incentive bonus

There is currently no short term incentive bonus plan currently in place.

Long-term incentive

In general meeting on 11 April 2008, shareholders "renewed" the pieNETWORKS Option Incentive Plan "OIP".

On 27 November 2009, shareholders approved the grant of 16,500,000 options to directors. The options are exercisable at 1 cent and have an expiry date of 30 November 2014. The options were issued in three tranches with share price performance hurdles of 3 cents, 5 cents and 7 cents and vesting periods of 12 months, 24 months and 36 months, respectively. In accordance with their terms 13,500,000 of these options have since lapsed following the resignations of Mr Peter Abery, Mr Campbell Smith and Mr Craig Ferrier.

On 8 July 2010, shareholders approved the grant of 17,600,000 options to employees under the Company's Employee Option Incentive Plan. The options are exercisable at 1 cent each and have an expiry date of 30 June 2015. The options were issued in three tranches with share price performance hurdles of 3 cents, 5 cents and 7 cents and vesting periods of 12 months, 24 months and 36 months, respectively.

On 24 November 2010, shareholders approved the grant of 4,000,000 share options to Messrs Peter Abery and Bill Zikou. The options, which vested immediately upon grant, were issued with an exercise price of 3 cents each and an expiry date of 30 November 2014. 3,000,000 of these options have since lapsed following the resignation of Mr Peter Abery in accordance with their terms.

On 29 November 2011, shareholders approved the grant of 10,000,000 share options to Mr Justin Milne (the former Chairman). The options, which vested immediately upon grant, were issued with an exercise price of 1.8 cents each and an

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Directors' report (continued)
For the year ended 30 June 2012

4.7 Remuneration report – audited (continued)
4.7.1 Compensation policies (continued)

expiry date of 30 November 2015. These options have since lapsed following the resignation of Mr Milne in accordance with their terms.

The grant of options to directors and employees is designed to encourage the recipients to have a greater involvement in the achievement of the Company's objectives and to provide an incentive to directors and employees by participating in the future growth and prosperity of the Company through share ownership. The ability to compensate directors and employees by way of a grant of options enables the Company to provide a means of non-cash compensation and thereby reduce the amount that would otherwise have to be paid in cash.

The Group has a policy that prohibits those that are granted share-based payments as part of their remuneration from entering into other arrangements that limit their exposure to losses that would arise from share price decreases.

As per the Securities trading policy Directors and Executives are not allowed to enter into transactions in associated products which operate to limit the economic risk of security holdings in the Company over unvested entitlements.

In addition, the Company operates an Employee Share Acquisition Scheme ("ESAS"). Participation in the ESAS is available to all Australian employees other than directors. There were no shares issued under the ESAS during or since the end of the financial year (2011: Nil).

Consequences of performance on shareholders wealth
In considering the Group's performance and benefits for shareholder wealth, regard is had to the following indices in respect of the current financial year and the previous four financial years.

	2012	2011	2010	2009	2008
Net (loss)	(3,906,768)	(3,361,578)	(2,074,815)	(2,307,611)	(2,042,111)
Loss per share (cents per share)	(0.36)	(0.38)	(0.30)	(0.55)	(0.72)
Dividends paid	-	-	-	-	-
Change in share price – (decrease)/increase	($0.021)	$0.002	$0.011	($0.03)	($0.07)
Return on capital	-	-	-	-	-
Net cash (used in) operations	(2,817,176)	(2,943,081)	(1,964,165)	(1,977,364)	(2,030,394)

In establishing performance measures and benchmarks to ensure incentive plans are appropriately structured to align corporate behaviour with the long term creation of shareholder wealth, the Board has had regard to the stage of development of the Company's business and given consideration to each of the indices outlined above. In relation to long term incentives, a share price exceeding the option exercise price is required before holders can realise any value from Directors' Options or options issued under the pieNETWORKS OIP.

Service agreements
On 25 February 2000, pieNETWORKS Limited, Gocom Pty Ltd and Campbell Smith entered into a Consultancy Agreement pursuant to which the Company agreed to engage Gocom Pty Ltd as consultant to provide the services of Campbell Smith as managing director of the Company for a fixed term of 3 years. The contract was extended for a 3 year fixed term to 25 February 2006. The contract remained in force subject to a term to the effect that either party may terminate the contract on 30 days written notice. During the 2011 financial year, the Board agreed to increase the fee to be paid to Gocom Pty Ltd to $220,000 per annum beginning 1 August 2010. On 28 September 2011 the Company gave notice of the termination of the Consultancy Agreement with Gocom Pty Ltd and the engagement of Mr Smith as Managing Director/Chief Executive Officer of the Company.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4.7 Remuneration report – audited (continued)
4.7.1 Compensation policies (continued)

$73,333 was paid in termination benefits to Mr Smith pursuant to the terms of the above consulting agreement. The Directors of the Company further resolved to pay Mr Smith an additional amount of $169,334 in lieu of early termination and to issue to him 15,000,000 share options with an estimated fair value of $4,656. These additional payments are subject to shareholder approval, which has not been granted at the date of this report. An agreement signed with Mr Smith provides that should shareholder approval not be obtained, the Company and Mr Smith will negotiate in good faith with a view to agreeing an arrangement that, subject to any restrictions imposed by law, would confer on Mr Smith a benefit consistent with these payments (but in any event no greater than these payments). Any new arrangement which is negotiated may include cash payments and options in an amount that the Company believes reasonably will receive the support of shareholders.

On 15 April 2005, the Company entered into a contract for services with Atamo Pty Ltd, a Company of which Mr S. Snell and Mr P. Barrow are directors and shareholders. The contract was for the provision of services of Mr Snell as Chief Operating Officer and Mr Barrow as Product Development Manager. The contract was for an initial period of 2 years and fees payable on the contract were based on market rates. The contract was terminated on 21 May 2012. During the period, Mr P. Barrow ceased to be a Key Management Personnel. Mr S. Snell continues to act as the Company's Chief Operating Officer. Fees payable for the services that he provides are based on market rates.

In March 2008, the Company entered into a contract for services with Endeavour Corporate Pty Ltd, a Company of which Mr Mark Pitts is a partner, for the provision of company secretarial services. The contract is for no fixed term and fees payable are based on market rates for these types of services and are payable on a monthly basis for the duration of the contract. The contract may be terminated by either party on 30 days written notice. Since 6 February 2012, payments made pursuant to this contract also compensate Mr Pitts for his role as a director.

On 1 October 2010, the Company entered into a contract for services with Clarrily Pty Ltd, a Company of which Mr Reg Bowler is a director, for the provision of business development and management services. The contract is for no fixed term and may be terminated by either party on 30 days written notice. Fees payable are based on market rates for these types of services and are payable on a monthly basis for the duration of the contract. This contract was terminated during the year.

In June 2011, the Company entered into a contract with Seinecorp Pty Ltd, a Company of which Mr Craig Ferrier is a director and shareholder. The contract was for the provision of corporate finance, financial management and business management services. The contract is for no fixed term and fees payable are based on market rates. This contract was terminated during the year.

On 22 March 2012, the Company entered a contract for services with Profound Accounting and Tax, an entity owned by Mr Ohimai Mukanda. The contract is for the supply of accounting, tax and financial management services. The contract is for no fixed term and fees payable are based on market rates for these types of services.

Non-executive directors

Shareholders in a general meeting have approved a directors' fee pool limit of $300,000 from which non-executive directors' fees may be paid.

4.7.2 Directors' and executive officers' remuneration (Consolidated)

Details of the nature and amount of each major element of remuneration of each director of the Company, and other key management personnel of the Group are:

		Short-term			Post-employment	Other long term		Share-based payments			
		Salary & fees $	STI cash bonus $	Total $	Super-annuation benefits $	$	Termination benefits $	Options $ (Note 4)	Total $	Proportion of remuneration performance related %	Value of options as proportion of remuneration %
DIRECTORS											
(i) Non-executive Directors											
Mr PL Gunzburg, Chairman	2012	40,000	-	40,000	3,600	-	-	3,422	47,022	7%	7%
	2011	40,833	-	40,833	3,675	-	-	-	44,508	0%	0%
Mr BV Zikou	2012	40,000	-	40,000	3,600	-	-	-	43,600	0%	0%
	2011	36,666	-	36,666	3,300	-	-	12,000	51,966	23%	23%
Mr ME Pitts, Company Secretary	2012	60,000	-	60,000	-	-	-	4,177	64,177	7%	7%
	2011	60,000	-	60,000	-	-	-	8,912	68,912	13%	13%
Mr JT Milne (Resigned 6 February 2012)	2012	34,495	-	34,495	3,105	-	-	77,000	114,600	67%	67%
	2011	13,333	-	13,333	1,200	-	-	-	14,533	0%	0%
Mr P Abery (Resigned 27 July 2011)	2012	4,286	-	4,286	386	-	-	(9,091)	(4,419)	(205%)	(205%)
	2011	58,000	-	58,000	5,220	-	-	36,000	99,220	36%	36%
Mr CJ Ferrier (Resigned 30 January 2012). Note 1 below.	2012	116,814	-	116,814	-	-	-	(1,421)	115,393	(1%)	(1%)
	2011	83,460	-	83,460	-	-	-	-	83,460	0%	0%
(ii) Executive Directors											
Mr CD Smith, Managing Director (until 28/9/11)	2012	55,000	-	55,000	-	-	247,323	(22,727)	279,596	(8%)	(8%)
non-executive director (until 11 November 2011). Note 2 below	2011	218,334	-	218,334	-	-	-	-	218,334	0%	0%
(iii) Executives											
Mr Craig Turner, Chief Executive Officer (Ceased 21 May 2012)	2012	215,014	-	215,014	15,606	-	-	-	230,620	0%	0%
	2011	-	-	-	-	-	-	-	-	0%	0%
Mr S Snell, Chief Operating Officer	2012	176,320	-	176,320	-	-	-	9,081	185,401	5%	5%
	2011	169,960	-	169,960	-	-	-	13,864	183,824	7%	7%
Mr R. Bowler, General Manager Australia and New Zealand (Resigned 25 January 2012)	2012	136,930	-	136,930	-	-	-	-	136,930	0%	0%
	2011	140,732	-	140,732	-	-	-	-	140,732	0%	0%
Mr P Barrow, Product Development Manager (Ceased 21 May 2012)	2012	184,800	-	184,800	-	-	-	9,081	193,881	5%	5%
	2011	172,800	-	172,800	-	-	-	13,864	186,664	8%	8%

4.7.2 Directors' and executive officers' remuneration (Consolidated)

		Short-term			*Post-employment*	*Other long term*		*Share-based payments*			
		Salary & fees $	*STI cash bonus $*	*Total $*	*Super-annuation benefits $*	*$*	*Termination benefits $*	*Options $ (Note 4)*	*Total $*	*Proportion of remuneration performance related %*	*Value of options as proportion of remuneration %*
Mr B Paul, Retail Sales and Customer Services Manager (Ceased 16 December 2011)	*2012*	*153,925*	*-*	*153,925*	*7,341*	*34,402*	*31,731*	*9,340*	*236,739*	*4%*	*4%*
	2011	*138,029*	*-*	*138,029*	*12,423*	*12,568*	*-*	*14,260*	*177,280*	*8%*	*8%*
Mr O Mukanda, Financial Controller. Note 3 below	*2012*	*122,765*	*-*	*122,765*	*9,551*	*8,604*	*18,462*	*7,783*	*167,165*	*5%*	*5%*
	2011	*120,461*	*-*	*120,461*	*10,842*	*-*	*-*	*11,883*	*143,186*	*8%*	*8%*
Total compensation: key management personnel (company and consolidated)	*2012*	*1,340,349*	*-*	*1,340,349*	*43,189*	*43,006*	*297,516*	*86,645*	*1,810,705*	*5%*	*5%*
	2011	*1,252,608*	*-*	*1,252,608*	*36,660*	*12,568*	*-*	*110,783*	*1,412,619*	*8%*	*8%*

Notes to table of Directors' and executive officers' remuneration:

1. Includes an amount of $91,850 (2011: $35,633) payable for consulting services by Seinecorp Pty Ltd, an entity controlled by Mr CJ Ferrier and $24,964 (2011: $43,267) for director fees. In addition, an amount of Nil (2011: $4,560) was recognised for director fees relating to a prior year.
2. During the financial year, the Directors resolved to pay Mr CD Smith $169,334 in lieu of early termination and to issue 15,000,000 options, with an estimated fair value at 30 June 2012 of $4,656 to Mr Smith in addition to termination benefits of $73,333 that were paid to him on termination of contract. These additional termination payments are subject to shareholder approval, which has not been granted at the date of this report. An agreement signed with Mr Smith provides that should shareholder approval not be obtained, the Company and Mr Smith will negotiate in good faith with a view to agreeing an arrangement that, subject to any restrictions imposed by law, would confer on Mr Smith a benefit consistent with these payments (but in any event no greater than these payments). Any new arrangement which is negotiated may include cash payments and options in an amount that the Company believes reasonably will receive the support of shareholders.
3. During the period, Mr Mukanda ceased as an employee of the Company and now provides services as a consultant under Profound Accounting and Tax.
4. Share based payments for certain key management personnel include the 'true-up' of amounts previously expensed for non-vesting options.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4.7 Remuneration report – audited (continued)

4.7.3 Analysis of bonuses included in remuneration
There were no bonuses paid during or since the end of the financial year.

4.7.4 Equity instruments
All options refer to options over ordinary shares of pieNETWORKS Limited, which are exercisable on a one-for-one basis under the Director Option plan and under the pieNETWORKS OIP. All options expire on the earlier of their expiry date or termination of the individual's employment.

4.7.4.1 Options over equity instruments granted as compensation
During the year, the Company granted 10,000,000 options to Directors and Executives as compensation as set out below.

	Number of options granted during 2012	Grant date	Exercise price per option ($)	Expiry date	Number of options vested during 2012
Directors					
Justin Milne	10,000,000	29 Nov 2011	$0.018	30 Nov 2015	10,000,000

The fair value of these options at grant date has been determined using the Binomial model, utilising the following model assumption:

Item	
Underlying share spot price	$0.015
Exercise price	$0.018
Grant date	29 November 2011
Expiration date	30 November 2015
Life of options	4 years
Volatility	70%
Risk free rate	4.50%
Fair value	$0.0077

4.7.4.2 Modification of terms of equity-settled share-based payment transactions

No terms of equity-settled share-based payment transactions (including options granted as compensation to a key management person) have been altered or modified by the issuing entity during the reporting period or the prior period.

4.7.4.3 Exercise of options granted as compensation
During the financial year, no shares were issued as a result of the exercise of options.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4.7 Remuneration report – audited (continued)
4.7.4 Equity instruments – (continued)
4.7.4.1 Options over equity instruments granted as compensation– (continued)

4.7.4.4 Vesting profile of options granted as compensation

Details of vesting profile of the options granted as remuneration to key management personnel of the Group are detailed below.

	Options granted				
Directors	**Number**	**Date**	**% vested in year**	**% forfeited* in year**	**Financial years in which grant vests**
Peter Gunzburg	3,000,000	27 Nov 2009	-	-	2011-2015
Bill Zikou	1,000,000	24 Nov 2010	-	-	2011
Mark Pitts	749,999	8 Jul 2010	-	-	2012-2015
Justin Milne	10,000,000	29 Nov 2011	100%	100%	2012
Campbell Smith	7,500,000	27 Nov 2009	-	100%	2011-2015
Peter Abery	3,000,000	27 Nov 2009	-	100%	2011-2015
	3,000,000	24 Nov 2010	-	100%	2011
Craig Ferrier	3,000,000	27 Nov 2009	-	100%	2011-2015
Executives					
Stewart Snell	1,166,667	8 Jul 2010	-	-	2012-2015
Peter Barrow	1,166,667	8 Jul 2010	-	-	2012-2015
Bryan Paul	1,200,000	8 Jul 2010	-	-	2012-2015
Ohimai Mukanda	999,999	8 Jul 2010	-	-	2012-2015

*Options forfeited lapsed in accordance with their terms following the termination of the option holders' employment with the Company.

4.7.4.5 Analysis of movements in options

The movement during the reporting period, by value, of options over ordinary shares in the Company held by key management personnel is detailed below.

Directors	Granted in year $ (A)	Value of Options Exercised in year $	Lapsed in year $(B)
Justin Milne	77,000	-	33,000
Campbell Smith	-	-	99,750
Peter Abery	-	-	95,100
Craig Ferrier	-	-	18,900

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

4. Corporate governance statement (continued)
4.7 Remuneration report – audited (continued)
4.7.4 Equity instruments – (continued)
4.7.4.5 Analysis of movements in options (continued)

(A) The value of options granted in the year is the fair value of the options calculated at grant date using a binominal option-pricing model.
(B) The value of options that lapsed during the year represents the benefit foregone and is calculated at the date the option lapsed using the Binomial option pricing method assuming performance criteria had been achieved.

5. Principal activities

The principal activities of the Group during the financial period were the continued development and commercialisation of its public internet access, WiFi and telephony terminals, network management systems and related services.

6. Operating and financial review

During the financial year, the Group continued to invest in product and business development. Revenues increased by 18.8% in comparison to the previous financial year. The Consolidated net loss after tax for the year was $3,906,768 compared with a net loss of $3,361,578 in 2011.

The Group has been implementing a strategy over the past 2 years of establishing a Hotspot Webphone network with the aim of then securing a major contract with a large telecommunications company capable of providing both capacity and scale. In August 2011, the Group announced that the trial deployment had been deemed successful by Telstra with Telstra agreeing to acquire the network of 50 Webphones.

Following this announcement, the Group commenced discussions with Telstra with the aim of agreeing terms for the deployment of a larger network of pieNETWORKS' Hotspot Web phone in the Australian market.

During this time, the Group acquired inventory and fixed assets and increased operational spend in anticipation of finalising such arrangements with Telstra. The Group has to date been unable to substantially progress arrangements with Telstra for the larger network deployment. In March 2012, as a consequence of being unable to determine when such arrangements may be concluded, Directors commenced a restructure and major cost cutting initiative in order to reduce the Group's cash burn rate with the aim of preserving cash. In connection with this initiative, the Group made redundancy and other termination payments to employees amounting to $346,095 in the financial year.

Additionally, Directors determined that the Group should consider alternative business strategies, notwithstanding that discussions with Telstra would continue. The Directors have and continue to consider alternative complimentary business and investment opportunities for the Group and believe this to be the best course of action for shareholders. The opportunities being considered include an expansion of the Company's business in the communications field and potential acquisitions. One such opportunity under consideration is the acquisition of a telecommunications company in South-East Asia. The potential acquisition is however still subject to due diligence and no agreement has been reached in relation to key commercial considerations.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

7. Dividends
No dividends were paid or declared since the end of the previous financial year. The directors do not recommend a payment of a dividend in respect of the current financial year.

8. Events subsequent to reporting date
Subsequent to 30 June 2012, with the exception of that listed below, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Group, the results of those operations, or the state of affairs of the Group, in future financial years:

- On 6 August 2012, the Company announced a capital raising program to raise up to $2,560,671. The capital is planned to be raised through a non-renounceable entitlement offer to existing shareholders (partially underwritten by certain directors in the amount of $700,000) and a placement. The non-renounceable entitlement offer, if fully subscribed, will raise up to $2,226,669 on the basis of one new share for each existing share at 0.2 cents per new share. In addition to the entitlement offer, the Company may seek to complete a placement at the same price within its 15% placement capacity.

9. Likely developments
The Directors will continue to consider alternative complimentary business and investment opportunities for the Group and believe this to be the best course of action for shareholders. The opportunities being considered include an expansion of the Company's business in the communications field and potential acquisitions. One such opportunity under consideration is the acquisition of a telecommunications company in South-East Asia. The potential acquisition is however still subject to due diligence and no agreement has been reached in relation to key commercial considerations.

Further information about likely developments in the operations of the Company and the expected results of those operations in future financial years has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the Company.

10. Directors' interests
The relevant interest of each director in the shares and options over such instruments issued by the companies within the Group and other related bodies corporate, as notified by the directors to the Australian Securities Exchange in accordance with S205G(1) of the Corporations Act 2001, at the date of this report is as follows:

	Ordinary shares	Options over ordinary shares
Peter L Gunzburg	111,359,703[(1)]	3,000,000
Bill Zikou	1,125,000	1,000,000
Mark Pitts	2,250,000	749,999

(1) Includes up to 16,454,131 shares held by other parties and the subject of an agreement granting security over those shares, giving rise to a relevant interest pursuant to the Corporations Act.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

11. Share options

Options granted to directors and officers of the Company

Other than the options granted to Directors detailed in section 4.7.4.1 of this Directors' report, there were no options over ordinary shares in the Company granted to directors and officers of the Company during the reporting period or options granted since the end of the financial year.

Unissued shares under options

At the date of this report unissued ordinary shares of the Company under option are:

Option Plan	Expiry date	Exercise price	Number of shares
Director Incentive options	30 November 2014	$0.01	3,000,000
Options to financial advisors	31 March 2013	$0.05	20,000,000
Employee incentive options	30 June 2015	$0.01	17,600,000
Director Incentive options	30 November 2014	$0.03	1,000,000
Options to financial advisors	30 November 2015	$0.03	20,000,000
			61,600,000

Unless determined otherwise by the Board, all options expire on the earlier of their expiry date or termination of the employee's employment.

These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

Shares issued on exercise of options

During and since the end of the financial year, the Company has issued no ordinary shares as a result of the exercise of options.

12. Indemnification and insurance of officers

Indemnification

The Company has agreed to indemnify the current directors of the Company Mr. Peter L Gunzburg, Mr. Bill Zikou, Mr. Mark Pitts and certain former directors, against all liabilities to another person (other than the Company or a related body corporate) that may arise from their position as directors of the company and its controlled entities, except where the liability arises out of conduct involving a lack of good faith. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

The Company has also agreed to indemnify the current directors of its controlled entities for all liabilities to another person (other than the company or a related body corporate) that may arise from their position, except where the liability arises out of conduct involving a lack of good faith. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

Insurance premiums

Since the end of the previous financial year the Company has paid or agreed to pay insurance premiums in respect of directors' and officers' liability, legal expenses and insurance contracts, for current and former directors and officers, including executive officers of the Company. The details of the policy remain confidential between the insurer and the Company.

pieNETWORKS Limited
Directors' report (continued)
For the year ended 30 June 2012

13. Non-audit services
During the year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The board has considered the non-audit services provided during the year by the auditor and is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit and Compliance Committee to ensure they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services provided during the year are set out below.

	Consolidated	
	2012	**2011**
	$	**$**
Audit services:		
Auditors of the Company		
KPMG Australia:		
Audit and review of financial reports	67,100	70,652
	67,100	70,652
Services other than statutory audit:		
Auditors of the Company		
KPMG Australia		
Taxation services	15,139	10,790
	82,239	81,442

14. Lead auditor’s independence declaration

The Lead auditor’s independence declaration is set out on page 74 and forms part of the directors’ report for financial year ended 30 June 2012.

This report is made with a resolution of the directors:

Peter Gunzburg
Director

Dated at Perth this 28th day of September 2012.

pieNETWORKS Limited
Consolidated statement of comprehensive income
For the year ended 30 June 2012

In AUD	***Note***	**2012**	**2011**
Revenue from sale of goods	*6*	444,774	330,079
Revenue from rendering services	*6*	511,111	474,765
Cost of sales		(730,376)	(614,027)
Gross profit		225,509	190,817
Other income from ordinary activities	*7*	459,570	722
Network management expenses		(609,694)	(871,773)
Sales and marketing expenses		(642,370)	(476,989)
Research and development expenses		(939,281)	(996,813)
Administrative and corporate expenses		(2,468,448)	(1,697,819)
Other expenses from ordinary activities	*8*	(6,874)	(7,891)
Results from operating activities		(3,981,588)	(3,859,746)
Financial income		75,955	71,438
Financial expenses		(1,135)	(25,434)
Net financing income	*10*	74,820	46,004
Loss before income tax		(3,906,768)	(3,813,742)
Income tax benefit	*11*	-	452,164
Loss after income tax attributable to Owners of the Company		(3,906,768)	(3,361,578)
Other comprehensive income:			
Foreign currency translation differences for foreign operations		(12,247)	9,773
Total comprehensive income attributable to Owners of the Company		(3,919,015)	(3,351,805)
Earnings per share for loss attributable to the ordinary equity holders of the Company:			
Basic and diluted loss per share (cents)	*19*	(0.361)	(0.379)

The notes on pages 30 to 70 are an integral part of these consolidated financial statements

pieNETWORKS Limited
Consolidated statement of changes in equity
For the year ended 30 June 2012

In AUD	*Note*	Share capital	Share option reserve	Translation reserve	Accumulated losses	Total equity
		Attributable to shareholders of the Company				
Balance at 1 July 2010		23,572,077	270,895	-	(21,535,271)	2,307,701
Total comprehensive income for the period						
Loss for the period		-	-	-	(3,361,578)	(3,361,578)
Other comprehensive income						
Foreign currency translation differences		-	-	9,773	-	9,773
Total comprehensive income for the period		-	-	9,773	(3,361,578)	(3,351,805)
Transactions with Owners, recorded directly in equity						
Issue of ordinary shares	*18*	2,804,768	-	-	-	2,804,768
Share-based payment transactions	*22*	-	486,014	-	-	486,014
Total transactions with Owners		2,804,768	486,014	-	-	3,290,782
Balance at 30 June 2011		26,376,845	756,909	9,773	(24,896,849)	2,246,678

In AUD	*Note*	Share capital	Share option reserve	Translation reserve	Accumulated losses	Total equity
		Attributable to shareholders of the Company				
Balance at 1 July 2011		26,376,845	756,909	9,773	(24,896,849)	2,246,678
Total comprehensive income for the period						
Loss for the period		-	-	-	(3,906,768)	(3,906,768)
Other comprehensive income						
Foreign currency translation differences		-	-	(12,247)	-	(12,247)
Total comprehensive income for the period		-	-	(12,247)	(3,906,768)	(3,919,015)
Transactions with Owners, recorded directly in equity						
Issue of ordinary shares	*18*	2,098,250	-	-	-	2,098,250
Share-based payment transactions	*22*	-	295,522	-	-	295,522
Total transactions with Owners		2,098,250	295,522	-	-	2,393,772
Balance at 30 June 2012		28,475,095	1,052,431	(2,474)	(28,803,617)	721,435

The notes on pages 30 to 70 are an integral part of these consolidated financial statements.

pieNETWORKS Limited
Consolidated statement of financial position
As at 30 June 2012

In AUD	***Note***	**2012**	**2011**
Assets			
Cash and cash equivalents	*17(a)*	521,302	1,315,026
Trade and other receivables	*16*	500,359	35,094
Inventories	*15*	83,564	420,741
Current income tax receivable	*14*	1,954	453,488
Restricted cash deposits	*17(a)*	4,463	-
Other current assets		56,675	76,846
Total current assets		1,168,317	2,301,195
Restricted cash deposits	*17(a)*	105,709	108,624
Property, plant and equipment	*12*	60,371	403,305
Intangible assets	*13*	-	587
Other non-current assets	*32*	-	33,041
Total non-current assets		166,080	545,557
Total assets		1,334,397	2,846,752
Liabilities			
Trade and other payables	*23*	343,531	288,117
Loans and borrowings	*20*	1,850	1,620
Employee benefits	*21*	44,759	212,828
Deferred revenue		24,830	79,476
Provisions	*34*	70,217	-
Total current liabilities		485,187	582,041
Loans and borrowings	*20*	5,453	7,304
Employee benefits	*21*	2,656	10,729
Provisions	*34*	119,666	-
Total non-current liabilities		127,775	18,033
Total liabilities		612,962	600,074
Net assets		721,435	2,246,678
Equity			
Share capital	*18*	28,475,095	26,376,845
Reserves		1,049,957	766,682
Accumulated losses		(28,803,617)	(24,896,849)
Total equity		721,435	2,246,678

The notes on pages 30 to 70 are an integral part of these consolidated financial statements.

pieNETWORKS Limited
Consolidated statement of cash flows
For the year ended 30 June 2012

In AUD	Note	2012	2011
Cash flows from operating activities			
Cash receipts from customers		991,282	974,686
Cash paid to suppliers and employees		(4,260,622)	(4,155,162)
Cash utilised in operating activities		(3,269,340)	(3,180,476)
Research and development tax offset rebate received		452,164	237,395
Net cash (used in) operating activities	*17b*	(2,817,176)	(2,943,081)
Cash flows from investing activities			
Interest received		67,412	71,438
Proceeds from sale of property, plant and equipment		1,781	-
Acquisition of property, plant and equipment		(254,494)	(182,069)
Deposits made		-	(33,041)
Acquisition of intangible asset	*13*	(1,194)	(619)
Net cash (used in) investing activities		(186,495)	(144,291)
Cash flows from financing activities			
Payment of finance lease liabilities		(1,620)	(1,680)
Proceeds from share issues	*18*	2,320,000	3,151,320
Payments for equity raising costs	*18*	(105,750)	(166,553)
Interest paid	*10*	(1,135)	(1,678)
Net cash provided by financing activities		2,211,495	2,981,409
Net (decrease) in cash and cash equivalents		(792,176)	(105,963)
Cash and cash equivalents at 1 July		1,423,650	1,529,613
Cash and cash equivalents at 30 June	*17a*	631,474	1,423,650

The notes on pages 30 to 70 are an integral part of these consolidated financial statements.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

1. Reporting Entity

pieNETWORKS Limited (the 'Company') is a company domiciled in Australia. The address of the Company's registered office is C/- Suite 8, 7 The Esplanade, Mount Pleasant WA 6153. The consolidated financial statements of the Company as at and for the year ended 30 June 2012 comprise the Company and its subsidiary (together referred to as the "Group"). The Group is a for-profit entity primarily involved in the development, manufacture, installation and management of fully managed and controlled "self service" internet access "infrastructure" and webphones.

2. Basis of Preparation

(a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Accounting Interpretations) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The consolidated financial statements comply with International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB).

The consolidated financial statements were approved by the Board of Directors on 28 September 2012.

(b) Going concern basis

The Group incurred a loss after tax for the year of $3,906,768 (2011: $3,361,578) and has a surplus in working capital at 30 June 2012 of $683,130 (30 June 2011: $1,719,154). During the year, the Group used cash of $2,817,176 (2011:$2,943,081) in its operations and the Group has continued to have net cash outflows from its operations since 30 June 2012.

The Group has been implementing a strategy over the past 2 years of establishing a Hotspot Webphone network with the aim of then securing a major contract with a large telecommunications company capable of providing both capacity and scale. To this end:

- In late 2010 the Group commenced a 4 month market assessment with Telstra with a network of 50 Hotspot Webphones deployed across Australia in the majority of major airports; and
- In August 2011, the Group announced that the trial deployment had been deemed successful by Telstra with Telstra agreeing to acquire the network of 50 Webphones.

Following this announcement, the Group commenced discussions with Telstra with the aim of agreeing terms for the deployment of a larger network of pieNETWORKS' Hotspot Webphone in the Australian market. During this time, the Group acquired inventory and fixed assets and increased operational spend in anticipation of finalising such arrangements with Telstra. In September 2011, the Group raised $2.32 million (before capital raising costs) to provide working capital for the anticipated expansion of its business activities.

Since August 2011, the Group has been unable to substantially progress arrangements with Telstra for the larger network deployment. In March 2012, as a consequence of being unable to determine when such arrangements may be concluded, Directors commenced a restructure and major cost cutting initiative in order to reduce the Group's cash burn rate with the aim of preserving cash. In connection with this initiative, the Group made redundancy and other termination payments to employees during year ended 30 June 2012.

Additionally, Directors determined that the Group should consider alternative business strategies, notwithstanding that discussions with Telstra would continue.

Subsequent to the year-end, the Company has issued a prospectus on 3 September 2012 under which two offers have been made:

- Pro-rata non-renounceable entitlement offer (approximately 1,113,334,510 shares) of one share for every one share held by the shareholders at an issue price of $0.002 per share (Entitlements Offer) to raise up to $2,226,669; and
- Offer of up to 167,000,000 shares at an issue price of $0.002 per share (Placement Offer) to raise up to $334,000.

2. Basis of Preparation (continued)

(b) Going concern basis (continued)

The Entitlements Offer is partially underwritten by Zitta Pty Limited, a company controlled by Bill Zikou (director of the Company) and Trovex Pty Limited, a company controlled by Peter Gunzborg (director of the Company) for $200,000 and $500,000 respectively. The Entitlements Offer is being managed by Cunningham Peterson Sharbanee Securities Pty Limited ("CPBS"). Pursuant to the agreement between the Company and CPBS, subject to certain conditions being satisfied, CPBS will place the shortfall shares (i.e. shares for which valid applications have not been received) to some of its sophisticated clients.

The financial report for the year ended 30 June 2012 has been prepared on the basis of going concern, which contemplates continuity of business activities and the realisation of assets and settlement of liabilities in the ordinary course of business. Directors believe this to be appropriate for the following reasons:

- Directors have prepared a cash flow forecast for the 12 month period subsequent to the date of this report. The cash flow forecast takes into account, amongst other factors, contractual commitments relating to its New Zealand contracts, reduced cash burn as a consequence of the major cost cutting activities noted above and revenue from its current web-phone and kiosk networks at levels materially consistent with recent months. Subject to the completion of capital raising noted above, the Group anticipates having sufficient cash reserves for at least the next 12 months; and
- Directors anticipate the support of major shareholders and are confident in the Group's ability to raise an appropriate level of funding to provide ongoing working capital and to enable the identification and assessment of new projects.

Should the Group be unable to develop and identify new opportunities and projects to achieve a sustainable business and/or be unable to raise sufficient capital when required there is a material uncertainty which may cast significant doubt as to whether the Group will continue as a going concern and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report.

(c) Basis of measurement

The consolidated financial report is prepared on the historical cost basis.

(d) Functional and presentation currency

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

(e) Use of estimates and judgements

The preparation of a financial report requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are disclosed in the following notes:

- note 22 – measurement of share-based payments
- note 34 – measurement of onerous contract provisions

(f) Removal of parent entity financial statements

The Group has applied amendments to the Corporations Act (2001) that remove the requirement for the Group to lodge parent entity financial statements. Parent entity financial statements have been replaced by the specific parent entity disclosures in note 33.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities. Certain comparative amounts have been reclassified to conform to the current year's presentation.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exits when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

(ii) Transactions eliminated on consolidation

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

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the foreign exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss.

(ii) Foreign operations

The assets and liabilities of foreign operations, including fair value adjustments arising on acquisition, are translated to Australian dollars at foreign exchange rates at the reporting date. The income and expenses of foreign operations are translated to Australian dollars at exchange rates at the dates of the transactions.

Foreign currency differences are recognised in other comprehensive income, and presented in the foreign currency translation reserve (translation reserve) in equity. When a foreign operation is disposed of such that control or significant influence is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and are presented in the translation reserve in equity.

(c) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Cash and cash equivalents comprise cash balances and call deposits.

3. Significant accounting policies (continued)

(c) Financial instruments (continued)

(ii) Share capital

Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any related income tax benefit.

(d) Property, plant and equipment

(i) Recognition and measurement

Items of plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within “other income” in profit or loss.

(ii) Subsequent costs

The cost of replacing part of an item of plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

(iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment.

The estimated useful lives in the current and comparative periods are as follows:

• equipment and fittings	5 years
• kiosks and webphones	2.5 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

(e) Intangible assets

(i) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in profit or loss when incurred.

3. Significant accounting policies (continued)

(e) Intangible assets (continued)

(i) Research and development (continued)

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in profit or loss when incurred.

Capitalised development expenditure is measured at cost less accumulated amortisation and impairment losses.

(ii) Other intangible assets

Other intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and impairment losses.

(iii) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss when incurred.

(iv) Amortisation

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The estimated useful lives in the current and comparative periods are as follows:

- capitalised software and business management systems 2.5 years

(f) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and are not recognised in the Group's statement of financial position.

(g) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the weighted average cost, and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(h) Impairment

(i) Financial assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

3. Significant accounting policies (continued)

(h) Impairment (continued)

(i) Financial assets (continued)

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics

All impairment losses are recognised in profit or loss.

ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. Impairment losses are recognised in profit or loss. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(i) Employee benefits

(i) Defined contribution superannuation funds

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in profit or loss when they are due.

(ii) Long-term service benefits

The Group's net obligation in respect of long-term employee benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods plus related on costs; that benefit is discounted to determine its present value, and the fair value of any related assets is deducted. The discount rate is the yield at the reporting date on Commonwealth Government bonds that have maturity dates approximating the terms of the Group's obligations. Any gains or losses are recognised in profit or loss in the period in which they arise.

(iii) Short-term benefits

Liabilities for employee benefits for wages, salaries and annual leave represent present obligations resulting from employees' services provided to reporting date and are calculated at undiscounted amounts based on remuneration wage and salary rates that the Group expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax.

(iv) Share-based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised is adjusted to reflect the actual number of share options that vest, except for those that fail to vest due to market conditions not being met.

3. Significant accounting policies (continued)

(i) Employee benefits (continued)

(v) Termination benefits

Termination benefits are recognised as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognised if the Group has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(j) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(i) Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable costs of meeting its obligations under the contract. The provision is measured at present value of the lower of the expected cost of terminating the contract and the expected cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on assets associated with that contract.

(k) Revenue

(i) Goods sold

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

Transfers of risks and rewards vary depending on the individual terms of the contract of sale.

(ii) Services

Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at reporting date. The stage of completion is assessed by reference to the extent of work performed.

(l) Expenses

(i) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance lease are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

3. Significant accounting policies (continued)

(l) Expenses (continued)

(ii) Finance income and expenses

Finance income comprises interest income on funds invested. Interest income is recognised as it accrues, using the effective interest method. The interest expense component of finance lease payments is recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or loss position.

(m) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

(n) Segment reporting

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

Segment results that are reported to the COO include items directly attributable to a segment as well as those that can be allocated based on a reasonable basis. Unallocated items comprise mainly corporate assets (primarily the Company's headquarters), head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.

(o) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

3. Significant accounting policies (continued)

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

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

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

(q) Government grants
Government grants that compensate the Group for expenses incurred are recognised in the profit and loss as other income on a systematic basis in the same periods in which the expenses are recognised.

(r) New standards and interpretations not yet adopted
A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 30 June 2012, and have not been applied in preparing these consolidated financial statements. Except for those listed below, none of these is expected to have a significant effect on the consolidated financial statements of the Group.

- *AASB 9 Financial Instruments* becomes effective for the Group's 2014 consolidated financial statements and could change the classification and measurement of financial assets. The Group does to plan to adopt this standard early and the extent of the impact has not yet been determined.
- *AASB 10 Consolidated Financial Statements* becomes effective for the Group's 2013 consolidated financial statements. The standard is not expected to have a material effect on the consolidated financial statements of the Group. The Group does not plan to adopt this standard early
- *Presentation of items in Other Comprehensive Income (Amendments to AASB 101 Presentation of Financial Statements)* becomes effective for the Group's 2013 consolidated financial statements. The amendments are expected to affect how the Group presents its financial statements. The impact of the amendment is expected to be non-significant and the Group does not plan to adopt the these amendments early.
- *Revised AASB 119 Employee benefits* becomes effective for the Group's 2013 consolidated financial statements. The standard is expected to affect how the Group classifies and measures its employee liabilities. The standard is not expected to have a material effect on the consolidated financial statements of the Group. The Group does not plan to adopt this standard early.

4. Determination of fair values
A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and / or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(a) Trade and other receivables
The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

(b) Non-derivative financial liabilities
Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. For finance leases, the market rate of interest is determined by reference to similar lease agreements.

pieNETWORKS Limited

Notes to the consolidated financial statements for the year ended 30 June 2012

4. Determination of fair values (continued)

(c) Share-based payment transactions

The fair value of employee share options is measured using a Binomial model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

The fair value of share based transactions with suppliers is measured by reference to the fair value of goods or services received. Where this cannot be measured directly, it is measured by reference to the fair value of share options granted. The measurement model and inputs are the same as those used for employee share options.

5. Financial Risk Management

The Group has exposure to the following risks from their use of financial instruments:

- credit risk
- liquidity risk
- market risk.

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout this financial report.

The Board of Directors has overall responsibility for the establishment and oversight of the risk management framework. The Board and the Audit & Compliance Committee is responsible for developing and monitoring risk management policies. The committee reports regularly to the Board of Directors on its activities.

Various financial and operational reporting procedures and other internal control and compliance systems are implemented to identify and monitor risks associated with the Group's business activities.

The Audit & Compliance Committee oversees how management monitors compliance with the Group's risk management procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group.

(a) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from transactions with customers and cash holdings with financial institutions.

Trade and other receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The Group is not materially exposed to credit risk as the majority of their services are prepaid. Approximately 22% percent (2011: 28% percent) of the Group's revenue is attributable to sales transactions with its largest customer. The Group's largest receivable balance at 30 June 2012 related to amounts to be claimed from the Australian Taxation Office under the Research and Development tax incentive program.

The Audit & Compliance Committee assists the Board in monitoring material business risks of the Group. Procedures are in place to monitor customer payments which include follow up of debtors aging reports on a regular basis.

The Group has established a provision for doubtful debts that represents their estimate of incurred losses in respect of trade and other receivables.

5. Financial Risk Management (continued)

(b) Credit risk (continued)

Cash and cash equivalents, restricted term deposits

The Group maintains its bank accounts with major Australian and New Zealand financial institutions only.

(c) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group manages its liquidity risk by monitoring its cash reserves and forecast spending. Management is cognisant of the future demands for liquid finance resources to finance the Group's current and future operations, and consideration is given to the liquid assets available to the Group before commitment is made to future expenditure or investment. Further information is set out in note 2(b).

(d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising any return.

Currency risk

The Group is exposed to currency risk on transactions with its foreign branch that is denominated in a currency other than the respective functional currency of the Group, being the Australian dollar (AUD). The currency in which these transactions primarily are denominated is NZD (New Zealand Dollar).

Transactions with foreign suppliers also expose the Group to currency risk. Such transactions are predominantly denominated in USD (United States Dollar).

Interest rate risk

As the Group has interest bearing assets, its income and operating cash flows are exposed to changes in market interest rates. The assets are short term interest bearing deposits, and no financial instruments are employed to mitigate risk. (Note 24 – Financial Instruments).

(e) Capital management

The Board's policy is to seek to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board of Directors closely monitors capital expenditure and cash.

The Board's approach to capital management has been to regularly monitor the Group's capital and to seek additional funding from investors on an as needs basis so as to facilitate the Group's webphone deployment and commercialisation strategy.

Details of the fundraising activities by the Group during the year are set out in note 18 and 30.

There were no changes in the Group's approach to capital management during the year. Neither the Company nor its subsidiary is subject to externally imposed capital requirements.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

6. Revenue

In AUD	**2012**	**2011**
Sales	444,774	330,079
Services	511,111	474,76 5
Total revenues	955,885	804,844

7. Other income

In AUD	**2012**	**2011**
WA State Payroll tax rebate	-	722
R&D tax incentive. (Note (i) below)	458,070	-
Traineeship rebate	1,500	-
	459,570	722

(i) The Group has incurred certain research and development expenditure which it has reasonable assurance will qualify for a research and development tax incentive pursuant to the Research and Development Tax Incentive Program commencing 1 July 2011. The amount has been accounted for in accordance with AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance.*

8. Other expenses

In AUD	**2012**	**2011**
(Decrease)/increase in provisions	(4,911)	319
Bad debts written off	10,634	7,572
Loss on disposal of non-current assets	1,151	-
	6,874	7,891

9. Personnel expenses

In AUD	***Note***	**2012**	**2011**
Wages and salaries		1,593,461	1,129,202
Other associated personnel expenses		81,117	54,476
Contributions to defined contribution superannuation funds	*21*	134,424	114,984
Consulting fees		1,195,288	1,155,500
(Decrease)/increase in liability for annual leave	*21*	(109,942)	3,249
(Decrease)/increase in liability for long service leave	*21*	(35,565)	13,603
Equity-settled share based payment transactions		179,523	306,014
		3,038,306	2,777,028

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

10. Finance income and expense

In AUD	**2012**	**2011**
Interest income	67,412	71,438
Net foreign exchange income	8,543	-
Financial income	75,955	71,438
Interest expense	1,135	1,678
Net foreign exchange expense	-	23,756
Financial expenses	1,135	25,434
Net finance income	74,820	46,004

11. Income tax benefit

In AUD	**2012**	**2011**
Current tax benefit		
R&D tax offset	-	(452,164)
	-	(452,164)

Numerical reconciliation between tax benefit and pre-tax net profit

In AUD	**2012**	**2011**
Loss for the period	3,906,768	3,361,578
Total income tax benefit	-	(452,164)
Loss excluding income tax	3,906,768	3,813,742
Income tax using the domestic corporation tax rate of 30% (2011: 30%)	(1,172,030)	(1,144,123)
Increase in income tax expense due to:		
Non-deductible expenses	2,131	92,181
R&D costs	81,080	345,928
Tax losses and movements in deferred taxes not recognised	1,088,819	706,014
Decrease in income tax expense due to:		
R&D tax offset (Note (i) below)	-	(452,164)
Income tax benefit on pre-tax net loss	-	(452,164)

(i) In the prior period, the Group was eligible for a Research and Development tax offset rebate pursuant to legislation applicable at that time.

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Notes to the consolidated financial statements for the year ended 30 June 2012

12. Property, plant and equipment

In AUD	Kiosks and Webphones	Equipment and fittings	Total
Cost			
Balance at 1 July 2010	648,369	515,646	1,164,015
Acquisitions	189,064	41,181	230,245
Disposals	-	(15,680)	(15,680)
Movements in exchange rates	(17,277)	(1,496)	(18,773)
Impairment and write offs	(272,807)	(165,503)	(438,310)
Balance at 30 June 2011	547,349	374,148	921,497
Balance at 1 July 2011	547,349	374,148	921,497
Acquisitions	203,557	95,035	298,592
Disposals	(20,915)	(32,204)	(53,119)
Movements in exchange rates	(2,908)	(729)	(3,637)
Impairment and write offs	(263,553)	(202,298)	(465,851)
Balance at 30 June 2012	463,530	233,952	697,482
Depreciation			
Balance at 1 July 2010	430,250	251,040	681,290
Depreciation charge for the year	120,784	78,229	199,013
Movements in exchange	(3,504)	(134)	(3,638)
Disposals	-	(15,680)	(15,680)
Impairment and write offs	(272,435)	(70,358)	(342,793)
Balance at 30 June 2011	275,095	243,097	518,192
Balance at 1 July 2011	275,095	243,097	518,192
Depreciation charge for the year	172,247	56,503	228,750
Movements in exchange rates	3,225	1,074	4,299
Disposals	(20,097)	(29,271)	(49,368)
Impairment and write offs	-	(64,762)	(64,762)
Balance at 30 June 2012	430,470	206,641	637,111
Carrying amounts			
At 1 July 2010	218,119	264,606	482,725
At 30 June 2011	272,254	131,051	403,305
At 1 July 2011	272,254	131,051	403,305
At 30 June 2012	33,060	27,311	60,371

Depreciation is included in administrative and corporate expenses in the income statement.

During the year, the Group recorded impairment losses of $401,089 (2011: $123,058) relating to Property, Plant and Equipment. These impairment losses have arisen as a consequence of the assessment by Directors as at 30 June 2012, that these assets will not be able to recover their carrying values from future cashflows.

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Notes to the consolidated financial statements for the year ended 30 June 2012

12. Property, plant and equipment (Continued)

Key determinants in these write downs include:
● an assessment that the scale and profitability of the New Zealand webphone network will not be sufficient to recover the carrying value of these assets; and
● the uncertainty of future arrangements with Telstra relating to further deployments of the Group's webphones (refer to note 3(a)) resulting in the write-off of equipment and other assets acquired to support this deployment.

The recoverable amount of Property, Plant and Equipment was predominantly measured using a value in use model utilising a pre-tax discount rate of 15%. Other assets impaired were written off in full, based on the uncertainty in relation to future arrangements with Telstra

Leased office equipment

The Group leases office equipment under finance lease agreements. At the end of the leases the Group has the option to purchase the equipment at a beneficial price. At 30 June 2012, the net carrying amount of leased equipment was $7,029 (2011: $9,092). The leased equipment secures the lease obligations (see note 20).

13. Intangible assets

In AUD	Software costs	Business management system costs	Total
Cost			
Balance at 1 July 2010	13,500	53,630	67,130
Acquisitions	-	619	619
Balance at 30 June 2011	13,500	54,249	67,749
Balance at 1 July 2011	13,500	54,249	67,749
Acquisitions	-	1,194	1,194
Impairment	-	(1,524)	(1,524)
Balance at 30 June 2012	13,500	53,919	67,419
Amortisation			
Balance at 1 July 2010	13,500	52,263	65,763
Amortisation for the year	-	1,399	1,399
Balance at 30 June 2011	13,500	53,662	67,162
Balance at 1 July 2011	13,500	53,662	67,162
Amortisation for the year	-	838	838
Impairment		(581)	(581)
Balance at 30 June 2012	13,500	53,919	67,419
Carrying amounts			
At 1 July 2010	-	1,367	1,367
At 30 June 2011	-	587	587
At 1 July 2011	-	587	587
At 30 June 2012	-	-	-

Amortisation

The amortisation is included in administrative and corporate expenses in the statement of comprehensive income.

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Notes to the consolidated financial statements for the year ended 30 June 2012

14. Tax assets and liabilities

Current tax assets and liabilities

In AUD	**2012**	**2011**
R&D tax offset rebate	-	452,164
Other income tax assets	1,954	1,324
Current tax assets at 30 June	1,954	453,488

R&D tax offset rebate of $Nil (2011: $452,164) represents the amount of income taxes recoverable in respect of the prior financial period arising from the Company's Research and Development Tax Rebate offset claim under legislation at that time.

Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

In AUD (net)	**2012**	**2011**
Deductible temporary differences	(139,540)	5,526
Tax losses	5,518,929	4,320,254
	5,379,389	4,325,780

The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the consolidated entity can utilise the benefits therefrom.

15. Inventories

In AUD	**2012**	**2011**
Raw materials and consumables	78,814	221,364
Work in progress	4,750	22,111
Finished products	-	177,266
	83,564	420,741

In the 2012 financial year raw materials, consumables and changes in finished goods and work in progress recognised as cost of sales amounted to $139,535 (2011: $197,383). Write-down of inventories to net realisable value amounted to $44,657 (2011: $53,651). The write-downs are included in cost of sales.

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Notes to the consolidated financial statements for the year ended 30 June 2012

16. Trade and other receivables

In AUD	***Note***	**2012**	**2011**
Current			
Trade receivables		42,289	35,094
R&D tax incentive		458,070	-
		500,359	35,094

Trade and other receivables are recorded net of an impairment provision of $13,449 (2011: $12,637).

17a. Cash and cash equivalents

In AUD	**2012**	**2011**
Bank balances	44,677	41,701
Call deposits	476,625	1,273,325
Restricted term deposits*	4,463	-
Cash and cash equivalents included under current assets	525,765	1,315,026
Restricted term deposits*	105,709	108,624
Cash and cash equivalents included under non-current assets	105,709	108,624
Total Cash and cash equivalents in the statement of cash flows	631,474	1,423,650

The effective interest rates on call deposits and term deposits were 4.00% (2011: 4.51%) and 4.56% (2011: 4.86%), respectively.

*Restricted term deposits of $110,172 (2011: $108,624) are being held by ASB Bank New Zealand Ltd as security for bank guarantees of NZ$135,000 and NZ$5,700 in favour of Westfield New Zealand Ltd and AMP Capital Property Portfolio Ltd, respectively. The effective interest rate on those deposits was 4.56% (2011: 4.90%).

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Notes to the consolidated financial statements for the year ended 30 June 2012

17b. Reconciliation of cash flows from operating activities

In AUD	*Note*	2012	2011
Cash flows from operating activities			
Loss for the period		(3,906,768)	(3,361,578)
Adjustments for:			
Depreciation	*12*	228,750	199,013
Amortisation	*13*	838	1,399
Net finance income	*10*	(74,820)	(46,004)
Write down in value of plant and equipment		400,880	95,517
Equity-settled share-based payment expense	*22*	179,523	306,014
Income tax benefit		-	(452,164)
Operating loss before changes in Working capital and provisions		(3,171,597)	(3,257,803)
Change in trade and other receivables		(465,265)	290,959
Change in other current assets		20,171	17,769
Change in inventories		337,177	(276,711)
Change in other income tax assets	*14*	(6,536)	(1,324)
Change in trade and other payables		55,996	(5,310)
Change in other non-current assets		-	231,100
Change in deferred revenue		(54,647)	(202,396)
Change in lease liabilities		1620	9,584
Change in employee provisions		(176,142)	13,656
Change in other provisions		189,883	-
Cash utilised in operating activities		(3,269,340)	(3,180,476)
R&D tax offset rebate received		452,164	237,395
Net cash (used in) operating activities		(2,817,176)	(2,943,081)

18. Capital and reserves

Share capital

	The Company Ordinary shares			
	2012 No.	2012 $	2011 No.	2011 $
On issue at 1 July	968,334,510	26,376,845	810,768,454	23,572,077
Issued for cash	145,000,000	2,098,250	157,566,056	2,804,768
On issue at 30 June – fully paid	1,113,334,510	28,475,095	968,334,510	26,376,845

During the year, 145,000,000 (2011: 157,566,056) shares were issued to raise $2,320,000 (2011: $3,151,321) before $221,750 (2011: $346,553) of issue costs, including $116,000 (2011: $180,000) of share based payments, were incurred.

Effective 1 July 1998, the Company Law Review Act abolished the concept of par value shares and the concept of authorised capital. Accordingly, the Company does not have authorised capital or par value in respect of its issued shares.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to the Company's residual assets

Share options reserve

The share option reserve comprises the cumulative fair value of vested and vesting options provided as compensation by the Company and Group.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

19. Loss per share

Basic Loss per share

The calculation of basic and diluted loss per share at 30 June 2012 was based on the loss attributable to ordinary shareholders of $3,906,768 (2011: $3,361,578) and a weighted average number of ordinary shares outstanding of 1,083,621,395 (2011: 886,577,725), calculated as follows:

Weighted average number of ordinary shares

	Note	2012	2011
Issued ordinary shares at 1 July	18	968,334,510	810,768,454
Effect of shares issued		115,286,885	75,809,271
Weighted average number of ordinary shares at 30 June		1,083,621,395	886,577,725

Options to acquire ordinary shares granted by the Company and not exercised at the reporting date which are considered to be potential ordinary shares are included in the determination of diluted earnings per share to the extent to which they are dilutive. At 30 June 2012, none of the options on issue were considered to be dilutive and accordingly the options have not been included in the determination of diluted loss per share. Refer to note 22 for details of the options granted.

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Notes to the consolidated financial statements for the year ended 30 June 2012

20. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings. For more information about the Group's exposure to interest rate risk see note 24.

In AUD	2012	2011
Current liabilities		
Finance lease liabilities	1,850	1,620
Non-current liabilities		
Finance lease liabilities	5,453	7,304

Finance lease liabilities

Finance lease liabilities of the Group are payable as follows:

	Future Minimum lease payments	Interest	Principal*	Future Minimum lease payments	Interest	Principal*
In AUD	2012	2012	2012	2011	2011	2011
Less than one year	2,715	865	1,850	2,715	1,095	1,620
Between one and five years	6,384	931	5,453	9,100	1,796	7,304
	9,099	1,796	7,303	11,815	2,891	8,924

* Principal represents the present value of minimum lease payments.

The Group leases office equipment under a finance lease expiring in 4 years. At the end of the lease term, the Group has the option to purchase the equipment at a price deemed to be a bargain purchase option.

21. Employee benefits

Current

In AUD	**2012**	**2011**
Liability for annual leave	23,822	133,764
Liability for long service leave	-	37,953
Employee superannuation	20,937	41,111
	44,759	212,828
Non Current		
Liability for long-service leave	2,656	10,729
Total employee benefits	2,656	10,729

(a) Defined contribution superannuation funds

The consolidated entity makes contributions to a defined contribution superannuation fund. The amount recognised as an expense was $134,424 for the financial year ended 30 June 2012 (2011: $114,984).

22. Share based payments

On 28 April 2005 the Group established a share option programme "pieNETWORKS OIP" that entitles employees to subscribe for shares in the entity.

During 2007, two offerings were made under the terms of the pieNETWORKS OIP :
- 21 November 2006 – 500,000 options with exercise price of $0.03 expiring 23 November 2010;
- 30 April 2007 – 2,000,000 options with exercise price of $0.12 expiring 23 November 2010.

These options expired unexercised in the previous financial year.

During 2008, incentive options were issued to Mr Peter Abery, a director, under the terms of the pieNETWORKS OIP:
- 5 December 2007 – 1,000,000 options with exercise price of $0.12 expiring 23 November 2010.

These options expired unexercised in the previous financial year.

During 2010, incentive options were issued to Directors under the terms of the pieNETWORKS OIP:
- 27 November 2009 – 16,500,000 options with exercise price of $0.01 expiring 30 November 2014.

13,500,000 of these options expired unexercised during the financial year.

During 2011, the Group granted options to directors, employees, contractors as follows:
- 8 July 2010 – 17,600,000 options were granted to employees and contractors. These options had an exercise price of $0.01 and expiring date of 30 June 2015; and
- 24 November 2010 – 4,000,000 options granted to directors with an exercise price of $0.03 expiring 30 November 2014.

4,000,000 of these options expired unexercised during the financial year.

During the current financial year, the Group granted options to director as follows:
- 29 November 2011 – 10,000,000 options granted to directors with an exercise price of $0.018 expiring 30 November 2015. These options expired unexercised.

On 8 July 2010 the Group granted 20,000,000 options with an exercise price of $0.05 and expiry date of 31 March 2013 to CPS Securities, pursuant to the terms of an advisory mandate and services related to an equity raising.

On 29 November 2011, the Group granted 20,000,000 options with an exercise price of $0.03 and an expiry date of 30 November 2015 to Bell Porter Securities. The options were issued as part consideration for advisory and equity raising services.

The terms and conditions of the grants in 2012 and 2011 are as follows:

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Notes to the consolidated financial statements for the year ended 30 June 2012

22. Share based payments (continued)

Grant date / employee entitled	Number of instruments	Vesting conditions	Contractual life of options
Option grant to director at 27 November 2009	16,500,000	Vest in 3 tranches over 3 years	5 years
Option grant to employees and contractors 8 July 2010	17,600,000	Vest in 3 tranches over 3 years	5 years
Option grant to CPS Securities 8 July 2010	20,000,000	Fully vested from the date of grant	3 years
Option grant to directors at 24 November 2010	4,000,000	Fully vested from the date of grant	4 years
Option grant to directors at 29 November 2011	10,000,000	Fully vested from the date of grant	4 years
Option grant to Bell Porter Securities at 29 November 2011	20,000,000	Fully vested from the date of grant	4 years
Total share options	88,100,000		

The number and weighted average exercise prices of share options is as follows:

	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	2012	2012	2011	2011
Outstanding at the beginning of the period	0.05	58,100,000	0.03	24,550,000
Expired during the period	0.02	(26,500,000)	0.06	(8,050,000)
Granted during the period	0.03	30,000,000	0.03	41,600,000
Outstanding at the end of the period		61,600,000		58,100,000
Exercisable at the end of the period	0.04	41,000,000	0.05	24,000,000

The options outstanding at 30 June 2012 have exercise prices in the range of $0.01 to $0.05 and a weighted average contractual life of 4 years.

There were no options exercised during the financial year (2011: Nil).

22. Share based payments (continued)

The fair value of options granted to Bell Porter Securities at the grant date has been determined using the Binomial model,
which is considered to approximate the fair value of the services received, utilising the following model assumptions:

Item	
Underlying share spot price	$0.015
Exercise price	$0.03
Grant date	29 November 2011
Expiration date	30 November 2015
Life of options	4 years
Volatility	70%
Risk free rate	4.50%
Fair value	$0.0058

The full cost of these options of $116,000 has been recognised as issued capital costs.
The fair value of options granted to Mr J Milne at the grant date has been determined using the Binomial model, utilising the following model assumptions:

Item	
Underlying share spot price	$0.015
Exercise price	$0.018
Grant date	29 November 2011
Expiration date	30 November 2015
Life of options	4 years
Volatility	70%
Risk free rate	4.50%
Fair value	$0.0077

The full fair value of these options of $77,000 has been recognised as share based payment expense in the income statement. These options lapsed unexercised on resignation of Mr. J Milne on 6 February 2012.

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22. Share based payments (continued)

The fair value of options granted to CPS Securities (in 2011) at the grant date has been determined using the Binomial model, which is considered to approximate the fair value of the services received, utilising the following model assumptions:

Item	
Underlying share spot price	$0.02
Exercise price	$0.05
Grant date	8 July 2010
Expiration date	31 March 2013
Life of options	2.73 years
Volatility	90%
Risk free rate	4.79%
Fair value	$0.009

The full cost of these options has been recognised as issued capital costs.

The terms and conditions of the options granted to employees and contractors on 8 July 2010 are as follows:

Item	**Tranche A**	**Tranche B**	**Tranche C**
Number of options	5,866,667	5,866,667	5,866,667
Exercise price	$0.01	$0.01	$0.01
Expiry date	30 Jun 2015	30 Jun 2015	30 Jun 2015
Vesting period	12 months	24 months	36 months

Vesting conditions:

1. The Tranche A options vest after 12 months from the date of issue if at the anniversary the underlying shares have traded and are trading based on a 30 day average, at or above $0.03.
2. The Tranche B options vest after 24 months from the date of issue if at the anniversary the underlying shares have traded and are trading based on a 30 day average, at or above $0.05.
3. The Tranche C options vest after 36 months from the date of issue if at the anniversary the underlying shares have traded and are trading based on a 30 day average, at or above $0.07.

The fair value of these options at the grant date was determined using the Binomial model, utilising the following model assumptions:

Item	**Tranche A**	**Tranche B**	**Tranche C**
Underlying share spot price	$0.02	$0.02	$0.02
Exercise price	$0.01	$0.01	$0.01
Share price barrier	$0.03	$0.05	$0.07
Grant date	8 Jul 2010	8 Jul 2010	8 Jul 2010
Expiration date	30 Jun 2015	30 Jun 2015	30 Jun 2015
Life of options	5 years	5 years	5 years
Volatility	90%	90%	90%
Risk free rate	4.79%	4.79%	4.79%
Number of options	5,866,667	5,866,667	5,866,667
Fair value	$0.02	$0.02	$0.019

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Notes to the consolidated financial statements for the year ended 30 June 2012

22. Share based payments (continued)

The options granted to Messrs P Abery and B Zikou on 24 November 2010 had the following terms and conditions:

Item	
Underlying share spot price	$0.02
Exercise price	$0.03
Grant date	24 November 2010
Expiration date	30 November 2014
Life of options	4 years
Volatility	90%
Risk free rate	5.47%
Fair value	$0.012

Employee Expenses

	Note	**Consolidated**	
In AUD		**2012**	**2011**
Share options granted - equity settled	*9*	179,523	306,014
Total expense recognised as employee costs		179,523	306,014

23. Trade and other payables

In AUD	**2012**	**2011**
Payables and accrued expenses	343,531	288,117

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Notes to the consolidated financial statements for the year ended 30 June 2012

24. Financial instruments

Credit risk

The carrying amount of the Group's financial assets represents the maximum credit exposure. The Group's maximum exposure to credit risk at the reporting date was:

		Carrying amount	
In AUD	***Note***	**2012**	**2011**
Trade and other receivables	*16*	500,359	35,094
Cash and cash equivalents	*17(a)*	631,474	1,423,650
		1,131,833	1,458,744

The Group's maximum exposure to credit risk for trade and other receivables by geographic region was:

	Carrying amount	
In AUD	**2012**	**2011**
Australia	496,386	33,112
New Zealand	3,973	1,982
	500,359	35,094

The Group's maximum exposure to credit risk for trade and other receivables at the reporting date by type of customer was:

	Carrying amount	
In AUD	**2011**	**2011**
Wholesale customers	9,491	1,850
Retail customers	32,798	27,239
Other receivables(Note (i) below)	458,070	6,005
	500,359	35,094

(i) For 2012, Other receivables comprise the amount to be received by the Group from the Australian Taxation Office pursuant to its 30 June 2012 R&D Tax Incentive application.

The Group's most significant customer accounts for $9,491 of the trade receivables carrying amount at 30 June 2012 (2011: $5,112).

24. Financial instruments (continued)

Impairment losses
$31,436 of the Group's trade receivables are past due (2011: $34,164). The aging of the Group's trade receivables at the reporting date was:

In AUD	Gross 2012	Impairment 2012	Gross 2011	Impairment 2011
Not past due	24,302	-	6,623	-
Past due 0-30 days	1,569	-	9,769	-
Past due 31-90 days	29,867	13,449	31,339	12,637
	55,738	13,449	47,731	12,637

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

In thousands of AUD	2011	2011
Balance at 1 July	12,637	12,066
Impairment loss recognised	812	571
Balance at 30 June	13,449	12,637

Based on past customer default experience, the provision for impairment at the year-end is considered to be sufficient for the Group.

Liquidity risk
The following are the contractual maturities of financial liabilities, including estimated interest payments:

30 June 2012
In AUD

	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years
Trade and other payables	343,531	(343,531)	(343,531)	-	-	-
Finance lease liabilities	7,303	(9,099)	(1,357)	(1,358)	(2,715)	(3,669)
	350,834	(352,630)	(344,888)	(1,358)	(2,715)	(3,669)

30 June 2011
In AUD

	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years
Trade and other payables	288,117	(288,117)	(288,117)	-	-	-
Finance lease liabilities	8,924	(11,815)	(1,357)	(1,358)	(2,715)	(6,385)
	297,041	(299,932)	(289,474)	(1,358)	(2,715)	(6,385)

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Notes to the consolidated financial statements for the year ended 30 June 2012

24. Financial instruments (continued)

Currency risk

The Group's exposure to foreign currency risk at 30 June 2012 is as follows, based on notional amounts:

NZD	30 June 2012		30 June 2011	
	AUD	**NZD**	**AUD**	**NZD**
Cash and Cash equivalents*	122,900	156,956	127,603	165,284
Trade receivables	3,973	5,074	1,982	2,567
Trade and other payables	(624)	(797)	(31,972)	(41,414)
Net statement of financial position exposure	126,249	161,233	97,613	126,437

*Cash and cash equivalents includes restricted deposits of AUD $110,172 (NZD $140,700),(2011: AUD $108,623 (NZD $140,700)).

The following significant exchange rates applied during the year:

	2012		2011	
	Average rate	**Reporting date spot rate**	**Average rate**	**Reporting date spot rate**
AUD/NZD	1.2831	1.2771	1.3044	1.2953

Sensitivity analysis

A 10 percent strengthening of the Australian dollar against the New Zealand dollar at 30 June would have increased the loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2011.

	Consolidated
AUD	Loss
30 June 2012	
NZD- increase in loss	11,476
30 June 2011	
NZD - increase in loss	8,874

A 10 percent weakening of the Australian dollar against the New Zealand dollar at 30 June would have the following effect on New Zealand dollar to the amounts shown above, on the basis that all other variables remain constant.

	Consolidated
AUD	Loss
30 June 2012	
NZD- decrease in loss	(14,028)
30 June 2011	
NZD - decrease in loss	(8,874)

24. Financial instruments (continued)

Interest rate risk

At the reporting date the interest profile of the Group's interest-bearing financial instruments was:

	Carrying amount	
AUD	**2012**	**2011**
Fixed rate instruments		
Financial liabilities – finance lease	7,303	8,924
Financial assets –term deposits	110,172	108,624
Variable rate instruments		
Cash and cash equivalents	521,302	1,315,026

Fair value sensitivity analysis for fixed rate investments

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss. Therefore a change in interest rates at the reporting date would not affect profit or loss.

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased/(decreased) profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	Loss	
Consolidated	**100bp**	**100bp**
AUD	**increase**	**decrease**
30 June 2012		
Variable rate instruments	(5,213)	5,213
30 June 2011		
Variable rate instruments	(13,150)	13,150

24. Financial instruments (continued)

Fair values

Fair values versus carrying amounts
The fair values of financial assets and liabilities approximate their carrying amounts shown in the statement of financial position due to their short term nature. The basis for determining fair values is disclosed in note 4.

25. Operating leases

Leases as lessee
Non-cancellable operating lease rentals are payable as follows:

In AUD	**2012**	**2011**
Less than one year	28,000	61,732
Between one and five years	9,800	-
	37,800	61,732

The Group leased a warehouse and factory facility under an operating lease. The lease was for a period of 3 years, with an option to renew the lease after that date. The lease expired on 30 April 2012 and was not renewed.

In addition, the Group leases office space in Sydney under an operating lease. The lease is for a period of 2 years, with an option to renew the lease after that date. The Group also leases office space in Perth under a sublease arrangement. The sublease is ongoing and can be terminated on a month's notice.

During the financial year ended 30 June 2012, $123,122 was recognised as an expense in the statement of comprehensive income in respect of operating leases and subleases (2011: $108,456).

26. Capital and other commitments

Capital commitments

	Consolidated	
Contracted but not provided for:	**2012**	**2011**
Less than one year	82,360	33,041
	82,360	33,041

27. Related parties

The following were key management personnel of the Group at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Non-executive directors
Peter L Gunzburg (Chairperson)
Bill Zikou
Mark Pitts
Justin Milne (resigned)
Peter Abery (resigned)
Craig Ferrier (resigned)
Executive director
Campbell Smith (Managing Director/Chief Executive Officer) (ceased)
Executives
Craig Turner (Chief Executive Officer) (Ceased)
Stewart Snell (Chief Operating Officer)
Reg Bowler (General Manager Australia and New Zealand) (Resigned)
Ohimai Mukanda (Financial Controller)
Peter Barrow (Project Manager) (Ceased)
Bryan Paul (Sales and Network Operations Manager) (Ceased)

Key management personnel compensation

The key management personnel compensation included in 'personnel expenses' (see note 9) are as follows:

	Consolidated	
In AUD	**2012**	**2011**
Short-term employee benefits	1,340,349	1,252,608
Share-based payments	86,645	110,783
Post-employment benefits	43,189	36,660
Termination benefits	297,516	-
Other long term benefits	43,006	12,568
	1,810,705	1,412,619

Individual directors and executive compensation disclosure

Information regarding individual directors and executives compensation and some equity instruments disclosures as required by the Corporations Regulations 2M.3.03 is provided in the remuneration report section of the directors' report.

Apart from the details disclosed in this note, note 30 and the Remuneration Report, no director has entered into a material contract with the Group since the end of the financial year and there were no material contracts involving directors' interests existing at year-end.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

27. Related parties (continued)

Key management personnel and director transactions

Mr. S. Snell and Mr. P. Barrow, both key management personnel of the Group, hold positions in another entity, Atamo Pty Ltd, that result in them having control or significant influence over the financial or operating policies of that entity.

The Group transacted with the Atamo Pty Ltd in the reporting period. The terms and conditions of transactions with Atamo Pty Ltd were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-key management personnel related entities on an arm's length basis.

The aggregate value of transactions and outstanding balances relating to Key management personnel and entities over which they have control or significant influence were as follows:

In AUD		Transaction value year ended 30 June		Balance outstanding at 30 June	
	Note	**2012**	**2011**	**2012**	**2011**
Key management person					
S. Snell and P. Barrow	*(i)*	157,553	156,225	4,020	41,913
		157,553	156,225	4,020	41,913

(i) The Group used technical consultancy services of Atamo Pty Ltd in relation to product development and other related research and development activities. Amounts were billed based on normal market rates for such services and were due and payable under normal payment terms. The Group also entered into a sublease arrangement with Atamo Pty Ltd for the supply of office space for the Group's operations in Perth. Rents paid under the sublease arrangement are based on normal market rates and are due and payable on normal payment terms. These amounts exclude compensation paid to S.Snell and P.Barrow in connection with performance of their key management personnel roles.

Options over equity instruments

The movement during the reporting period in the number of options over ordinary shares in pieNETWORKS Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 July 2011	Granted as compensation	Other changes (i)	Expired	Held at 30 June 2012	Vested during the year	Vested and exercisable at 30 June 2012
Directors							
Peter L Gunzburg	3,000,000	-	-	-	3,000,000	-	-
Bill Zikou	1,000,000	-	-	-	1,000,000	-	1,000,000
Mark Pitts	749,999	-	-	-	749,999	-	-
Justin Milne	-	10,000,000	-	(10,000,000)	-	10,000,000	-
Craig Ferrier	3,000,000	-	-	(3,000,000)	-	-	-
Peter Abery	6,000,000	-	-	(6,000,000)	-	-	-
Campbell Smith	7,500,000	-	-	(7,500,000)	-	-	-
Executives							
Stewart Snell	1,166,167	-	-	-	1,166,167	-	-
Peter Barrow	1,166,167	-	(1,166,167)	-	-	-	-
Bryan Paul	1,200,000	-	(1,200,000)	-	-	-	-
Ohimai Mukanda	999,999	-	-	-	999,999	-	-

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

27. Related parties (continued)

Options over equity instruments (continued)

	Held at 1 July 2010	Granted as compensation	Other Changes (i)	Expired	Held at 30 June 2011	Vested during the year	Vested and exercisable at 30 June 2011
Directors							
Peter Abery	4,000,000	3,000,000	-	(1,000,000)	6,000,000	3,000,000	3,000,000
Peter L Gunzburg	3,000,000	-	-	-	3,000,000	-	-
Bill Zikou	-	1,000,000	-	-	1,000,000	1,000,000	1,000,000
Craig Ferrier	3,000,000	-	-	-	3,000,000	-	-
Campbell Smith	7,500,000	-	-	-	7,500,000	-	-
Executives							
Mark Pitts	-	749,999	-	-	749,999	-	-
Stewart Snell	-	1,166,167	-	-	1,166,167	-	-
Peter Barrow	-	1,166,167	-		1,166,167	-	-
Bryan Paul	2,000,000	1,200,000	-	(2,000,000)	1,200,000	-	-
Ohimai Mukanda	-	999,999	-	-	999,999	-	-

(i) Other changes include changes in holdings on cessation or resignation as Key Management Personnel.

Movements in shares

The movement during the reporting period in the number of ordinary shares in pieNETWORKS Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 July 2011	Purchases	Received on exercise of options	Other changes (i)	Held at 30 June 2012
Directors					
Peter L Gunzburg	121,134,703	-	-	(9,775,000)	111,359,703
Bill Zikou	1,125,000	-	-	-	1,125,000
Mark Pitts	2,250,000	-	-	-	2,250,000
Campbell Smith	17,169,131	-	-	(17,169,131)	-
Craig Ferrier	1,125,000	-	-	(1,125,000)	-
Peter Abery	2,531,000	-	-	(2,531,000)	-
Justin Milne	-	1,040,000	-	(1,040,000)	-
Executives					
Stewart Snell	1,999,164	-	-	-	1,999,164
Bryan Paul	1,255,000	-	-	(1,255,000)	-
Peter Barrow	1,694,684	-	-	(1,694,684)	-
	150,283,682	1,040,000	-	(34,589,815)	116,733,867

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

27. Related parties (continued)
Movements in shares (continued)

	Held at 1 July 2010	Purchases	Received on exercise of options	Other changes (i)	Held at 30 June 2011
Directors					
Peter L Gunzburg	106,159,738	14,974,965	-	-	121,134,703
Campbell Smith	16,969,131	200,000	-	-	17,169,131
Craig Ferrier	1,000,000	125,000	-	-	1,125,000
Peter Abery	-	2,531,000	-	-	2,531,000
Bill Zikou	-	1,125,000	-	-	1,125,000
Executives					
Mark Pitts	2,000,000	250,000	-	-	2,250,000
Stewart Snell	851,110	1,148,054	-	-	1,999,164
Bryan Paul	1,115,556	139,444	-	-	1,255,000
Peter Barrow	1,506,387	188,297	-	-	1,694,684
	129,601,922	20,681,760	-	-	150,283,682

(i) Other changes include changes in holdings on cessation or resignation as Key Management Personnel.

No shares were granted to key management personnel during the reporting period as compensation in 2012 or 2011.

28. Group entities

		2012	2011
Parent entity			
pieNETWORKS Limited	Australia		
Subsidiaries			
pieNETWORKS Plc	United Kingdom	100%	100%

Subsidiaries

Loans previously made by the Company to its wholly owned subsidiary are $3,766,539 (2011: $3,688,590). A provision for impairment of $3,766,539 (2011: $3,688,590) has been recognised. The loans will not be called within 12 months of the reporting date.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

29. Operating segments

The Group has two reportable segments, as detailed below, which are the Group's strategic operational units. The strategic operational units operate in separate geographical locations and offer similar products and services, and are managed centrally because they require similar administrational, operational and marketing support. For each strategic operational unit, the Chief Operating Officer (COO) reviews internal management reports on a monthly basis. The following summary describes the operations in each of the Group's reportable segments:

- Australia – Includes manufacture, distribution and management of self service telecommunications infrastructure within Australia.

- New Zealand – Includes assembly, distribution and management of self service telecommunications infrastructure within New Zealand.

There is some level of integration between the two segments. The integration includes transfers of webphone units and component parts between the two segments. The accounting policies of the two segments are the same as those described in notes 2 and 3.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit/loss after income tax as included in the internal management reports that are reviewed by the Group COO. Segment profit/loss is used to measure performance as management believes that such information is the most relevant in evaluating the results of the two segments. Inter-segment pricing is determined on an arm's length basis.

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

29. Operating segments (continued)

Information about reportable segments

	Australia		New Zealand		Total	
In AUD	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
External revenue	844,509	745,843	111,376	59,001	955,885	804,844
Inter-segment revenue	84,474	146,372	-	-	84,474	146,372
Total segment revenue	928,983	892,215	111,376	59,001	1,040,359	961,216
Other income	459,570	-	-	-	459,570	-
Interest income	62,429	65,865	4,983	5,573	67,412	71,438
Interest expense	(1,135)	(1,678)	-	-	(1,135)	(1,678)
Impairment on kiosks and webphones and equipment and fittings	(131,233)	(95,517)	(269,856)	-	(401,089)	(95,517)
Depreciation and amortisation	(64,296)	(82,500)	(205,046)	(145,859)	(269,342)	(228,359)
Income tax benefit	-	452,164	-	-	-	452,164
Segment loss after tax	(4,608,034)	(2,954,985)	(666,201)	(405,403)	(5,274,235)	(3,360,388)
Segment assets	1,155,084	3,518,882	179,313	459,343	1,334,397	3,978,225
Capital expenditure	96,229	41,237	203,557	181,913	299,786	223,150
Segment liabilities	418,563	568,101	1,497,608	1,099,188	1,916,171	1,667,289

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

29. Operating segments (continued)

Reconciliation of reportable segment revenues, loss, assets and liabilities and other material items

In AUD	2012	2011
Revenue		
Total revenue for reportable segments	1,040,359	951,216
Elimination of inter-segment revenue	(84,474)	(146,372)
Consolidated revenue	955,885	804,844
Loss		
Total loss for reportable segments	(5,274,235)	(3,360,388)
Impairment of inter-segment assets	1,303,209	-
Elimination of inter-segment profit	64,258	(1,190)
Consolidated loss after tax	(3,906,768)	(3,361,578)
Assets		
Total assets for reportable segments	1,334,397	3,978,225
Eliminiation of inter-segment assets	-	(1,067,215)
Elimination of inter-segment profit	-	(64,258)
Consolidated total assets	1,334,397	2,846,752
Liabilities		
Total liabilities for reportable segments	1,916,171	1,667,289
Elimination inter-segment liabilities	(1,303,209)	(1,067,215)
Consolidated total liabilities	612,962	600,074

Other material items 2012 *In AUD*	Reportable segment totals	Adjustments	Consolidated totals
Interest revenue	67,412	-	67,412
Interest expense	1,135	-	1,135
Impairment on kiosks and webphones and equipment and fittings	401,089	-	401,089
Depreciation and amortisation	269,342	(39,754)	229,588

Other material items 2011 *In AUD*	Reportable segment totals	Adjustments	Consolidated totals
Interest revenue	71,438	-	71,438
Interest expense	1,678	-	1,678
Impairment on kiosks and webphones and equipment and fittings	-	-	-
Depreciation and amortisation	228,359	(27,947)	200,412
Income tax benefit	452,164	-	452,164

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

29. Operating segments (continued)

Major Customer

Revenues from one customer of the Group's Australian segment represents $207,785 (2011: $225,636) of the Group's total revenues.

30. Subsequent events

Subsequent to 30 June 2012:

- On 6 August 2012, the Company announced a capital raising program to raise up to $2,560,671. The capital is planned to be raised through a non-renounceable entitlement offer to existing shareholders, which is partially underwritten by certain directors to the amount of $700,000, and a placement. The non-renounceable entitlement offer, if fully subscribed, will raise up to $2,226,669 on the basis of one new share for each existing share at 0.2 cents per new share. In addition to the entitlement offer the Company may seek to complete a placement at the same price within its 15% placement capacity.

Other than the matters discussed above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Group, the results of those operations, or the state of affairs of the Group, in future financial years.

31. Auditors' remuneration

In AUD	**2012**	**2011**
Audit services		
Auditors of the Company		
KPMG Australia:		
Audit and review of financial reports	67,100	70,652
	67,100	70,652

	2012	**2011**
Other services		
Auditors of the Company		
KPMG Australia		
Taxation services	15,139	10,790
	15,139	10,790

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

32. Other non-current assets

The amount of $33,041 at 30 June 2011 represents deposits advanced by the Group to suppliers in connection with the manufacture of webphones.

33. Parent entity disclosures

As at and throughout the financial year ending 30 June 2012, the parent entity of the Group was pieNETWORKS Ltd.

In AUD	**2012**	**2011**
Result of the parent entity		
Loss for the period	(3,906,768)	(3,361,578)
Other comprehensive income	(12,247)	9,773
Total comprehensive income for the period	(3,919,015)	(3,351,805)
Financial position of parent entity at year end		
Current assets	1,168,317	2,301,195
Total assets	1,334,397	2,846,752
Current liabilities	485,187	582,041
Total liabilities	612,962	600,074
Total equity of parent entity comprising of:		
Share capital	28,475,095	26,376,845
Share option reserve	1,052,431	756,909
Translation reserve	(2,474)	9,773
Accumulated loss	(28,803,617)	(24,896,849)
Total equity	721,435	2,246,678

Parent entity capital commitments

Contracted but not provided for and payable:	**2012**	**2011**
Less than one year	82,360	33,041
	82,360	33,041

34. Provisions

In AUD	**2012**	**2011**
Current		
Provision for onerous contracts	70,217	-
Current provisions	70,217	-
Non-current		
Provision for onerous contracts	119,666	-
Non-current provisions	119,666	-
Total provisions	189,883	-

pieNETWORKS Limited
Notes to the consolidated financial statements for the year ended 30 June 2012

34. Provisions (Continued)

The Group has recognised a provision for onerous contracts of $189,883 (Jun 2011: Nil) in relation to its contracts with Westfield and AMP shopping centres in New Zealand. The Group has assessed these contracts as onerous in the light of reduced opportunities for further revenue development in shopping centre webphones, reduced business development resources assigned to the New Zealand market and the high costs of terminating or continuing with these contracts. The provision is determined based on the least net cost of exiting from the contracts, which is the lower of the cost of fulfilling them and any compensation or penalties arising from the failure to fulfil them.

In estimating the cost to fulfil contract obligations, uncertainties about the amount and timing of outflows include monthly phone and internet usage revenue, RBNZ Government bond rates and ISP and phone operating costs.

Movements in Provisions

In AUD	**2012**	**2011**
Opening balance 1 July	-	-
Increase in provision	189,883	-
Closing balance 30 June	189,883	-

Directors' declaration

1 In the opinion of the directors of pieNETWORKS Limited ('the Company'):

(a) the consolidated financial statements and notes that are set out on pages 26 to 70 and the remuneration report in paragraph 4.7.1 to 4.7.4 of the Directors' report, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the Group's financial position as at 30 June 2012 and of its performance, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

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

2 The directors have been given the declarations required by Section 295A of the Corporations Act 2001 from the chief operating officer and financial controller for the financial year ended 30 June 2012.

3 The directors draw attention to note 2(a) to the consolidated financial statements, which includes a statement of compliance with International Financial Reporting Standards.

Dated at Perth on 28th day of September 2012.

Signed in accordance with a resolution of the directors:

____

Peter Gunzburg
Director

Independent auditor's report to the members of pieNETWORKS Limited

Report on the financial report

We have audited the accompanying financial report of pieNETWORKS Limited (the Company), which comprises the consolidated statement of financial position as at 30 June 2012, and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, notes 1 to 34 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Group 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* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements of the Group comply with International Financial Reporting Standards.

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Group's financial position and of its performance.

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 the Group is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Group's financial position as at 30 June 2012 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

Material uncertainty regarding continuation as a going concern

Without modification to the opinion expressed above, attention is drawn to the following matter.

As detailed in note 2(b), the Group's ability to continue as a going concern is dependent upon developing and identifying new opportunities and projects to achieve a sustainable business, and/or raising sufficient funding. The outcome of these activities cannot presently be determined with certainty.

Accordingly, there is material uncertainty which may cast significant doubt as to whether the Group will be able to continue as a going concern and therefore whether it will be able to realise its assets and extinguish 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 paragraphs 4.7.1 to 4.7.4 of the directors' report for the year ended 30 June 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 auditing standards.

Auditor's opinion

In our opinion, the remuneration report of pieNETWORKS Limited for the year ended 30 June 2012, complies with Section 300A of the *Corporations Act 2001*.

KPMG

KPMG

Matthew Beevers
Partner

Perth

28 September 2012

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of pieNETWORKS Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 30 June 2012 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

Matthew Beevers
Partner

Perth

28 September 2012