



PHOSPHAGENICS

19 February 2010

**THE MANAGER  
COMPANY ANNOUNCEMENTS OFFICE  
ASX LIMITED**

Dear Sir/Madam

**re : Phosphagenics Limited**

**APPENDIX 4E REPORT  
AND FINANCIAL REPORT FOR YEAR ENDED 31 DECEMBER 2009**

Attached for release to the market are the Company's Appendix 4E Report and Financial Report for the year ended 31 December 2009.

During 2009 the Company significantly progressed its product development pipeline including the successful Oxycodone Phase 1 Clinical Study.

At the end of December 2009, the Company held \$10.9 million (2008 : \$12.9 million) in cash and cash equivalents after successfully raising \$7.0 million by way of a Share Purchase Plan offering to shareholders.

The operating loss for the period before the impairment of acquired intangible assets and goodwill after income tax expenses was \$8.5 million (2008 : \$8.4 million).

For further details refer to the attached Appendix 4E Directors' Report, Financial Statements and Notes.

Yours faithfully  
Phosphagenics Limited

Mourice R Garbutt  
Company Secretary  
p:\asx\appendix 4e report - 31 12 09

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**Phosphagenics Limited**

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# Appendix 4E

## Preliminary final report Period ending on or after 31 December 2009

Introduced 1/1/2003. Origin: Appendix 4B

Name of entity

Phosphagenics Limited

The following information must be given to ASX under listing rule 4.3.

1.

ABN or equivalent company  
reference

Year ended:  
current period

previous corresponding period

32 056 482 403	31 December 2009	31 December 2008
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### Results for announcement to the market

		\$A'000
2.1 Revenues from ordinary activities	down	56.83% to 1,404
2.2 Profit (loss) from activities before impairment of acquired intangible assets and goodwill and after tax attributable to members	up	1.00% to (8,501)
2.3 Profit (loss) from activities after tax attributable to members	down	90.61% to (8,501)
2.4 Net profit (loss) for the period attributable to members	down	90.61% to (8,501)
<b>2.4 Dividends (distributions)</b>		
	Amount per security	Franked amount per security
Final dividend	-	-
Interim dividend	-	-
In Specie Dividend	-	-
Previous corresponding period:		
Final dividend	-	-
Interim dividend		
In Specie Dividend		
2.5 Record date for determining entitlements to the dividend	N/A	

+ See chapter 19 for defined terms.

2.6 Brief explanation of any of the figures in 2.1 to 2.4 necessary to enable the figures to be understood.

At the end of December 2009, the company held \$10.9 million in cash and cash equivalents after successfully raising \$7.0 million by way of a share purchase plan in October 2009. Closing cash was 16% below the amount held at December 2008 of \$12.9 million.

Revenues for the year of \$1.4 million were down 57% from \$3.2 million in 2008, due mainly to a decline in royalties received by the nutraceutical division and the expiry of both government grants (Commercial Ready and P3) during the first half of 2009.

The operating loss (before impairment of acquired intangible assets and goodwill) after income tax was \$8.5 million, a marginal increase from \$8.4 million in 2008.

A number of R&D milestones were achieved in 2009 including:

Insulin

- Completion of a transdermal insulin human trial demonstrating the proprietary TPM/insulin formulation can safely deliver insulin into patients with Type 1 diabetes.

Diclofenac

- Completion of a Phase 1 diclofenac study demonstrating the proprietary TPM/diclofenac formulation was safe and well tolerated in humans.

Retinoic Acid

- Completion of a Two-staged Phase 1 clinical trial not only demonstrating Phosphagenics proprietary drug delivery system could significantly increase the delivery of retinoic acid compared with benchmark products, but that it could do so with less irritation than a leading commercial product used for the treatment of acne, Retin-A®.

Oxycodone

- Completion of preclinical studies for the proprietary TPM/oxycodone transdermal patch system. The results of the preclinical studies demonstrated that by incorporating TPM/oxycodone into innovative patch systems developed by Phosphagenics, the delivery of oxycodone was significantly increased when compared to Phosphagenics TPM/oxycodone gel alone.
- Completion of a Phase 1 Repeat Insult Patch Test (RIPT) demonstrating that the repeated application of the proprietary TPM/oxycodone formulation did not cause any significant erythema or sensitisation in humans.
- Completed a Phase 1 clinical study of the proprietary oxycodone transdermal matrix and reservoir patch systems. The results of the trial established that after a single dose the matrix patch delivered oxycodone into the blood stream in a reproducible, consistent and sustained manner.

Commercial Agreements

- Phosphagenics signed an agreement with CSL to evaluate the TPM delivery technology
- Entered into an exclusive agreement with Métier Tribeca LLC, ("Métier") to enable Métier to launch a premier line of cosmetic products utilising the TPM delivery technology, under its brand name Le Métier de Beauté. Métier launched the new cosmetic treatment products, Peau de Vierge Anti-Aging Collection, across the US in November 2009.

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- Signed a collaborative research and option agreement with Metabolic Pharmaceuticals Limited. Under the terms of the agreement, Phosphagenics may elect to license Metabolic's patented compound, AOD9604, for use as a cosmeceutical product marketed as a cellulite and subcutaneous fat reduction treatment. The license, should Phosphagenics elect to exercise the option, will be a worldwide exclusive license.
- Announced the results of its Phospha-E® clinical trial for the treatment of Metabolic Syndrome.

Phosphagenics now has four products in various clinical development:

- transdermal insulin delivery formulation
- retinoic acid formulation
- oxycodone patch
- topical diclofenac formulation

### **Looking Forward**

Clinical trials have clearly shown TPM technology can be used to safely deliver active agents into the blood stream, or the dermis, without causing irritation or erythema.

Phosphagenics announced the successful completion of its Phase 1B repeat dose trial for its proprietary oxycodone/TPM (Targeted Penetration Matrix) transdermal patch system which delivered oxycodone in therapeutic doses in a consistent and sustained manner. This trial was conducted over 10 days.

Phosphagenics plans to return to the clinic in the first half of 2010 with TPM/insulin for human trials, following an analysis of a range of possible adaptations of the TPM delivery technology for delivering insulin, including a patch.

In parallel to applying its proprietary delivery technology for use in pharmaceuticals, which have the potential to generate high value products, but which are subject to stringent regulatory requirements and long product development timelines, Phosphagenics is leveraging the research and development already undertaken to apply the TPM delivery technology to cosmetic and personal care products. The TPM delivery technology is well suited to products in this growing market, as products can be brought to market relatively quickly and with relatively low expenditure. Phosphagenics aims to generate cash from the sale of cosmeceutical products, which can be used to support research to develop the more costly, but higher value generating, pharmaceutical products.

In 2010 Phosphagenics will launch its own brand of personal care products (Elixia) into the Australian market through pharmacies, while continuing to expand the cosmetics business globally through the relationship with Le Métier de Beauté in the USA.

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Note: The information required by item 2 must be placed at the beginning of the report. The other information may be presented in whatever way is the most clear and helpful to users, eg combined with the body of the report, combined with notes to the accounts, or set out separately.

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+ See chapter 19 for defined terms.

3. A statement of financial performance together with notes to the statement, prepared in compliance with AASB 1018 or the equivalent foreign accounting standard:

Attached Statement of Comprehensive Income

4. A statement of financial position together with notes to the statement. The statement may be condensed but must report as line items each significant class of asset, liability, and equity element with appropriate sub-totals:

Attached Statement of Financial Position

5. A statement of cash flows together with notes to the statement. The statement of cash flows may be condensed but must report as line items each significant form of cash flow and comply with the disclosure requirements of AASB 1026 Statement of Cash Flows, or for foreign entities, the equivalent foreign accounting standard:

Attached Statement of Cash Flow

6. Details of individual and total dividends or distributions and dividend or distribution payments. The details must include the date on which each dividend or distribution is payable, and (if known) the amount per security of foreign sourced dividend or distribution:

<b>Dividend or distribution payments:</b>	<b>Amount</b>	<b>Date on which each dividend or distribution is payable</b>	<b>Amount per security of foreign sourced dividend or distribution (if known)</b>
N/A			

+ See chapter 19 for defined terms.

7. Details of any dividend or distribution reinvestment plans in operation and the last date for the receipt of an election notice for participation in any dividend or distribution reinvestment plan:

N/A

8. A statement of retained earnings showing movements:

	<b>Current period \$A'000</b>	<b>Previous corresponding period \$A'000</b>
Retained profits (accumulated losses) at the beginning of the financial period	(147,248)	(56,042)
Net profit (loss) attributable to members	(8,501)	(91,206)
Net transfers from (to) reserves	-	-
Net effect of changes in accounting policies	-	-
Dividends and other equity distributions paid or payable	-	-
<b>Retained profits (accumulated losses) at end of financial period</b>	<b>(155,749)</b>	<b>(147,248)</b>

9. Net tangible assets per security with the comparative figure for the previous corresponding period.

	<b>Current period</b>	<b>Previous corresponding Period</b>
Net tangible assets per security	1.6 cents	2.1 cents

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+ See chapter 19 for defined terms.

10. Details of entities over which control has been gained or lost during the period:

10.1 Name of the entity. N/A

10.2 The date of the gain or loss of control. N/A

		Current period	Previous corresponding period
10.3	Where material to an understanding of the report – the contribution of such entities to the reporting entity’s profit from ordinary activities during the period and the profit or loss of such entities during the whole of the previous corresponding period.	N/A	N/A

11. Details of associates and joint venture entities including the name of the associate or joint venture entity and details of the reporting entity’s percentage holding in each of these entities and – where material to an understanding of the report - aggregate share of profits (losses) of these entities, details of contributions to net profit for each of these entities, and with comparative figures for each of these disclosures for the previous corresponding period.

Name of entity	% Holding	Aggregate Share of profit (losses)		Contribution to net profit	
		Current period \$'000	Previous corresponding Period \$'000	Current period \$'000	Previous corresponding Period \$'000
Vital Health Sciences Pty Ltd	100	N/A	N/A	(5,655)	(6,594)
Phosphagenics Inc	100	N/A	N/A	(553)	(221)

12. Any other significant information needed by an investor to make an informed assessment of the entity’s financial performance and financial position:

N/A

+ See chapter 19 for defined terms.

13. For foreign entities, which set of accounting standards is used in compiling the report (e.g. International Accounting Standards).

International Financial Reporting Standards

14. A commentary on the results for the period. The commentary must be sufficient for the user to be able to compare the information presented with equivalent information for previous periods. The commentary must include any significant information needed by an investor to make an informed assessment of the entity's activities and results, which would include but not be limited to discussion of the following:

- 14.1 The earnings per security and the nature of any dilution aspects:

Basic earnings per share (1.26) cents (2008: (14.21))

Diluted earnings per share (1.26) cents (2008: (14.21))

- 14.2 Returns to shareholders including distributions and buy backs:

N/A

- 14.3 Significant features of operating performance:

N/A

- 14.4 The results of segments that are significant to an understanding of the business as a whole:

Refer to financial statements

- 14.5 A discussion of trends in performance:

N/A

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+ See chapter 19 for defined terms.

- 14.6 Any other factors which have affected the results in the period or which are likely to affect results in the future, including those where the effect could not be quantified:

Refer "Future Developments" and "Subsequent Events" in the attached Directors Report.

15. A statement as to whether the report is based on accounts which have been audited or subject to review, are in the process of being audited or reviewed, or have not yet been audited or reviewed.

The accounts of the Company have been audited.

Note: If the \*accounts have been audited or subject to review, the audit report should be provided with the report.

16. If the accounts have not yet been audited or subject to review and are likely to be subject to dispute or qualification, a description of the likely dispute or qualification:

N/A

17. For all entities, if the accounts are subject to audit dispute or qualification, a description of the dispute or qualification.

N/A

Note: The audit report or review must be provided as part of the report.

Signed by Company Secretary:



Mourice Garbutt

Date: 19 February 2010

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+ See chapter 19 for defined terms.

# Phosphagenics Limited

ABN 32 056 482 403

Annual Financial Report  
for the year ended 31 December 2009

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## Directors' Report

Your directors submit their report for the year ended 31 December 2009.

### DIRECTORS

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

#### NAMES, QUALIFICATIONS, EXPERIENCE AND SPECIAL RESPONSIBILITIES

**ASSOCIATE PROFESSOR ANDREW LANCELOT VIZARD (AGED 51 YEARS) BVSC (HONS) MVPM  
NON EXECUTIVE INDEPENDENT DIRECTOR SINCE JULY 1999 AND CHAIRMAN SINCE OCTOBER 2000  
LAST RE-ELECTED MAY 2007**

With a background in research and agricultural consultancy, Professor Vizard is the Senior Consultant with and former Director of the Mackinnon Project at the University of Melbourne. This enterprise is recognised as a leader in delivering practical advice to farmers and agribusiness on a wide range of agricultural and economic issues. Professor Vizard is the author of over fifty scientific papers.

Professor Vizard is an experienced company director, having served on the board of numerous statutory, scientific and commercial organisations. He is currently a Non-Executive Director of Ridley Corporation Ltd and Animal Health Australia Ltd, a Trustee of the Australian Wool Education Trust and a member of the Management Advisory Committee for Melbourne Water.

Professor Vizard is a member of the Company's Audit, Compliance and Corporate Governance Committee.

**HARRY ROSEN (AGED 62 YEARS) BA , LLB  
EXECUTIVE DIRECTOR APPOINTED TO THE BOARD IN JUNE 1999  
APPOINTED CHIEF EXECUTIVE OFFICER DECEMBER 2005  
LAST RE-ELECTED MAY 2004\***

Mr Rosen is one of the founders of Betatene Limited and Denehurst Limited, two formerly ASX listed companies which commercialised significant research and development. Betatene is the world's largest producer of natural beta carotene. After the purchase of Betatene Limited by Henkel Corporation, Mr Rosen served as Vice President, Corporate Development. As a Vice President of Henkel Corporation, he worked for a number of years in the U.S. in the nutrition and health care industries.

Mr Rosen has consulted to many technology companies assisting them with the commercialisation of new technologies. He has had significant experience in the areas of seed capital raising, stock exchange listings, taxation and corporate law. Mr Rosen graduated from the Australian National University (BA-Psychology) and Melbourne University (LLB).

\* As Chief Executive Officer Mr Rosen is not required to retire by rotation.

**JONATHAN LANCELOT ADDISON (AGED 57 YEARS) BEC (TAS), ASIC, CFTP (SNR)  
NON EXECUTIVE INDEPENDENT DIRECTOR SINCE NOVEMBER 2002  
LAST RE-ELECTED MAY 2008**

Mr Addison has over 30 years in the investment management industry, including wide experience in superannuation. Currently he is the Investment Manager (formerly Fund Manager) of the Meat Industry Employee Superannuation Fund ("MIESF") whom he joined in June 1999 and where he is responsible for the investment management of MIESF.

MIESF, a self-administered industry superannuation fund established in 1981 which operates nationally, currently holds 21,800,000 shares in Phosphagenics Limited.

Prior to his appointment to MIESF, Mr Addison was a Director and Asset Consultant within the Corporate Finance section of PricewaterhouseCoopers and in this role was responsible for establishing an investment consulting practice with clients ranging from superannuation funds to insurance funds and funds managers. Prior to that, he was Manager Investment Consultant at Sedgwick Noble Lowndes.

## Directors' Report (continued)

Mr Addison also holds Non-Executive Directorships with African Enterprise Limited, African Enterprise New Zealand Limited, and African Enterprise International, Hawksbridge Limited, Global Masters Fund Limited and TPCG Limited.

Mr Addison is the Chairman of the Company's Audit, Compliance and Corporate Governance Committee.

**PROFESSOR JOHN MILLS (AGED 69 YEARS) BS (HONS), MD, FACP, FRACP  
NON-EXECUTIVE INDEPENDENT DIRECTOR SINCE MARCH 2004  
LAST RE-ELECTED MAY 2007**

Professor Mills has a long and distinguished career in medical research, clinical medicine and biomedical business. In addition to his position as a Non-Executive Director of Phosphagenics, he is Executive Chairman of Cavid AB, an Executive Director of TissuPath Pty Ltd and a Non-Executive Director of GBS Venture Partners Pty Ltd. He was previously a Non-Executive Director (1995-2003) and Chairman (2001-2) of AMRAD Corporation. He is also a Non-Executive Director of the Prostate Cancer Foundation of Australia and Chair of the PCFA Research Committee. He holds appointments at Monash University, the University of California, San Francisco and RMIT, and is a consulting physician at The Alfred and Austin Hospitals in Melbourne.

Professor Mills is a member of the Company's Audit, Compliance and Corporate Governance Committee.

**MICHAEL RICHARD DWYER ASHTON (AGED 63 YEARS) BPHARM, MBA  
NON-EXECUTIVE DIRECTOR APPOINTED TO THE BOARD ON 8 JULY 2008**

Mr Ashton has more than thirty years' experience in the international pharmaceutical industry having held senior management positions with Merck Inc. and Pfizer Inc., and executive board positions with Faulding Inc. and SkyePharma Plc.

Mr Ashton was CEO and Director of SkyePharma Plc., initially he was responsible for the re-organisation of SkyePharma AG as a public enterprise (1997 – 1998). In 1998 he took over responsibility of the operations of the SkyePharma Plc. group and re-organised the international structure in Europe and the U.S. and the world wide Business Development Group.

Earlier Mr Ashton was Chairman, President and CEO of Faulding Inc., the U.S. subsidiary he opened for FH Faulding, Australia's largest pharmaceutical company, and CEO of Purepac Inc. During that time, he supervised the start-up of David Bull in the U.S. and Canada and oversaw restructuring of Purepac Inc., into a leader of the U.S. generic pharmaceutical industry.

In addition, Mr Ashton served with Pfizer International for fourteen years in various roles, which included Director of Pharmaceutical Business Development for Europe/Canada, Vice President of Pharmaceutical Development for Africa/Middle East, Pharmaceutical Business Director of Nigeria and Group Product Manager for the International Division in New York.

Mr Ashton previously applied his pharmacist background to various management positions during six years at MerckSharp and Dohme in Sydney and the U.S.

Mr Ashton is a member of the Boards of Hikma Pharmaceuticals Plc, Proximagen Neuroscience Plc and Transition Therapeutics Inc.

Mr Ashton holds a Bachelor of Pharmacy degree from Sydney University and a Masters in Business Administration from Rutgers University, New Jersey, USA.

## **Directors' Report (continued)**

**DR ESRA OGRU (AGED 34 YEARS) BSC (HONS) PHD**  
**CHIEF OPERATING OFFICER SINCE JANUARY 2009**  
**LAST RE-ELECTED MAY 2009**

Dr Ogru is an Executive Director of Phosphagenics and is responsible for the management of the operations and development in Australia and internationally. She achieves this through strong leadership of a team of experienced pharmaceutical scientists and chemists and strategic collaborations.

In this role, Dr Ogru has developed commercial opportunities for both the Company's nutraceutical division and pharmaceutical technologies, such as transdermal drug delivery and drug enhancement platforms for cancer, heart disease and chronic pain management.

Dr Ogru has many years experience in both the academic and commercial aspects of the industry. Prior to joining Phosphagenics in 2001, Dr Ogru carried out significant research on obesity and diabetes. Additionally, she has considerable experience in the management and coordination of pre-clinical and clinical development of pharmaceutical products.

Dr Ogru has numerous publications in peer-reviewed journals.

## Directors' Report (continued)

### DIRECTORSHIPS OF OTHER LISTED COMPANIES

Directorships of other listed companies held by Directors in the three years immediately before the end of the financial year are as follows:

NAME	COMPANY	PERIOD OF DIRECTORSHIP
Prof. Andrew Vizard	Ridley Corporation Limited	Since 29 January 2001
Prof. John Mills	Narhex Life Sciences Limited	10 April 2001 to 17 December 2007
Jonathan Addison	Global Masters Fund Limited	Since 19 April 2005

### COMPANY SECRETARY

Mourice Garbutt FCIS, Honorary Justice of the Peace in Victoria

Mr Garbutt, through his professional corporate secretarial and compliance service company, provides secretarial, clerical and corporate governance support to client companies in Australia many of which are listed on the ASX Limited. Fees are charged on normal commercial terms.

### PRINCIPAL ACTIVITIES

The principle activities of the Company are the production, sale and licensing of products for the nutraceutical and pharmaceutical industries.

### OPERATING AND FINANCIAL REVIEW

At the end of December 2009, the company held \$10.9 million in cash and cash equivalents after successfully raising \$7.0 million by way of a share purchase plan in October 2009. Closing cash was 16% below the amount held at December 2008 of \$12.9 million.

Revenues for the year of \$1.4 million were down 57% from \$3.2 million in 2008, due mainly to a decline in royalties received by the nutraceutical division and the expiry of both government grants (Commercial Ready and P3) during the first half of 2009. Product sales increased year on year by 50%, more than 8 tonnes of Vital ET was sold in 2009.

The operating loss (before impairment of acquired intangible assets and goodwill) after income tax was \$8.5 million, a marginal increase from \$8.4 million in 2008.

A number of R&D milestones were achieved in 2009 including:

#### *Insulin*

Completion of a transdermal insulin human trial demonstrating the proprietary TPM/insulin formulation can safely deliver insulin into patients with Type 1 diabetes.

#### *Diclofenac*

Completion of a Phase 1 diclofenac study demonstrating the proprietary TPM/diclofenac formulation was safe and well tolerated in humans.

#### *Retinoic Acid*

Completion of a Two-staged Phase 1 clinical trial not only demonstrating Phosphagenics proprietary drug delivery system could significantly increase the delivery of retinoic acid compared with benchmark products, but that it could do so with less irritation than a leading commercial product used for the treatment of acne, Retin-A®.

## Directors' Report (continued)

### *Oxycodone*

Completion of preclinical studies for the proprietary TPM/oxycodone transdermal patch system. The results of the preclinical studies demonstrated that by incorporating TPM/oxycodone into innovative patch systems developed by Phosphagenics, the delivery of oxycodone was significantly increased when compared to Phosphagenics TPM/oxycodone gel alone.

Completion of a Phase 1 Repeat Insult Patch Test (RIPT), demonstrating the repeated application of the proprietary TPM/oxycodone formulation did not cause any significant erythema or sensitisation in humans.

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### *Commercial Agreements*

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Entered into an exclusive agreement with Métier Tribeca LLC, (“Métier”) to enable Métier to launch a premier line of cosmetic products utilising the TPM delivery technology, under its brand name Le Métier de Beauté. Métier launched the new cosmetic treatment products, Peau de Vierge Anti-Aging Collection, across the US in November 2009.

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### **Looking Forward**

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In 2010 Phosphagenics will launch its own brand of personal care products (Elixia) into the Australian market through pharmacies, while continuing to expand the cosmetics business globally through the relationship with Le Métier de Beauté in the USA.

## Directors' Report (continued)

### FUTURE DEVELOPMENTS

Disclosure of information regarding likely developments in the operations of the consolidated entity in future financial years and the expected results of those operations is likely to result in unreasonable prejudice to the consolidated entity. Accordingly, this information has not been disclosed in this report.

### ENVIRONMENTAL REGULATIONS

The Company is registered with relevant authorities to use certain compounds in the manufacture of goods. All waste chemicals are disposed of using accredited service providers with notification to the relevant authorities.

### DIVIDENDS

The Directors have not recommended the payment of any dividends and no dividends were declared, paid or reinvested in the year to 31 December 2009.

### SHARE OPTIONS

Share options convertible to ordinary shares on issue at 31 December 2009

Issuing entity	Australian stock exchange listed	shares under option No.	Class of shares	Exercise price \$	Expiry date
Phosphagenics Ltd	unquoted	1,000,000	Ordinary	\$0.22	18 Aug 2010
Phosphagenics Ltd	unquoted	500,000	Ordinary	\$0.24	28 Mar 2011
Phosphagenics Ltd	unquoted	1,600,000	Ordinary	\$0.24	22 May 2011
Phosphagenics Ltd	unquoted	100,000	Ordinary	\$0.36	28 Aug 2011
Phosphagenics Ltd	unquoted	1,300,000	Ordinary	\$0.26	06 June 2012
Phosphagenics Ltd	unquoted	2,350,000	Ordinary	\$0.15	17 Aug 2013
Phosphagenics Ltd	unquoted	2,850,000	Ordinary	\$0.15	17 June 2014
Phosphagenics Ltd	unquoted	2,650,000	Ordinary	\$0.13	30 June 2018
<b>Total</b>		<b>12,350,000</b>			

The holders of share options do not have voting rights or ability to participate in any share or rights issue. Since the end of the financial year no options have been exercised.

### ROUNDING OF AMOUNTS

The amounts contained in this report and in the financial report have been rounded to the nearest \$1,000 (where rounding is applicable and where noted (\$'000)), under the option available to the company under ASIC Class Order 98/0100. The company is an entity to which the Class Order applies.

### INDEMNIFICATION OF OFFICERS AND AUDITORS

During the financial year, the Company paid a premium in respect of a contract insuring its Directors and Officers against a liability, other than a wilful breach of duty, of a nature that is required to be disclosed under section 300(8) of the *Corporations Act 2001*. In accordance with section 300(9) of the *Corporations Act 2001*, further details have not been disclosed due to confidentiality provisions contained in the insurance contract.

## Directors' Report (continued)

### DIRECTORS' MEETINGS

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

Directors	Board of Directors		Share Allotment committee		Audit, Compliance and Corporate Governance committee	
	Held	Attended	Held	Attended	Held	Attended
<b>Non-executive directors</b>						
Vizard, A L	9	9	-	-	5	5
Addison, J L	9	9	-	-	5	5
Mills, J	9	9	-	-	5	5
Ashton, M R D	9	9	-	-	-	-
<b>Executive directors</b>						
Rosen, H	9	9	-	-	-	-
Ogru, E	9	9	-	-	-	-

### Committee Membership

For all committees, any two Directors constitutes a quorum. All Directors are eligible to sit on the share allotment committee. The audit, compliance and corporate governance committee comprises of Independent Directors; J L Addison (chairman), J Mills and A L Vizard.

### Directors Shareholdings

During the reporting period shares issued to A. Vizard, J. Mills and M. Ashton resulted from their participation in the Share Purchase Plan. Entitlements during this period, as reported to the ASX Limited, include share and option transactions and are as follows:

Directors	2009	2009
	Number of ordinary shares	Number of options over ordinary shares
<b>Non-executive directors</b>		
Vizard, A L	177,758	-
Addison, J L	19,000	-
Mills, J	694,057	-
Ashton, M R D	263,043	-
<b>Executive directors</b>		
Rosen, H	64,226,436	-
Ogru, E	5,711,610	-
<b>Total</b>	<b>71,091,904</b>	-

## Directors' Report (continued)

### REMUNERATION REPORT (AUDITED)

This remuneration report for the year ended 31 December 2009 outlines the remuneration arrangements of the Company and the Group in accordance with the requirements of the *Corporations Act 2001* (the Act) and its regulations. This information has been audited as required by section 308(3C) of the Act.

For the purposes of this report, key management personnel (KMP) of the Group are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the Company and the Group, directly or indirectly, including any director (whether executive or otherwise) of the parent company.

Details of Key Management Personnel	Position
<b>Non-executive directors</b>	
Vizard, A L	Chairman and Independent Director
Addison, J L	Independent Director
Mills, J	Independent Director
Ashton, M R D	Independent Director
<b>Executive directors</b>	
Rosen, H	President and Chief Executive Officer
Ogru, E <sup>1</sup>	Chief Operating Officer
<b>Key management personnel</b>	
Banti, F	President Phosphagenics Inc, Senior Vice President Australia
Hodges, A	Chief Financial Officer
Gavin, P <sup>1</sup>	Vice President R&D - Pharmaceuticals

<sup>1</sup> Dr Ogru and Dr Gavin were promoted to their new positions effective 20 February 2009.

### Remuneration Committee

The remuneration committee, part of the audit, compliance and corporate governance committee, is responsible for determining and reviewing remuneration arrangements for the directors and executives. The remuneration committee assesses the appropriateness of the nature and amount of remuneration of executives on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality, high performing director and executive team.

### Remuneration philosophy and structure

The performance of the Company depends upon the quality of its directors and executives. Attempts to prosper include attracting, motivating and retaining highly skilled directors and executives. The broad remuneration philosophy is to ensure a remuneration package properly reflects the person's duties and responsibilities and that remuneration is competitive in attracting, retaining and motivating people of the highest quality.

In accordance with best practice corporate governance, the structure of non-executive director and executive remuneration is separate and distinct.

### Non executive director remuneration

#### *Objective*

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

## Directors' Report (continued)

### *Structure*

The constitution and the ASX listing rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. The latest determination was at the annual general meeting held on 29 January 2004 when shareholders approved an aggregate remuneration of \$300,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the fee structure is reviewed annually. The board considers advice from external consultants as well as the fees paid to non-executive directors of comparable companies when undertaking the annual review process. A review was conducted in late 2009 resulting in no change to remuneration of non-executive directors.

Each non-executive director receives a base fee of \$38,000 for being a director of the Group. The non-executive directors do not receive retirement benefits, nor do they participate in any incentive programs. The remuneration of non-executive directors for the period ending 31 December 2009 and 31 December 2008 is detailed in the tables within this report.

### **Executive remuneration**

#### *Objective*

The Group aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities so as to align the interests of executives with those of shareholders to retain executives at the Company to ensure that total remuneration is competitive by market standards.

#### *Structure*

In determining the level and make-up of executive remuneration, the board engages external consultants as needed to provide independent advice. The process consists of a review of company and individual performance, relevant comparative remuneration in the market and internally, and where appropriate, external advice on policies and practices.

Remuneration packages contain the following key elements:

- Fixed remuneration (base salary, superannuation and non-monetary benefits).
- Variable remuneration long term incentive (options issued under the Employee Share Option Plan (ESOP))

Executive directors' remuneration was reviewed in late 2009 resulting in a 5% increase.

### **Fixed remuneration**

#### *Objective*

Fixed remuneration is reviewed annually by the board of directors. The process consists of a review of company and individual performance, relevant comparative remuneration externally and internally and, where appropriate, external advice on policies and practices. As noted above, the committee has access to external advice independent of management.

#### *Structure*

Executives are given the opportunity to receive their fixed (primary) remuneration in a variety of forms including cash and fringe benefits such as motor vehicles. It is intended that the manner of payment chosen will be optimal for the recipient without creating undue cost for the Group. Apart from termination benefits which accrue under statute such as unpaid annual leave, long service leave and superannuation benefits, there are no post employment retirement benefits.

### **Variable remuneration long term incentive plan**

#### *Objective*

The objective of the long term incentive plan is to reward executives in a manner that aligns remuneration with the creation of shareholder wealth and to ensure that executives view their relationship with the Group as a long-term one.

## Directors' Report (continued)

As such the long term incentive plan is only offered to executives who are able to influence the generation of shareholder wealth and thus have an impact on the Group's performance.

### Structure

The long term incentive plan grants to executives are delivered in the form of share options under the Employee Share Option Plan (ESOP). The share options will vest over differing periods depending on the offer conditions, with no opportunity to retest. Executives are able to exercise the share options after vesting and before the options lapse.

Where a participant ceases employment prior to the vesting of their share options, the share options are forfeited unless cessation of employment is due to retirement or death. In the event of a change of control of the Group, the performance period end date will be brought forward to the date of the change of control and awards will vest over this shortened period.

The Groups current remuneration policies provide some degree of linkage between an executive's variable long term incentive remuneration and the overall financial performance of the Group. However, given the position of the Group and its stage of development, the remuneration is aimed at retaining key individuals to ensure the success of current and future product development and successful commercialisation of products, which will in turn impact future profitability of the Group and shareholder wealth.

### Employment contracts

No executives have fixed term contracts with the Group. The company or the executive may terminate employment by providing four weeks written notice. On termination, any long term incentive plan (ESOP) options that have vested are available to be exercised. Any options that have not yet vested will be forfeited. The company may terminate employment at any time without notice if serious misconduct has occurred. Where termination with cause occurs the executive is only entitled to that portion of remuneration that is fixed, and only up to the date of termination. On termination with cause any unvested options will immediately be forfeited.

### Options granted during the year to key management personnel

Key management personnel	Granted No.	Grant Date	Fair value (\$)	Exercise price (\$)	Vested No.	Expiry Date
Banti F	650,000	29 May 2009	\$0.124	\$0.14	650,000	30 June 2018
Hodges A <sup>1</sup>	300,000	18 June 2009	\$0.095	\$0.15	-	18 June 2014
Gavin P <sup>1</sup>	300,000	18 June 2009	\$0.095	\$0.15	-	18 June 2014
<b>Totals</b>	<b>1,250,000</b>				<b>650,000</b>	

<sup>1</sup> vest 18 June 2010

All share options issued to key management personnel during the reporting period were in accordance with the provisions of the Employee Share Option Plan (ESOP), 50% have vested and none were forfeited.

### Remuneration of key management personnel

Aggregates	2009	2009	2008	2008
	Consolidated	Parent	Consolidated	Parent
	\$	\$	\$	\$
Short-Term Benefits	1,083,557	1,083,557	1,128,691	1,128,691
Post-Employment	89,581	89,581	120,077	120,077
Share Based Payment	137,125	137,125	212,812	212,812
<b>Totals</b>	<b>1,310,263</b>	<b>1,310,263</b>	<b>1,461,580</b>	<b>1,461,580</b>

## Directors' Report (continued)

### Remuneration of key management personnel (continued)

2009	Salary & Fees	Cash Bonus	Short – Term	Non monetary benefits	Other	Superannuation	Post-Employment Retirement benefits	Cash Incentives	Long Service Leave	Options	Share Based Payment	Total	Performance Related
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	%
<b>Non-executive directors</b>													
Vizard, A L	69,725	-	-	-	-	6,275	-	-	-	-	-	76,000	-
Addison, J L	34,862	-	-	-	-	3,138	-	-	-	-	-	38,000	-
Mills, J	34,862	-	-	-	-	3,138	-	-	-	-	-	38,000	-
Ashton, M R D	18,841	-	-	-	-	-	-	-	-	-	-	18,841	-
<b>Executive directors</b>													
Rosen, H	252,294	-	-	-	-	22,706	-	-	-	-	-	275,000	-
Ogru, E	206,422	-	-	-	-	18,578	-	-	-	-	-	225,000	-
<b>Key management personnel</b>													
Banti, F	211,409	-	-	-	-	-	-	-	-	80,321	-	291,730	-
Hodges, A	138,508	-	-	-	-	25,249	-	-	-	28,402	-	192,159	-
Gavin, P	116,634	-	-	-	-	10,497	-	-	-	28,402	-	155,533	-
<b>Totals</b>	<b>1,083,557</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>89,581</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>137,125</b>	<b>-</b>	<b>1,310,263</b>	<b>-</b>

## Directors' Report (continued)

### Remuneration of key management personnel (continued)

2008	Short – Term Salary & Fees	Cash Bonus	Non monetary benefits	Other	Post- employ- ment superan- uation	Refire- ment benefits	Cash Incentives	Long Service Leave	Share Based Payment Options	Shares	Total	Performance Related
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	%
<b>Non-executive directors</b>												
Vizard, A L	69,725	-	-	-	6,275	-	-	-	-	-	76,000	-
Addison, J L	34,862	-	-	-	3,138	-	-	-	-	-	38,000	-
Mills, J	34,862	-	-	-	3,138	-	-	-	-	-	38,000	-
Preston, M D	25,333	-	-	-	-	-	-	-	-	-	25,333	-
Ashton, M R D	18,841	-	-	-	-	-	-	-	-	-	18,841	-
<b>Executive directors</b>												
Rosen, H	277,293	-	-	-	24,866	-	-	-	-	-	302,159	-
Ogru, E	212,422	-	-	-	19,118	-	-	-	-	-	231,540	-
<b>Key management personnel</b>												
Banti, F	176,413	-	-	-	-	-	-	-	191,463	-	367,876	-
Hodges, A	122,324	-	-	-	31,009	-	-	-	16,012	-	169,345	-
McSwiggan, M	86,000	-	-	-	7,740	-	-	-	5,337	-	99,077	-
Chilton, M	19,884	-	-	-	20,227	-	-	-	-	-	40,111	-
Karanikolopoulos, K	50,732	-	-	-	4,566	-	-	-	-	-	55,298	-
<b>Totals</b>	<b>1,128,691</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>120,077</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>212,812</b>	<b>-</b>	<b>1,461,580</b>	<b>-</b>

## Directors' Report (continued)

### Option holdings of key management personnel

2009	01 Jan 09 Balance No.	Granted as remuneration No.	Options Exercised No.	Net other change No.	31 Dec 09 Balance No.	Vested No.	Not Vested No.
<b>Non Executive Directors</b>							
Vizard, A.L	1,200,000	-	-	(1,200,000) <sup>1</sup>	-	-	-
Addison, J.L	-	-	-	-	-	-	-
Mills, J	-	-	-	-	-	-	-
Ashton, M R D	-	-	-	-	-	-	-
<b>Executive Directors</b>							
Rosen, H	5,050,000	-	-	(5,050,000) <sup>1</sup>	-	-	-
Ogru, E	-	-	-	-	-	-	-
<b>Key Management Personnel</b>							
Banti, F	2,000,000	650,000	-	-	2,650,000	2,150,000	500,000
Hodges, A	300,000	300,000	-	-	600,000	300,000	300,000
Gavin, P	500,000	300,000	-	-	800,000	500,000	300,000
<b>Totals</b>	<b>9,050,000</b>	<b>1,250,000</b>	<b>-</b>	<b>(6,250,000)</b>	<b>4,050,000</b>	<b>2,950,000</b>	<b>1,100,000</b>

<sup>1</sup>Options quoted on the Australian Stock Exchange were issued as part of the original subscriptions for shares in Phosphagenics Ltd. These options expired on 7<sup>th</sup> June 2009.

2008	01 Jan 08 Balance No.	Granted as remuneration No.	Options Exercised No.	Net other change No.	31 Dec 08 Balance No.	Vested No.	Not Vested No.
<b>Non Executive Directors</b>							
Vizard, A.L	1,200,000	-	-	-	1,200,000	1,200,000	-
Addison, J.L	-	-	-	-	-	-	-
Mills, J	-	-	-	-	-	-	-
Preston, M.D	-	-	-	-	-	-	-
Ashton, M R D	-	-	-	-	-	-	-
<b>Executive Directors</b>							
Rosen, H	5,050,000	-	-	-	5,050,000	5,050,000	-
Ogru, E	-	-	-	-	-	-	-
<b>Key Management Personnel</b>							
Banti, F	-	2,000,000	-	-	2,000,000	500,000	1,500,000
Hodges, A	-	300,000	-	-	300,000	-	300,000
McSwiggan, M	200,000	100,000	-	-	300,000	200,000	100,000
West, S.M	2,675,000	-	-	-	2,675,000	2,675,000	-
Chilton, M	500,000	-	-	-	500,000	500,000	-
Karanikolopoulos, K	400,000	-	-	(400,000)	-	-	-
<b>Totals</b>	<b>10,025,000</b>	<b>2,400,000</b>	<b>-</b>	<b>(400,000)</b>	<b>12,025,000</b>	<b>10,125,000</b>	<b>1,900,000</b>

All options granted to key management personnel have been issued in accordance with the provisions of the Employee Share Option Plan (ESOP).

## Directors' Report (continued)

### Shareholdings of Key Management Personnel

2009	01 Jan 09 Balance No.	Granted as remuneration No.	Received on exercise of options No.	Net other change No.	31 Dec 09 Balance No.
<b>Non Executive</b>					
<b>Directors</b>					
Vizard, A.L	123,411	-	-	54,347 <sup>1</sup>	177,758
Addison, J.L	19,000	-	-	-	19,000
Mills, J	476,667	-	-	217,390 <sup>1</sup>	694,057
Ashton, M R D	100,000	-	-	163,043 <sup>1</sup>	263,043
<b>Executive Directors</b>					
Rosen, H	64,226,436	-	-	-	64,226,436
Ogru, E	5,711,610	-	-	-	5,711,610
<b>Key Management Personnel</b>					
Banti, F	-	-	-	-	-
Hodges, A	52,420	-	-	-	52,420
Gavin, P	99,000	-	-	-	99,000
<b>Totals</b>	<b>70,808,544</b>	<b>-</b>	<b>-</b>	<b>434,780</b>	<b>71,243,324</b>

<sup>1</sup>During the reporting period shares issued to A Vizard, J. Mills and M. Ashton resulted from their participation in the Share Purchase Plan.

2008	01 Jan 08 Balance No.	Granted as remuneration No.	Received on exercise of options No.	Net other change No.	31 Dec 08 Balance No.
<b>Non Executive</b>					
<b>Directors</b>					
Vizard, A.L	123,411	-	-	-	123,411
Addison, J.L	19,000	-	-	-	19,000
Mills, J	302,667	-	-	174,000	476,667
Preston, M.D	2,172,659	-	-	(2,172,659)	-
Ashton, M R D	-	-	-	100,000	100,000
<b>Executive Directors</b>					
Rosen, H	64,176,436	-	-	50,000	64,226,436
Ogru, E	5,711,610	-	-	-	5,711,610
<b>Key Management Personnel</b>					
Banti, F	-	-	-	-	-
Hodges, A	-	-	-	52,420	52,420
McSwiggan, M	20,000	-	-	7,500	27,500
West, S.M	50,242,658	-	-	-	50,242,658
Chilton, M	100,000	-	-	(100,000)	-
Karanikolopoulos, K	-	-	-	-	-
<b>Totals</b>	<b>122,868,441</b>	<b>-</b>	<b>-</b>	<b>(1,888,739)</b>	<b>120,979,702</b>

## Directors' Report (continued)

### NON-AUDIT SERVICES

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are outlined in note 6 to the financial statements.

### AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration is included on page 15 of the financial report.

### CHANGES IN STATE OF AFFAIRS

During the financial year there was no significant change in the state of affairs of the consolidated entity other than that referred to in the financial statements or notes thereto.

### SUBSEQUENT EVENTS

There has not been any matter or circumstance, other than that referred to in the financial statements or notes thereto, that has arisen since the end of the financial year, that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

Signed in accordance with a resolution of the Directors made pursuant to s.298(2) of the *Corporations Act 2001*.



Andrew Lancelot Vizard  
Chairman

19 February 2010  
Melbourne



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## Auditor's Independence Declaration to the Directors of Phosphagenics Limited

In relation to our audit of the financial report of Phosphagenics Limited for the financial year ended 31 December 2009, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

A handwritten signature in blue ink that reads 'Ernst &amp; Young'.

Ernst & Young

A handwritten signature in blue ink that reads 'Don Brumley'.

Don Brumley  
Partner  
19 February 2010

# Corporate Governance Statement

## CORPORATE GOVERNANCE PRACTICES AND CONDUCT

The board of directors of Phosphagenics Limited is responsible for establishing the corporate governance framework of the Group having regard to the ASX Corporate Governance Council (CGC) published guidelines as well as its corporate governance principles and recommendations. The board guides and monitors the business and affairs of Phosphagenics Limited on behalf of the shareholders by whom they are elected and to whom they are accountable.

The table below summarises the Company's compliance with the CGS's recommendations.

Principle	Recommendation	Comply Yes/No	Reference/explanation	ASX Listing Rule/ Recommendation
<b>1</b>	<b>Lay solid foundations for management and oversight</b>			
1.1	Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.	Yes	Page 20	ASX LR 1.1
1.2	Companies should disclose the process for evaluating the performance of senior executives.	Yes	Page 22	ASX LR 1.2
1.3	Companies should provide the information indicated in the guide to reporting on Principle 1.	Yes		ASX LR 1.3
<b>2</b>	<b>Structure the board to add value</b>			
2.1	A majority of the board should be independent directors.	Yes	Page 20	ASX LR 2.1
2.2	The chair should be an independent director.	Yes	Page 20	ASX LR 2.2
2.3	The roles of chair and chief executive officer should not be exercised by the same individual.	Yes	Page 20	ASX LR 2.3
2.4	The board should establish a nomination committee.	No	Page 21	ASX LR 2.4
2.5	Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.	Yes	Page 9, 22	ASX LR 2.5
2.6	Companies should provide the information indicated in the guide to reporting on Principle 2.	Yes		ASX LR 2.6
<b>3</b>	<b>Promote ethical and responsible decision-making</b>			
3.1	Companies should establish a code of conduct and disclose the code or a summary of the code as to: _ The practices necessary to maintain confidence in the company's integrity. _ The practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders. _ The responsibility and accountability of individuals for reporting and investigating reports of unethical practices.	Yes	Website	ASX LR 3.1
3.2	Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.	Yes	Page 22	ASX LR 3.2
3.3	Companies should provide the information indicated in the guide to reporting on Principle 3	Yes		ASX LR 3.3

Principle	Recommendation	Comply Yes/No	Reference/explanation	ASX Listing Rule/ Recommendation
<b>4</b>	<b>Safeguard integrity in financial reporting</b>			
4.1	The board should establish an audit committee.	Yes	Page 22	ASX LR 4.1
4.2	The audit committee should be structured so that it: - Consists only of non-executive directors - Has at least three members - Consists of a majority of independent directors - Is chaired by an independent chair, who is not chair of the board	Yes	Page 22	ASX LR 4.2 ASX LR 12.7
4.3	The audit committee should have a formal charter.	Yes	Page 22	ASX LR 4.3
4.4	Companies should provide the information indicated in the Guide to reporting on Principle 4.	Yes		ASX LR 4.4
<b>5</b>	<b>Make timely and balanced disclosure</b>			
5.1	Companies should establish written policies designed to ensure compliance with ASX listing rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.	Yes	Page 22	ASX LR 5.1
5.2	Companies should provide the information indicated in the guide to reporting on Principle 5.	Yes		ASX LR 5.2
<b>6</b>	<b>Respect the rights of shareholders</b>			
6.1	Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.	Yes	Page 24	ASX LR 6.1
6.2	Companies should provide the information indicated in the guide to reporting on Principle 6.	Yes		ASX LR 6.2
<b>7</b>	<b>Recognise and manage risk</b>			
7.1	Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.	Yes	Page 23	ASX LR 7.1
7.2	The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks	Yes	Page 22 & 23	ASX LR 7.2
7.3	The board should disclose whether it has received assurance from the chief executive officer [or equivalent] and the chief financial officer [or equivalent] that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.	Yes	Page 24	ASX LR 7.3
7.4	Companies should provide the information indicated in the guide to reporting on Principle 7.	Yes		ASX LR 7.4
<b>8</b>	<b>Remunerate fairly and responsibly</b>			
8.1	The board should establish a remuneration committee.	Yes	Page 24	ASX LR 8.1
8.2	Companies should clearly distinguish the structure of nonexecutive directors' remuneration from that of executive directors and senior executives.	Yes	Page 9 & 24	ASX LR 8.2
8.3	Companies should provide the information indicated in the Guide to reporting on Principle 8.	Yes		ASX LR 8.3

## Corporate Governance Statement (continued)

The Companies corporate governance practices were in place throughout the year ended 31 December 2009.

### Board functions

The board seeks to identify the expectations of the shareholders, as well as other regulatory and ethical expectations and obligations. In addition, the board is responsible for identifying areas of significant business risk and ensuring arrangements are in place to adequately manage those risks. To ensure that the board is well equipped to discharge its responsibilities it has established guidelines for the nomination and selection of directors and for the operation of the board. The responsibility for the operation and administration of the Group is delegated, by the board, to the Chief Executive Officer and the executive management team. The board ensures that this team is appropriately qualified and experienced to discharge their responsibilities and has in place procedures to assess the performance of the Chief Executive Officer and the executive management team. Whilst at all times the board retains full responsibility for guiding and monitoring the Group, in discharging its stewardship it makes use of sub-committees. Specialist committees are able to focus on a particular responsibility and provide informed feedback to the board. To this end the board has established Share Allotment and Audit, Compliance and Corporate Governance Committees.

The Directors in office at the date of this statement, their skills, experience, expertise and period of directorship are detailed in the Directors' Report. In respect of the attendance at Board and Committee Meetings, shareholders are referred to the table of Meeting Attendance contained on page 8.

### Structure of the Board

The skills, experience and expertise relevant to the position of director held by each director in office at the date of the annual report are included in the directors' report. Directors of Phosphagenics Limited are considered to be independent when they are independent of management and free from 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 the context of director independence, "materiality" is considered from both the Group and individual director perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal to or less than 5% of the appropriate base amount. It is presumed to be material (unless there is qualitative evidence to the contrary) if it is equal to or greater than 10% of the appropriate base amount. Qualitative factors considered include whether a relationship is strategically important, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors that point to the actual ability of the director in question to shape the direction of the Group's loyalty.

In accordance with the definition of independence above, and the materiality thresholds set, the following directors of Phosphagenics Limited are considered to have the following status:

Name	Position and status	Term in Office
<b>Non-executive directors</b>		
Vizard, A L	Chairman and Independent Director	10 years
Addison, J L	Independent Director	7 years
Mills, J	Independent Director	5 years
Ashton, M R D	Independent Director	1 year
<b>Executive directors</b>		
Rosen, H	Chief Executive Officer	10 years
Ogru, E	Chief Operating Officer	4 years

The board recognises the Corporate Governance Council's recommendation that the Chair should be an independent director.

## Corporate Governance Statement (continued)

### *Composition of the Board*

The Company's Constitution provides for the appointment of a minimum of three Directors and up to a maximum of eight. At the date of this report, the Company has six Directors comprising two Executive and four Non-Executive Directors. The Chairman of the Board and the Chairman of the Board's Committees' are Non-Executive Directors.

In November 2009 the Board of Directors undertook a review of the status of each Director and reached the opinion that each Director, apart from Mr Rosen and Dr Ogru, could be classified as a Non-Executive Director. In addition, this assessment has concluded Prof. A Vizard, Prof. J. Mills, Mr Addison and Mr Ashton qualified as Independent Directors.

### **Board Responsibilities**

The responsibility for the operation and administration of the Company is delegated by the Board to the specifically identified outsourced service providers. The Board ensures that this team of service providers is appropriately qualified and experienced to discharge their responsibilities and has in place procedures to assess their performance.

The Board is responsible for ensuring that management's objectives and activities are aligned with the expectations and risks identified by the Board. The Board has a number of mechanisms in place to ensure this is achieved. In addition to the establishment of specific committees referred in this statement, these mechanisms include the following:

- Implementation of operating plans and budgets by management and Board monitoring of progress against budget – this includes the establishment and monitoring of key performance indicators (both financial and non-financial) for all significant business processes;
- Procedures to allow Directors, in the furtherance of their duties, to seek independent professional advice at the company's expense;
- The review and approval of acquisitions and disposals of businesses and assets, and the approval of contracts and financing arrangements within defined limits; and
- The appointment of an outsourced service provider, which is responsible for managing the Company's public image and communication with shareholders.

In conjunction with an ongoing review of the Board Charter, the Board will consider its responsibilities and delegated authorities to ensure they comply with best practice corporate governance.

### *Nomination and Membership*

Subject to the provisions of the Company's Constitution, Board composition and selection criteria for Directors are addressed by the full Board. Accordingly, a Nomination and Membership Committee has not been established.

The Constitution provides for events whereby Directors may be removed from the Board. Similarly shareholders have the ability to nominate, appoint and remove Directors. The Constitution also provides for the regular rotation of Directors, which ensures that Directors seek re-election by shareholders at least once every three years.

### *Independent Professional Advice*

Directors, in carrying out their duties as Directors or as members of Board Committees, may, after prior consultation with the Chairman, seek independent professional advice at the expense of the Company. If appropriate, such advice will be available to all Directors.

## Corporate Governance Statement (continued)

### *Timely and Balanced Disclosure*

The Board of Directors has established written policies and procedures designed to ensure compliance and at each meeting of the Board of Directors and specifically monitors the Company's activities and disclosures. On average there are between six and ten Board meetings a year. The Board of Directors has endorsed the principles of best corporate governance practice as set out by the Council.

### *Performance*

The performance of the board and key executives is reviewed periodically against both measurable and qualitative indicators. The performance criteria against which directors and executives are assessed are aligned with the financial and non-financial objectives of Phosphagenics Limited.

### **Trading Policy**

Under the Company's Securities Trading Policy, an executive or director must not trade in any securities of the Company at any time when they are in possession of unpublished, price-sensitive information in relation to those securities. The Directors are permitted to deal in securities in which they have a relevant interest without restriction for any period other than the last day in each half or full year reporting period until two business days after the release to the ASX of the announcements by the Company of its full year or half year results. Directors are required to wait at least two business days after the release of any market sensitive announcement by the Company so that the market has had time to absorb the information.

As required by the ASX listing rules, the Company notifies the ASX of any transaction conducted by directors in the securities of the Company.

### **Board of Directors and its Committees**

The Board of Directors is responsible for the overall governance of the Company inclusive of its strategic development and the direction and the control of operations of the Company. Whilst the Board retains overall responsibility, it has established certain committees to assist in carrying out its responsibilities. Such committees include the audit, compliance and corporate governance committee and the share allotment committee.

### *Audit, Compliance and Corporate Governance Committee*

It is the board's responsibility to ensure that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators.

The board has delegated responsibility for establishing and maintaining a framework of internal control and ethical standards to the audit, compliance and corporate governance committee. The committee also provides the board with additional assurance regarding the reliability of financial information. A committee charter has been approved by the board.

The committee, as at the date of this statement, comprises three Non-Executive Independent Directors; Mr J Addison (Chairman), Prof. A Vizard and Prof. J Mills. The Company's Auditors are invited to attend meetings and to participate in committee discussions. The Group CFO and Company Secretary attend committee meetings.

## Corporate Governance Statement (continued)

The duties of the Committee include:

- The review of the Audit Programme and all matters relevant to the financial affairs of the Company's activities together with the production of Statutory Financial Reports inclusive of the Reports and Declarations by Directors.
- To review and advise on procedures in place to record the Company's activities and to ensure the safety of the Company's records and assets.
- To review Internal Control Procedures and the Auditor's Management letter.
- To review the half-yearly and yearly reports to the ASX Limited together with a review of the scope and quality of the annual statutory audit and the half-year audit review.
- To monitor Compliance with the provisions of the *Corporations Act 2001*, Australian Securities and Investment Commission guidelines and practice notes, ASX Listing Rules, taxation requirements and all regulatory bodies.
- Carry out the functions of the Remuneration Committee.
- Group Risk management

### *Share Allotment Committee*

Any two Directors will constitute a quorum for this committee, which deals with the allotment of new shares or grant or exercise of options.

### **Internal Control Framework and Ethical Standards**

The Board of Directors seeks to identify the expectations of shareholders as well as other regulatory and ethical expectations and obligations.

These matters are undertaken by the full Board together with the audit, compliance and corporate governance committee. In respect of the ethical standards, the full Board regularly discusses the maintenance by the Company of appropriate ethical standards in line with the Council's recommendations.

### **Risk**

The board acknowledges the Revised Supplementary Guidance to Principle 7 issued by the ASX in June 2008 and has continued its proactive approach to risk management. The identification and effective management of risk, including calculated risk-taking is viewed as an essential part of the company's approach to creating long-term shareholder value.

In recognition of this, the Board determines the company's risk profile and is responsible for overseeing and approving risk management strategy. The audit, compliance and corporate governance committee reviews policies, internal compliance and internal control.

The audit, compliance and corporate governance committee oversees the assessment of the effectiveness of risk management and internal compliance and control. The tasks of undertaking and assessing risk management and internal control effectiveness are delegated to management through the Chief Executive Officer and Chief Financial Officer, including responsibility for the day to day design and implementation of the company's risk management and internal control system.

Management reports to the audit, compliance and corporate governance committee on the company's key risks and the extent to which it believes these risks are being adequately managed. The reporting on risk by management is a standing agenda item at monthly Board meetings.

## Corporate Governance Statement (continued)

### *Business Risk*

The main areas of business risk, which are considered on an ongoing basis by the Board are;

- Failure to develop commercial products from the company's research and development
- Ability to raise capital or generate free cash flow to fund future research and development activities
- Failure to market the company's products
- General economic factors including those affecting interest and exchange rates
- Changes in Corporations and Taxation Law

### **CEO and CFO certification**

In accordance with section 295A of the *Corporations Act*, the Chief Executive Officer and Chief Financial Officer have provided a written statement to the board that:

- Their view provided on the Company's financial report is founded on a sound system of risk management and internal compliance and control which implements the financial policies adopted by the board
- The Company's risk management and internal compliance and control system is operating effectively in all material respects

The board agrees with the views of the ASX on this matter and notes that due to its nature, internal control assurance from the Chief Executive Officer and Chief Financial Officer can only be reasonable rather than absolute. This is due to such factors as the need for judgement, the use of testing on a sample basis, the inherent limitations in internal control and because much of the evidence available is persuasive rather than conclusive and therefore is not and cannot be designed to detect all weaknesses in control procedures. In response to this, internal control questions are required to be completed by the key management personnel in support of these written statements.

### **Remuneration**

The Board is responsible for determining and reviewing compensation arrangements for the directors themselves, the Chief Executive Officer and executive team. A Compensation (Remuneration) Committee has not been separately established, rather the function is performed by the Audit, Compliance and Corporate Governance Committee.

It is the Company's objective to provide maximum stakeholder benefit from the retention of a high quality Board and executive team by remunerating directors and key executives fairly and appropriately with reference to relevant employment market conditions. For a full discussion of the Company's remuneration philosophy and framework and the remuneration received by directors and executives in the current period please refer to the remuneration report, which is contained within the directors' report.

### **Shareholder communication policy**

Phosphagenics's objective is to promote effective communication with its shareholders at all times. Phosphagenics Limited is committed to:

- Ensuring that shareholders and the financial markets are provided with full and timely information about Phosphagenics's activities in a balanced and understandable way.
- Complying with continuous disclosure obligations contained in applicable the ASX listing rules and the Corporations Act in Australia.
- Communicating effectively with its shareholders and making it easier for shareholders to communicate with Phosphagenics Limited.

## Corporate Governance Statement (continued)

To promote effective communication with shareholders and encourage effective participation at general meetings, information is communicated to shareholders:

- Through the release of information to the market via the ASX
- Through the distribution of the annual report and Notices of Annual General Meeting
- Through shareholder meetings and investor relations presentations
- Through letters and other forms of communications directly to shareholders
- By posting relevant information on Phosphagenics website [www.phosphagenics.com](http://www.phosphagenics.com).

The Company's website [www.phosphagenics.com](http://www.phosphagenics.com) has a dedicated Investor Relations section for the purpose of publishing all important company information and relevant announcements made to the market. The Company has also established an e-mail directory for the direct distribution of announcements made to the ASX.

The external auditors are required to attend the Annual General Meeting and are available to answer any shareholder questions about the conduction of the audit and preparation of the audit report.

Annual Reports are provided to all share and option holders who have elected to receive the Report.

At the meetings of shareholders, Directors are subject to questioning by shareholders about the Directors' stewardship of the Company's affairs and it is shareholders who ultimately vote upon the financial statements and reports, the election of Directors, appointment of Auditors and any matters of Special Business.

Signed in accordance with a resolution of the Directors.



Andrew Lancelot Vizard  
Chairman

19 February 2010  
Melbourne

## Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2009	Note	CONSOLIDATED		PARENT	
		2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>Revenue</b>					
Sale of goods		670	446	-	-
Income from government grants		304	1,354	-	-
Royalties		-	539	-	-
Finance revenue		430	913	418	867
<b>Total revenue</b>		<b>1,404</b>	<b>3,252</b>	<b>418</b>	<b>867</b>
Cost of sales		(228)	(115)	-	-
<b>Gross profit</b>		<b>1,176</b>	<b>3,137</b>	<b>418</b>	<b>867</b>
Rental revenue	3a	113	113	113	113
Other income	3a	197	708	197	708
Employee and Directors benefits expenses		(3,504)	(2,815)	(1,334)	(1,528)
Occupancy and communications expenses		(242)	(245)	(131)	(131)
Consulting and professional expenses		(961)	(934)	(567)	(612)
Administration expenses		(516)	(611)	(410)	(495)
Research expenses		(3,450)	(6,389)	-	-
Impairment of acquired intangible assets		-	(69,300)	-	-
Impairment of investment in subsidiary		-	-	-	(69,300)
Impairment of goodwill		-	(34,261)	-	-
Impairment of intercompany loan		-	-	(743)	-
Other expenses	3b	(1,314)	(1,399)	(579)	(543)
Loss before income tax		(8,501)	(111,996)	(3,036)	(70,921)
Income tax benefit	4	-	20,790	-	-
Loss after income tax		(8,501)	(91,206)	(3,036)	(70,921)
<b>Other Comprehensive Income</b>					
Foreign currency translation	15	(18)	47	-	-
Income tax/(expense) on items of other comprehensive income		-	-	-	-
<b>Other comprehensive income for the period, net of tax</b>	15	<b>(18)</b>	<b>47</b>	<b>-</b>	<b>-</b>
<b>Total comprehensive income for the period</b>		<b>(8,519)</b>	<b>(91,159)</b>	<b>(3,036)</b>	<b>(70,921)</b>
<b>Earnings per share for loss from continuing operations attributable to the ordinary equity holders of the parent:</b>					
Basic (cents per share)	16	(1.26)	(14.21)	(0.35)	(11.05)
Diluted (cents per share)	16	(1.26)	(14.21)	(0.35)	(11.05)

The above Statement of comprehensive income should be read in conjunction with the accompanying notes

## Statement of financial position

AS AT 31 DECEMBER 2009	Note	CONSOLIDATED		PARENT	
		2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>ASSETS</b>					
<b>CURRENT ASSETS</b>					
Cash and cash equivalents	21a	10,868	12,896	10,759	12,097
Trade and other receivables	7	292	232	132	122
Inventories	8	58	212	-	-
Prepayments		329	170	217	170
<b>TOTAL CURRENT ASSETS</b>		<b>11,547</b>	<b>13,510</b>	<b>11,108</b>	<b>12,389</b>
<b>NON-CURRENT ASSETS</b>					
Other receivables	7	-	-	23,886	18,656
Investment in subsidiary	9	-	-	27,111	27,111
Plant and equipment	10	1,445	1,761	65	119
Intangible assets	11	54,372	53,918	-	-
<b>TOTAL NON-CURRENT ASSETS</b>		<b>55,817</b>	<b>55,679</b>	<b>51,062</b>	<b>45,886</b>
<b>TOTAL ASSETS</b>		<b>67,364</b>	<b>69,189</b>	<b>62,170</b>	<b>58,275</b>
<b>LIABILITIES</b>					
<b>CURRENT LIABILITIES</b>					
Trade and other payables	12	1,151	1,432	328	372
Provisions	13	96	76	96	76
<b>TOTAL CURRENT LIABILITIES</b>		<b>1,247</b>	<b>1,508</b>	<b>424</b>	<b>448</b>
<b>NON-CURRENT LIABILITIES</b>					
Deferred tax liability	4	16,128	16,128	-	-
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>16,128</b>	<b>16,128</b>	<b>-</b>	<b>-</b>
<b>TOTAL LIABILITIES</b>		<b>17,375</b>	<b>17,636</b>	<b>424</b>	<b>448</b>
<b>NET ASSETS</b>		<b>49,989</b>	<b>51,553</b>	<b>61,746</b>	<b>57,827</b>
<b>EQUITY</b>					
Contributed Equity	14	176,905	170,316	176,905	170,316
Reserves	15	28,833	28,485	992	626
Accumulated losses		(155,749)	(147,248)	(116,151)	(113,115)
<b>TOTAL EQUITY</b>		<b>49,989</b>	<b>51,553</b>	<b>61,746</b>	<b>57,827</b>

The above Statement of financial position should be read in conjunction with the accompanying notes

## Statement of cash flow

FOR THE YEAR ENDED 31 DECEMBER 2009	Note	CONSOLIDATED		PARENT	
		2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Receipts from customers		726	3,803	158	984
Receipt of government grants		334	1,489	-	-
Payments to suppliers and employees		(10,023)	(12,524)	(2,525)	(3,189)
Net cash used in operating activities	21(b)	(8,963)	(7,232)	(2,367)	(2,205)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Interest received		423	876	415	825
Purchase of plant and equipment		(76)	(235)	(2)	(30)
Net cash from investing activities		347	641	413	795
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Proceeds from issues of shares	14	6,589	8,772	6,589	8,772
Loan to subsidiary		-	-	(5,973)	(4,565)
Net cash from financing activities		6,589	8,772	616	4,207
Net increase/(decrease) in cash and cash equivalents		(2,027)	2,181	(1,338)	2,797
Cash and cash equivalents at the beginning of period		12,896	10,715	12,097	9,300
<b>CASH AND CASH EQUIVALENTS AT THE END OF PERIOD</b>	21(a)	10,869	12,896	10,759	12,097

The above Statement of cash flows statement should be read in conjunction with the accompanying notes

## Statement of Changes in Equity

Consolidated	Contributed Equity	Employee Benefits Reserve	Revaluation & Foreign Currency Translation Reserve	Accumulated Losses	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Balance at 1 January 2009</b>	170,316	626	27,859	(147,248)	51,553
Total comprehensive income for the period	-	-	(18)	(8,501)	(8,519)
<b>Transactions with owners in their capacity as owners:</b>					
Issue of shares	7,014	-	-	-	7,014
Transaction costs on share issue	(425)	-	-	-	(425)
Employee equity settlement benefits	-	366	-	-	366
<b>Balance at 31 December 2009</b>	<b>176,905</b>	<b>992</b>	<b>27,841</b>	<b>(155,749)</b>	<b>49,989</b>
<b>Balance at 1 January 2008</b>	161,544	448	27,812	(56,042)	133,762
Total comprehensive income for the period	-	-	47	(91,206)	(91,159)
<b>Transactions with owners in their capacity as owners:</b>					
Issue of shares	9,015	-	-	-	9,015
Transaction costs on share issue	(243)	-	-	-	(243)
Employee equity settlement benefits	-	178	-	-	178
<b>Balance at 31 December 2008</b>	<b>170,316</b>	<b>626</b>	<b>27,859</b>	<b>(147,248)</b>	<b>51,553</b>

The above Statement of changes in equity should be read in conjunction with the accompanying notes.

## Statement of Changes in Equity (continued)

Parent	Contributed Equity \$'000	Employee Benefits Reserve \$'000	Revaluation & Foreign Currency Translation Reserve \$'000	Accumulated Losses \$'000	Total \$'000
<b>Balance at 1 January 2009</b>	170,316	626	-	(113,115)	57,827
Total comprehensive income for the period	-	-	-	(3,036)	(3,036)
<b>Transactions with owners in their capacity as owners:</b>					
Issue of shares	7,014	-	-	-	7,014
Transaction costs on share issue	(425)	-	-	-	(425)
Employee equity settlement benefits	-	366	-	-	366
<b>Balance at 31 December 2009</b>	<b>176,905</b>	<b>992</b>	<b>-</b>	<b>(116,151)</b>	<b>61,746</b>
<b>Balance at 1 January 2008</b>	161,544	448	-	(42,194)	119,798
Total comprehensive income for the period	-	-	-	(70,921)	(70,921)
<b>Transactions with owners in their capacity as owners:</b>					
Issue of shares	9,015	-	-	-	9,015
Transaction costs on share issue	(243)	-	-	-	(243)
Employee equity settlement benefits	-	178	-	-	178
<b>Balance at 31 December 2008</b>	<b>170,316</b>	<b>626</b>	<b>-</b>	<b>(113,115)</b>	<b>57,827</b>

The above Statement of changes in equity should be read in conjunction with the accompanying notes.

# Notes to the Financial Statements

YEAR ENDED 31 DECEMBER 2009

## 1. CORPORATE INFORMATION

The financial report of Phosphagenics Limited for the year ended 31 December 2009 was authorised for issue in accordance with a resolution of the Directors on 19<sup>th</sup> February 2010.

Phosphagenics Limited (the parent) is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange (“ASX”).

The nature of the operations and principal activities of the Group are described in the directors' report.

The number of employees at 31 December 2009 is 30 (2008:24)

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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### **Basis of Preparation of the financial report**

The financial report is a general-purpose financial report, which has been prepared in accordance with the requirements of the *Corporations Act 2001* and Australian Accounting Standards. The financial report has also been prepared on a historical cost basis.

The financial report is presented in Australian dollars and all values are rounded to the nearest thousand dollars (\$'000) unless otherwise stated.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (a) Statement of Compliance

The financial report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

### (b) New Accounting Standards and Interpretations

#### *Changes in accounting policy and disclosures*

The accounting policies adopted are consistent with those of the previous financial year except as follows: The Group has adopted the following new and amended Australian Accounting Standards and AASB Interpretations as of 1 January 2009.

- AASB 2008-1 *Amendments to Australian Accounting Standard - Share-based Payments: Vesting Conditions and Cancellations* effective 1 January 2009
- AASB 7 *Financial Instruments: Disclosures* effective 1 January 2009
- AASB 8 *Operating Segments* effective 1 January 2009
- AASB 101 *Presentation of Financial Statements (revised 2007)* effective 1 January 2009
- AASB 2008-1 *Amendments to Australian Accounting Standard – Share-based Payment: Vesting Conditions and Cancellations [AASB 2]* effective 1 January 2009
- AASB 2008-5 *Amendments to Australian Accounting Standards arising from the Annual Improvements Project* effective 1 January 2009

When the adoption of the Standard or Interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below:

#### *AASB 8 Operating Segments*

AASB 2 replaced AASB 114 Segment Reporting upon its effective date. The Group concluded that the operating segments determined in accordance with AASB 8 are the same as the business segments previously identified under AASB 114. AASB 8 disclosures are shown in note 18, including the related revised comparative information.

#### *AASB 101 Presentation of Financial Statements*

The revised Standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity and included in the new statement of comprehensive income. The statement of comprehensive income presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present one statement.

#### *Accounting Standards and Interpretations issued but not yet effective.*

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet effective and have not been adopted by the Group for the annual reporting period ending 31 December 2009, outlined in the table below:

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 127 (Revised)	Consolidated and Separate Financial Statements	There are a number of changes arising from the revision to AASB 127 relating to changes in ownership interest in a subsidiary without loss of control, allocation of losses of a subsidiary and accounting for the loss of control of a subsidiary. Specifically in relation to a change in the ownership interest of a subsidiary (that does not result in loss of control) – such a transaction will be accounted for as an equity transaction. Amending Standard issued as a consequence of revisions to AASB 3 and AASB 127. Refer above.	1 July 2009	If the Group changes its ownership interest in existing subsidiaries in the future, the change will be accounted for as an equity transaction. This will have no impact on goodwill, nor will it give rise to a gain or loss in the Group's statement of comprehensive income.	1 January 2010
AASB 2008 -3	Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127		1 July 2009	Refer to AASB 127 (Revised) above	1 January 2010
AASB 2008 -6	Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project	This was the second omnibus of amendments issued by the IASB arising from the Annual Improvements Project.	1 July 2009	Refer to AASB 20085 below	1 January 2010

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 2009-4	Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 2 and AASB 138 and AASB Interpretations 9 & 16]	<p>This Standard makes amendments to Australian Accounting Standards AASB 2 Share-based Payment and AASB 138 Intangible Assets and AASB Interpretations 9 Reassessment of Embedded Derivatives and 16 Hedges of a Net Investment in a Foreign Operation. These amendments are as a consequence of the annual improvements project. The amendments to some Standards result in accounting changes for presentation, recognition or measurement purposes, while some amendments that relate to terminology and editorial changes are expected to have no or minimal effect on accounting.</p> <p>The main amendment of relevance to Australian entities is that made to Interpretation 16 which allows qualifying hedge instruments to be held by any entity or entities within the group, including the foreign operation itself, as long as the designation, documentation and effectiveness requirements in AASB 139 that relate to a net investment hedge are satisfied. More hedging relationships will be eligible for hedge accounting as a result of the amendment</p>	1 July 2009	These amendments are not expected to have any impact on the Group's financial report as the Group does not have any embedded derivatives or hedges of a net investment in a foreign operation.	1 January 2010

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 2009-5	Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 5, 8, 101, 107, 117, 118, 136 & 139]	<p>The amendments to some Standards result in accounting changes for presentation, recognition or measurement purposes, while some amendments that relate to terminology and editorial changes are expected to have no or minimal effect on accounting except for the following:</p> <p>The amendment to AASB 117 removes the specific guidance on classifying land as a lease so that only the general guidance remains. Assessing land leases based on the general criteria may result in more land leases being classified as finance leases and if so, the type of asset which is to be recorded (intangible vs. property, plant and equipment) needs to be determined.</p> <p>The amendment to AASB 101 stipulates that the terms of a liability that could result, at anytime, in its settlement by the issuance of equity instruments at the option of the counterparty do not affect its classification.</p> <p>The amendment to AASB 107 explicitly states that only expenditure that results in a recognised asset can be classified as a cash flow from investing activities.</p> <p>The amendment to AASB 118 provides additional guidance to determine whether an entity is acting as a principal or as an agent. The features indicating an entity is acting as a principal are whether the entity:</p> <ul style="list-style-type: none"> <li>▶ has primary responsibility for providing the goods or service;</li> <li>▶ has inventory risk;</li> <li>▶ has discretion in establishing prices;</li> <li>▶ bears the credit risk.</li> </ul>	1 January 2010	Some of these amendments may have an impact on the Group, however the Group has not yet assessed the impact.	1 January 2010

PHOSPHAGENICS LIMITED – FINANCIAL REPORT

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 2009-5 (cont)	Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 5, 8, 101, 107, 117, 118, 136 & 139]	<p>The amendment to AASB 136 clarifies that the largest unit permitted for allocating goodwill acquired in a business combination is the operating segment, as defined in IFRS 8 before aggregation for reporting purposes.</p> <p>The main change to AASB 139 clarifies that a prepayment option is considered closely related to the host contract when the exercise price of a prepayment option reimburses the lender up to the approximate present value of lost interest for the remaining term of the host contract.</p> <p>The other changes clarify the scope exemption for business combination contracts and provide clarification in relation to accounting for cash flow hedges.</p> <p>These comprise editorial amendments and are expected to have no major impact on the requirements of the amended pronouncements.</p>	1 July 2009	Some of these amendments may have an impact on the Group, however the Group has not yet assessed the impact.	1 January 2010
AASB 2009-7	Amendments to Australian Accounting Standards [AASB 5, 7, 107, 112, 136 & 139 and Interpretation 17]			Some of these amendments may have an impact on the Group, however the Group has not yet assessed the impact.	

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) Basis of consolidation

The consolidated financial statements comprise the financial statements of Phosphagenics Limited and its subsidiaries as at and for the period ended 31 December each year ('the Group').

Subsidiaries are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether a group controls another entity.

The financial statements of subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full.

Investments in subsidiaries held by Phosphagenics Limited are accounted for at cost in the separate financial statements of the parent entity less any impairment charges.

### (d) Operating Segments – refer note 18

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance and for which discrete financial information is available. Management will also consider other factors in determining operating segments such as the existence of a line manager and the level of segment information presented to the board of directors.

Operating segments that meet the quantitative criteria as prescribed by AASB 8 are reported separately. However, an operating segment that does not meet the quantitative criteria is still reporting separately where information about the segment would be useful to users of the financial statements.

Information about other business activities and operating segments that are below the quantitative criteria are combined and disclosed in a separate category for "all other segments".

### (e) Significant accounting judgements, estimates and assumptions

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

#### *Impairment of Goodwill and intangibles with indefinite useful lives*

The Group determines whether goodwill and intangible assets with indefinite useful lives are impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash-generating unit to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill and intangibles with indefinite useful lives are discussed in note 11.

#### *Share-based payment transactions*

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using the Binomial method taking into account the terms and conditions upon which the instruments were granted, as discussed in note 5. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liabilities with the next annual reporting period but may impact expenses and equity.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Operating lease commitments*

The Group has entered into commercial property leases for premises used for research and development, manufacturing and operating activities. The Group has classified the leases as operating leases as the lessor retains all of the risks and rewards of ownership.

### *Impairment of non-financial assets other than goodwill*

The Group assesses impairment of all assets at each reporting date by evaluating conditions specific to the Group and the particular asset that may lead to impairment. These include product and manufacturing performance, technology, economic and political environments and future product expectations. If an impairment trigger exists the recoverable amount of the asset is determined. This involves value in use calculations, which incorporate a number of key estimates and assumptions.

### **(f) Cash and cash equivalents – refer note 21(a)**

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less, that are readily convertible to known amounts of cash and which are subject to an insignificant rate of change in value.

For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

### **(g) Provisions and employee benefits – refer note 13**

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

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

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting date. The discount rate used to determine the present value reflects the current market assessments of the time value of money and the risks specific to the liability. The increase in the provision resulting from the passage of time is recognised in finance costs.

### **Employee leave benefits**

#### *Wages, salaries, annual leave and sick leave*

Liabilities for wages and salaries, including non-monetary benefits long service and annual leave expected to be settled within twelve months of the reporting date are recognised in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for non-accumulating sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

#### *Long service leave*

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

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (h) Government grants

Government Grants are recognised in the statement of comprehensive income as grant revenue to offset the expenses they are intended to compensate.

### (i) Income Tax and other taxes – refer note 4

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities based on the current period's taxable income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

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

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

- except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

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

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

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

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

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

### (j) Other taxes

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

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

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Cash flows are included in the statement of cash flows on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority is classified as part of operating cash flows. Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

### (k) Goodwill and intangibles – refer note 11

#### *Goodwill*

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the cash-generating unit(s) that is expected to benefit from the synergies of the combination. Phosphagenics is viewed as a single cash-generation unit.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Phosphagenics performs its impairment testing as at 31 December each year using a value in use, discounted cash flow methodology.

Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment losses recognised for goodwill are not subsequently reversed.

#### *Intangible assets acquired both separately and from a business combination*

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in profit or loss in the year in which the expenditure was incurred.

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

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed each reporting period to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate and is thus accounted for on a prospective basis.

#### *Research and Development costs*

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when Phosphagenics can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is amortised over the period of expected benefit from the related project.

The carrying value of an intangible asset arising from development expenditure is tested for impairment annually when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period.

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

Item	Intellectual Property	Development Costs
Useful Life	Finite	Finite
Amortisation method used	Amortised once significant revenues are generated over the remaining patent life on a straight-line basis	Amortised over the period of expected future benefit from the related project on a straight-line basis
Internally generated or acquired	Acquired	Internally generated
Impairment testing	Annually as at 31 December and more frequently when an indication of impairment exists	Annually as at 31 December for assets not yet available for use and more frequently when an indication of impairment exists. The amortisation method is reviewed at each financial year-end

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

### (l) Impairment of non- financial assets other than goodwill

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The Group conducts an annual review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in expected future processes, technology and economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that have previously been impaired are tested for possible reversal of the impairment whenever events or changes in circumstances indicate that the impairment may have reversed.

### (m) Trade and other payables – refer note 12

Trade payables and other payables are carried at amortised costs and are not discounted due to their short term nature. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are not secured and are usually paid within 30 days of recognition.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (n) Share-based payment transactions – refer note 5

The Group provides benefits to its employees, including Key Management Personnel (KMP), in the form of share-based payments, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions). There is currently one plan in place to provide these benefits being the Employee Share Option Plan (ESOP), which provides benefits to key management personnel.

In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of Phosphagenics Limited (market conditions) if applicable. The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by an external valuer using a binomial model, further details of which are given in note 5. The cost of equity-settled transactions is recognised together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period), ending on the date on which the relevant employees become fully entitled to the award (the vesting date).

At each subsequent reporting date until vesting, the cumulative charge to the income statement is the product of:

- (i) The grant date fair value of the award.
- (ii) The current best estimate of the number of awards that will vest, taking into account such factors as the likelihood of employee turnover during the vesting period.
- (iii) The expired portion of the vesting period.

The charge to the statement of comprehensive income for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding entry to equity.

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

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

Options are considered anti-dilutive and therefore have not been included in the calculation of diluted earnings per share for 2008 and 2009, refer note 16.

### (o) Leases – refer note 17

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

### (p) Inventories – refer note 8

Inventories including raw materials, work in progress and finished goods are valued at the lower of cost and net realisable value. Costs incurred in bringing each product to its present location and condition are accounted for as follows:

#### *Raw materials*

Purchase cost on a first-in, first-out basis. The cost of purchase comprises the purchase price including, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), transport, handling and other costs directly attributable to the acquisition of raw materials. Volume discounts and rebates are included in determining the cost of purchase.

#### *Finished goods and work-in-progress*

Cost of direct materials, labour and a proportion of variable and fixed manufacturing overheads based on normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### (q) Trade and other receivables – refer note 7

Trade receivables, which generally have thirty to sixty day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less an allowance for impairment.

Collectability of trade receivables is reviewed on an ongoing basis. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than ninety days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows, discounted at the original effective interest rate.

### (r) Plant and Equipment – refer note 10

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a diminishing value basis as follows:

Computer Equipment – 33% p.a.

Plant and equipment – 20% p.a.

Office Equipment - 20% p.a.

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at each reporting period. When no future economic benefits are expected to arise from the continued use of an item of property, plant and equipment, it is derecognised. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of comprehensive income in the year the item is derecognised.

### (s) Revenue recognition

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

#### *Sale of goods*

Revenue from the sale of goods is recognised when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods and the costs in respect of the transaction can be reliably measured. Risks and rewards are considered passed to the buyer at the time of delivery of the goods to the customer.

#### *Royalties*

Royalty revenue is recognised on an accrual basis in accordance with the substance of the relevant agreement.

#### *Interest income*

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

### (t) Contributed equity

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

### (u) Foreign currency translation

#### *Functional and presentation currency*

Both the functional and presentation currency of Phosphagenics Limited and its Australian subsidiaries is Australian dollars (\$). The United States subsidiaries functional currency is United States Dollars which is translated to the presentation currency.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### *Transactions and balances*

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

### *Translation of Group Companies functional currency to presentation currency*

The results of the United States subsidiary are translated into Australian Dollars as at the date of each transaction. Assets and liabilities are translated at exchange rates prevailing at reporting date. Exchange variations resulting from the translation are recognised in the foreign currency translation reserve in equity.

On consolidation, exchange differences arising from the translation of the net investment in the United States subsidiary are taken to the foreign currency translation reserve. If the United States subsidiary were sold, the proportionate share of exchange differences would be transferred out of equity and recognised in the statement of comprehensive income.

### (v) Earnings per share

Basic earnings per share is calculated as net loss attributable to members of the parent divided by the weighted average number of ordinary shares. Where the Group generates a loss attributable to members of the parent, basic and diluted earnings per share are the same as a loss attributable to members of the parent cannot be further diluted.

## 3. OTHER REVENUE AND EXPENSES

	CONSOLIDATED		PARENT	
	2009 \$'000's	2008 \$'000's	2009 \$'000's	2008 \$'000's
<b>(a) Other Income</b>				
Rental revenue	113	113	113	113
Other	197	708	197	708
<b>Total</b>	<b>310</b>	<b>821</b>	<b>310</b>	<b>821</b>
<b>(b) Other Expenses</b>				
Net foreign exchange gains/(losses)	(106)	(1)	-	-
Depreciation	(365)	(376)	(24)	(28)
Loss on disposal of plant & equipment	(39)	-	(39)	-
Amortisation	(101)	(482)	-	-
Operating lease rental expenses	(490)	(340)	(436)	(340)
Travel	(183)	(159)	(49)	(151)
Other	(30)	(41)	(31)	(24)
<b>Total</b>	<b>(1,314)</b>	<b>(1,399)</b>	<b>(579)</b>	<b>(543)</b>

## 4. INCOME TAXES

	CONSOLIDATED		PARENT	
	2009 \$'000's	2008 \$'000's	2009 \$'000's	2008 \$'000's
Major components of income tax expense are:				
<i>Current income tax</i>	-	-	-	-
<i>Deferred income tax</i>				
Relating to origination and reversal of temporary differences	-	(20,790)	-	-
Income tax expense recorded in the statement of comprehensive income	-	(20,790)	-	-
The prima facie income tax expense/(benefit) on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:				
Accounting (loss) before income tax	(8,501)	(111,996)	(3,036)	(70,921)
Income tax expense calculated at 30% (2008: 30%)	(2,550)	(33,599)	(911)	(21,276)
Non-deductible expenses	159	10,702	133	21,213
Research & development deduction	(259)	(479)	-	-
Unused tax losses and tax offsets not recognised as deferred tax assets	2,650	2,586	778	63
Income tax benefit reported in income statement	-	(20,790)	-	-
<b>Deferred tax liabilities comprise:</b>				
Fair value adjustments on acquisition	16,128	16,128	-	-
	16,128	16,128	-	-
<b>Unrecognised deferred tax balances</b>				
The following items have not been brought to account as deferred tax assets:				
Tax losses not recognised	15,452	12,802	3,544	2,766
Temporary differences not recognised	-	-	-	-
<b>Total</b>	<b>15,452</b>	<b>12,802</b>	<b>3,544</b>	<b>2,766</b>

**Tax consolidation**

The company and its wholly-owned Australian resident entities have not formed a tax-consolidated group and are therefore taxed as separate entities.

## 5. SHARE BASED PAYMENTS

The Group provides benefits to service providers in the form of share-based payments. Employees render services in exchange rights over shares (equity-settled transactions). There is currently one plan in place to provide these benefits to employees, being the Employee Share Option Plan (ESOP). The ESOP is designed to align participants' interests with those of shareholders by increasing the value of the Company's shares. Share options carry no rights to dividends and no voting rights.

Options held by directors of the parent and its subsidiaries were acquired as part of the original subscriptions for shares in Phosphagenics Limited in 1999. Subsequently, all options granted to key management personnel have been issued in accordance with the provisions of the Employee Share Option Plan (ESOP).

### Summary of options granted as share based payments

The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of, and movements in, share options issued during the year under the provisions of the employee share option plan (ESOP):

Item	2009 Options No.	2009 WAEP \$	2008 Options No.	2008 WAEP \$
Outstanding at beginning of the year	9,850,000	\$0.19	5,600,000	\$0.24
Granted during the year	3,650,000	\$0.15	5,050,000	\$0.14
Forfeited during the year	(1,150,000)	\$0.18	(800,000)	\$0.23
Exercised during the year	-	-	-	-
Expired during the year	-	-	-	-
<b>Outstanding at end of the year</b>	<b>12,350,000</b>	<b>\$0.18</b>	<b>9,850,000</b>	<b>\$0.19</b>
Exercisable at end of the year	9,000,000	\$0.22	5,300,000	\$0.23

When a participant in the employee share option plan ceases employment prior to the vesting of their share options, the share options are forfeited unless cessation of employment is due to retirement or death. The value of options forfeited during the reporting period is \$200,790 and the weighted average remaining contractual life is 4.03 years.

The outstanding balance as at 31 December 2009 is represented by:

Issuing entity	Australian stock exchange listed	shares under option No.	Class of shares	Exercise price \$	Expiry date
Phosphagenics Ltd	unquoted	1,000,000	Ordinary	\$0.22	18 Aug 2010
Phosphagenics Ltd	unquoted	500,000	Ordinary	\$0.24	28 Mar 2011
Phosphagenics Ltd	unquoted	1,600,000	Ordinary	\$0.24	22 May 2011
Phosphagenics Ltd	unquoted	100,000	Ordinary	\$0.36	28 Aug 2011
Phosphagenics Ltd	unquoted	1,300,000	Ordinary	\$0.26	06 June 2012
Phosphagenics Ltd	unquoted	2,350,000	Ordinary	\$0.15	17 Aug 2013
Phosphagenics Ltd	unquoted	2,850,000	Ordinary	\$0.15	17 June 2014
Phosphagenics Ltd	unquoted	2,650,000	Ordinary	\$0.13	30 June 2018
<b>Total</b>		<b>12,350,000</b>			

### Option pricing model

Share option fair values are calculated using a Binomial model. The options will be settled in ordinary shares of Phosphagenics Limited and vested options lapse if unexercised after the expiry date.

In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of Phosphagenics Limited.

**5. SHARE BASED PAYMENTS (continued)**

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period), ending on the date on which the relevant employees become fully entitled to the award (the vesting date).

A service period was determined as the most appropriate criteria to attach to the options given Phosphagenics is still developing its products for commercialisation. There are no other service or performance criteria attached to share based payment options.

Model Inputs	2009 ESOP	2009 ESOP	2008 ESOP	2008 ESOP
Dividend yield %	0.00%	0.00%	0.00%	0.00%
Expected volatility %	65%	65%	50%	40%
Risk-free interest rate %	4.49%	4.49%	6.64%	6.64%
Option life (years)	8.5 years	4.5 years	10 years	5 years
Option Exercise price \$	\$0.137	\$0.15	\$0.134	\$0.15
Weighted Average Share price at measurement date	\$0.126	\$0.129	\$0.105	\$0.09

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur.

The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

**6. REMUNERATION OF AUDITORS**

Amounts received or due and receivable	CONSOLIDATED		PARENT	
	2009 \$	2008 \$	2009 \$	2008 \$
Audit or review of the financial report	77,500	79,500	77,500	79,500
Other non audit services	4,500	3,400	4,500	3,400
Taxation services	17,500	16,500	17,500	16,500
<b>Total</b>	<b>99,500</b>	<b>99,400</b>	<b>99,500</b>	<b>99,400</b>

The auditor of Phosphagenics Ltd (the parent), and the Group is Ernst & Young.

**7. TRADE AND OTHER RECEIVABLES**

Current	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
Trade receivables	99	23	99	23
Allowance for impairment loss	-	-	-	-
	99	23	99	23
Other	4	-	5	-
Goods and services tax (GST) recoverable	189	209	28	99
<b>Total</b>	<b>292</b>	<b>232</b>	<b>132</b>	<b>122</b>

Trade receivables are non interest bearing and are generally 45 day terms or as specified in contracts or agreements.

## 7. TRADE AND OTHER RECEIVABLES (continued)

Non Current	CONSOLIDATED		PARENT	
	2009	2008	2009	2008
	\$'000	\$'000	\$'000	\$'000
Loan to subsidiaries	-	-	24,629	18,656

Outstanding intercompany loans as at 31 December 2009 are viewed as an investment and therefore are non trading, non interest bearing and have no fixed terms of repayment.

*Impairment*

A provision for impairment is recognised when there is objective evidence (such as the probability of insolvency or significant financial difficulty of the debtor) that the Group may not be able to collect all the amounts due under the original terms of the invoice. Impaired debts are derecognised when they are assessed as uncollectible. No debts were impaired at 31 December 2009.

Period	Total	Neither past due or impaired	Past due but not impaired		
			30-60 days	60-90 days	90-120 days
	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Consolidated</b>					
31 December 2009	99	22	77	-	-
31 December 2008	23	13	10	-	-
<b>Parent</b>					
31 December 2009	99	22	77	-	-
31 December 2008	23	13	10	-	-

Credit risk and effective interest rates of current receivables are disclosed in notes 2 and 23.

## 8. INVENTORIES

	CONSOLIDATED		PARENT	
	2009	2008	2009	2008
	\$'000	\$'000	\$'000	\$'000
<b>Raw materials:</b>				
At cost	58	39	-	-
<b>Finished goods:</b>				
At cost	-	173	-	-
<b>Total</b>	<u>58</u>	<u>212</u>	<u>-</u>	<u>-</u>

## 9. INVESTMENT IN SUBSIDIARIES

Shares in controlled entities	Interest	CONSOLIDATED		PARENT	
		2009	2008	2009	2008
		\$'000	\$'000	\$'000	\$'000
Vital Health Sciences Pty Ltd	100%	-	-	96,411	96,411
Provision for impairment		-	-	(69,300)	(69,300)
<b>Total</b>		<u>-</u>	<u>-</u>	<u>27,111</u>	<u>27,111</u>

The investment by the parent in Vital Health Sciences Pty Ltd was impaired resulting from the impairment of acquired intangible assets at 31 December 2008.

## 10. PLANT AND EQUIPMENT

2009	CONSOLIDATED		PARENT	
	Plant and equipment at cost \$'000	Total \$'000	Plant and equipment at cost \$'000	Total \$'000
<b>Year ended 31 December 2009</b>				
At 1 January 2009 net of accumulated depreciation and impairment	1,761	1,761	119	119
Additions	88	88	9	9
Disposals	(39)	(39)	(39)	(39)
Depreciation charge for the year	(365)	(365)	(24)	(24)
At 31 December 2009, net of accumulated depreciation and impairment	1,445	1,445	65	65
<b>At 31 December 2009</b>				
Cost	2,414	2,414	104	104
Accumulated depreciation and impairment	(969)	(969)	(39)	(39)
Net carrying value	1,445	1,445	65	65

2008	CONSOLIDATED		PARENT	
	Plant and equipment at cost \$'000	Total \$'000	Plant and equipment at cost \$'000	Total \$'000
<b>Year ended 31 December 2008</b>				
At 1 January 2008 net of accumulated depreciation and impairment	1,902	1,902	117	117
Additions	235	235	30	30
Depreciation charge for the year	(376)	(376)	(28)	(28)
At 31 December 2008, net of accumulated depreciation and impairment	1,761	1,761	119	119
<b>At 31 December 2008</b>				
Cost	2,538	2,538	309	309
Accumulated depreciation and impairment	(777)	(777)	(190)	(190)
Net carrying value	1,761	1,761	119	119

## 11. GOODWILL AND INTANGIBLE ASSETS

2009	CONSOLIDATED			Total \$000
	Goodwill \$000	Intellectual Property \$000	Development costs \$000	
<b>Balance at 1 January 2009 net of accumulated amortisation and impairment</b>	-	121,362	1,856	53,918
Additions	-	-	555	555
Provision for impairment	-	-	-	-
Amortisation	-	(69,300)	(101)	(101)
<b>Balance at 31 December 2009 net of accumulated amortisation and impairment</b>	-	52,062	2,310	54,372
<b>At 31 December 2009</b>				
Cost (gross carrying amount)	34,261	121,362	2,895	158,518
Accumulated amortisation and impairment	(34,261)	(69,300)	(585)	(104,146)
Net carrying amount	-	52,062	2,310	54,372

2008	CONSOLIDATED			Total \$'000
	Goodwill \$'000	Intellectual Property \$'000	Development costs \$'000	
<b>Balance at 1 January 2008 net of accumulated amortisation and impairment</b>	34,261	121,362	1,625	157,248
Additions	-	-	713	713
Provision for impairment	(34,261)	(69,300)	(466)	(104,027)
Amortisation	-	-	(16)	(16)
<b>Balance at 31 December 2008 net of accumulated amortisation and impairment</b>	-	52,062	1,856	53,918
<b>At 31 December 2008</b>				
Cost (Gross carrying amount)	34,261	121,362	2,340	157,963
Accumulated amortisation and impairment	(34,261)	(69,300)	(484)	(104,045)
Net carrying amount	-	52,062	1,856	53,918

**Impairment Testing**

Intangible assets with an indefinite useful life, or an intangible assets not yet available for use, are tested for impairment by comparing the asset carrying amount with its recoverable amount. Impairment indicators are used to help determine whether there is any indication that an asset may be impaired.

*Goodwill*

The Group determines whether goodwill acquired through business combinations is impaired at least annually in December, or earlier where an indicator of impairment arises. This requires an estimation of the recoverable amount of the cash-generating unit to which goodwill is allocated. The recoverable amount of the cash generating unit to which goodwill relates has been determined by calculating the value in use, being the present value of future cash flows expected to be derived, excluding expansionary activities, finance costs and income tax.

## 11. GOODWILL AND INTANGIBLE ASSETS (continued)

The consolidated group is viewed for impairment testing purposes as a single cash generating unit. For the year ended 31 December 2009 there is no impairment of the cash generating unit and subsequently no adjustment against Goodwill, (2008:34.3 million).

### *Intellectual Property*

Intellectual property assets represent the fair value of patents acquired by the Company at 31 December 2004.

Intangible assets are tested for impairment at least annually at 31 December, or earlier where an indicator of impairment arises. The recoverable amount has been determined by calculation of the value in use being the present value of future cash flows expected to be derived from intangible assets, excluding expansionary activities, finance costs and income tax.

Asset recoverable amounts (value in use) are calculated using discounted cash flow methodology.

Key assumptions of these valuations include:

- management opinion on future cash flows on a product by product basis
- different residual lifetime of acquired patents
- allocation of products' value to underlying patents
- probability adjustments (ranging from 0.225 to 1.00) to individual cash flows, reflecting various types of risks
- no terminal value

The pre-tax discount rate used was between 18% - 22%, based on:

- the required rates of return on listed companies in a similar business
- the indicative rates of return required by suppliers of venture capital
- the Groups current level of financial gearing

For the year ended 31 December 2009, no impairment expense is recognised, (2008: \$69.3 million).

### *Development costs*

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

Development expenditure is tested for impairment annually, when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period. At 31 December 2009 zero development costs were impaired and recognised as an expense (2008: \$0.466 million).

## 12. CURRENT TRADE AND OTHER PAYABLES

	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
Trade payables	989	1,032	179	135
Accrued expenses	83	97	83	97
Goods and services tax (GST) payable	-	21	-	20
Other	79	282	66	120
<b>Total</b>	<b>1,151</b>	<b>1,432</b>	<b>328</b>	<b>372</b>

No interest is charged on the trade payables for the first 60 days from the date of the invoice. Thereafter, interest is charged on the outstanding balance. The consolidated entity has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

Other payables are non-trade payables and non-interest bearing. There were no related party payables at 31 December 2009.

**13. CURRENT PROVISIONS**

CURRENT	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
Employee benefits	96	76	96	76

**14. CONTRIBUTED EQUITY**

Fully paid ordinary shares	CONSOLIDATED			
	2009 No. '000's	2009 \$'000	2008 No. '000's	2008 \$'000
Balance at beginning of year	663,542	170,316	603,440	161,544
Issue of shares	76,087	7,000	60,102	9,015
Exercise of options	67	14	-	-
Capital raising costs	-	(425)	-	(243)
Balance at end of year	739,696	176,905	663,542	170,316

Fully paid ordinary shares	PARENT			
	2009 No. '000's	2009 \$'000	2008 No. '000's	2008 \$'000
Balance at beginning of year	663,542	170,316	603,440	161,544
Issue of shares - cash	76,087	7,000	60,102	9,015
Exercise of options	67	14	-	-
Capital raising costs	-	(425)	-	(243)
Balance at end of year	739,696	176,905	663,542	170,316

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

**Share options**

As at close of business on 31 December 2009 there were a total of 12,350,000 unexercised unquoted options issued as share based payments.

Share options carry no rights to dividends and no voting rights. For further details of share based payments refer to note 5.

**15. RESERVES**

	<b>CONSOLIDATED</b>		<b>PARENT</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
<b>Reserves</b>				
Business combination	27,812	27,812	-	-
Employee equity-settled benefits	946	580	946	580
Other equity-settled benefits	46	46	46	46
Foreign Currency Translation Reserve	29	47	-	-
	<u>28,833</u>	<u>28,485</u>	<u>992</u>	<u>626</u>
<b>Business combination reserve</b>				
Balance at beginning of year	27,812	27,812	-	-
Balance at end of year	<u>27,812</u>	<u>27,812</u>	-	-
<b>Employee equity-settled benefits reserve</b>				
Balance at beginning of year	580	402	580	402
Share based payment expense	366	178	366	178
Balance at end of year	<u>946</u>	<u>580</u>	<u>946</u>	<u>580</u>

The employee share option and share plan reserve is used to record the value of equity benefits provided to employees and Directors as part of their remuneration. For further details refer to note 5 in the Financial Statements.

**Other equity-settled benefits reserve**

Balance at beginning of year	46	46	46	46
Share based payments	-	-	-	-
Balance at end of year	<u>46</u>	<u>46</u>	<u>46</u>	<u>46</u>

The other equity-settled benefits reserve is used to record the value of equity benefits provided to suppliers as part of their remuneration.

**Foreign Currency Translation Reserve**

Balance at beginning of year	47	-	-	-
Foreign Currency Translation	(18)	47	-	-
Balance at end of year	<u>29</u>	<u>47</u>	-	-

The foreign currency translation reserve is used to record the translation from Phosphagenics Inc.'s functional currency into Phosphagenics Ltd's reporting currency.

**16. EARNINGS PER SHARE****Basic earnings per share**

Basic earnings per share is calculated by dividing the net loss, from continuing operations attributable to ordinary equity holders of the parent for the year, by the weighted average number of ordinary shares outstanding during the year.

**Diluted earnings per share**

Diluted earnings per share is calculated by dividing the net loss attributable to ordinary shareholders by the weighted average number of ordinary shares on issue during the year (adjusted for the effects of dilutive options). There are no instruments (e.g., share options) excluded from the calculation of diluted earnings per share that could potentially dilute basic earnings per share in the future because they are antidilutive for either of the periods presented.

**16. EARNINGS PER SHARE (continued)**

There have been no transactions involving ordinary shares or potential ordinary shares that would significantly change the number of ordinary shares or potential ordinary shares outstanding between the reporting date and the date of completion of these financial statements.

<b>Earnings used in calculating earnings per share</b>	<b>2009</b> <b>\$'000's</b>	<b>2008</b> <b>\$'000's</b>
Net Loss from continuing operations attributable to ordinary equity holders for the calculation of basic and diluted earnings per share	(8,501)	(91,206)

<b>Weighted average number of shares</b>	<b>2009</b> <b>No. '000's</b>	<b>2008</b> <b>No. '000's</b>
Weighted average number of ordinary shares for the purposes of basic earnings per share	681,716	641,702
Effect of dilution:		
Share options	70,997	66,964
Weighted average number of ordinary shares adjusted for the effect of dilution	752,713	708,666

**Information on the classification of securities**

Options quoted on the ASX and options granted to employees and other service providers are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share to the extent they are dilutive. These options have not been included in the determination of basic earnings per share.

**17. COMMITMENTS FOR EXPENDITURE****Operating Leases**

Non-cancellable operating leases relate to the rent of commercial property used for business operations.

<b>Non-cancellable operating lease payments</b>	<b>CONSOLIDATED</b>		<b>PARENT</b>	
	<b>2009</b> <b>\$'000's</b>	<b>2008</b> <b>\$'000's</b>	<b>2009</b> <b>\$'000's</b>	<b>2008</b> <b>\$'000's</b>
Within 1 year	243	262	243	262
After 1 year but not more than 5 years	160	66	160	66
After more than 5 years	-	-	-	-
Total minimum lease payments	403	328	403	328

**18. OPERATING SEGMENTS****Identification of reportable segments**

The group has identified its operating segments based on the internal reports that are reviewed and used by the Chief Executive Officer and his management team (the chief operating decision makers) in assessing the performance and in determining the allocation of resources.

The operating segments are identified by management based on the group's risks and returns that are affected predominantly by differences in the products and services provided. The reportable segments are based on aggregated operating segments determined according to the nature of the products and services provided, with each reportable segment representing a strategic business unit that offers different products and serves different markets.

**18. OPERATING SEGMENTS (continued)****Types of products and services**Nutraceuticals

Nutraceuticals is the use of vitamins and nutritious products to improve human health. The nutraceutical business is developing active ingredients for the following market segments:

- Dietary Supplements - e.g. vitamin capsules & tablets. The Company is using its patented technology to orally deliver dietary supplements aimed at improving bioavailability and efficacy.
- Functional Foods and Beverages - e.g. nutritionally enhanced foods. Functional foods are an expanding nutraceutical market division, aimed at improving the nutritional benefits of everyday foods.
- Personal care products. Discovery research has shown that  $\alpha$ -tocopheryl phosphate (TPM) is a natural molecule with increased activity over standard Vitamin E ( $\alpha$  tocopherol). TPM has scientifically proven anti-inflammatory properties, it reduces redness, protects against UV induced photo damage, helps to heal and prevent acne. The structure of TPM allows it to act as a penetration enhancer, increasing dermal absorption compared to tocopherol acetate and  $\alpha$ -tocopherol, allowing it to penetrate deeper into the skin for increased action. TPM is also able to increase the penetration of molecules formulated in the same cream. TPM is well suited to products in the Cosmeceuticals market.

The Company's nutraceutical business is a revenue-generating growth business. The route to market for nutraceutical products is through partnering with companies that have established distribution networks within the relevant market segments.

Pharmaceuticals

The pharmaceutical division is focused on:

- Drug delivery – enhancing the delivery of existing drugs orally or through the skin, utilising Phosphagenics' proprietary delivery technology.
- Drug enhancement – augmenting the biological activity of existing drugs by adding a phosphate group to the chemical structure of the drug.

The route to market for the Company's pharmaceutical products is through partnering with a larger pharmaceutical company at the appropriate stage in a product's development so as to maximise return on the Company's research and development investment. The core competencies of the pharmaceutical business are generation of pharmaceutical intellectual property and translation of this knowledge base into commercially viable product candidates for the treatment of human conditions and disease.

The Company's strategy is to capitalise on its proprietary technology through joining its resources and development capabilities with co-development partners or licensees.

The objective of any development or marketing agreement entered into is to generate revenues from three sources:

- milestone payments and development fees during the pre-marketing phases of product development;
- royalties on product sales by partners; and
- manufacturing and supply of product to partners, predominantly of the phosphorylated delivery compound.

The Company's choice of development products is based strictly upon the market opportunity and the overall commercial viability of each individual drug candidate, including assessment of the current and expected competition for the product, the cost, timing and degree of difficulty to commercialise the product, the patent status of the drug compound and the market size of the drug to be developed.

**Accounting policies and inter-segment transactions**

Accounting policies used by the Group in reporting segments are contained in note 1 to the accounts.

18. OPERATING SEGMENTS (continued)

Business segments

2009	Nutraceuticals \$'000's	Pharmaceuticals \$'000's	Unallocated \$'000's	Total Group \$'000's
<b>Revenue</b>				
Sales and Royalties	670	-	-	670
Grant Income	-	304	-	304
<b>Total segment revenue</b>	<b>670</b>	<b>304</b>	<b>-</b>	<b>974</b>
<b>Net operating loss after tax</b>	<b>(2,647)</b>	<b>(2,976)</b>	<b>(2,840)</b>	<b>(8,463)</b>
Interest revenue	-	-	430	430
Depreciation and amortisation	(341)	(101)	(24)	(466)
Write off of assets	-	-	(38)	(38)
<b>Segment assets</b>	<b>799</b>	<b>923</b>	<b>65,642</b>	<b>67,364</b>
Capital Expenditure	7	74	7	88
<b>Segment liabilities</b>	<b>24</b>	<b>786</b>	<b>16,560</b>	<b>17,375</b>
<b>Cash flow information</b>				
Net cash flow from Operating activities	(2,395)	(2,287)	(4,281)	(8,963)
Net cash flow from investing activities	(7)	(62)	416	347
Net cash flow from financing activities	-	-	6,589	6,589

2008	Nutraceuticals \$'000's	Pharmaceuticals \$'000's	Unallocated \$'000's	Total Group \$'000's
<b>Revenue</b>				
Sales and Royalties	985	-	-	985
Grant Income	-	1,354	-	1,354
<b>Total segment revenue</b>	<b>985</b>	<b>1,354</b>	<b>-</b>	<b>2,339</b>
<b>Net operating loss after tax</b>	<b>(790)</b>	<b>(5,248)</b>	<b>(85,064)</b>	<b>(91,102)</b>
Interest revenue	-	-	913	913
Depreciation and amortisation	(348)	(482)	(28)	(858)
Impairment of intangible assets	-	(466)	(69,300)	(69,766)
Impairment of goodwill	-	-	(34,261)	(34,261)
Income tax benefit	-	-	20,790	20,790
<b>Segment assets</b>	<b>792</b>	<b>849</b>	<b>67,548</b>	<b>69,189</b>
Capital expenditure	28	177	30	235
<b>Segment liabilities</b>	<b>212</b>	<b>684</b>	<b>16,740</b>	<b>17,636</b>
<b>Cash flow information</b>				
Net cash flow from Operating activities	2,376	(4,165)	(5,443)	(7,232)
Net cash flow from investing activities	(28)	(177)	846	641
Net cash flow from financing activities	-	-	8,772	8,772

## 18. OPERATING SEGMENTS (continued)

### i) Segment revenue reconciliation to the statement of comprehensive income

Reconciliation of revenue	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Total segment revenue	974	2,339
Other revenue from continuing activities	430	913
Total revenue	1,404	3,252

Revenue from external customers by geographical locations is detailed below. Revenue is attributed to geographic location based on the location of the customers. The company does not have external revenues from external customers that are attributable to any foreign country other than as shown.

Revenue by geographical location	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Australia	734	2,267
United States	670	985
Other foreign countries	-	-
Total revenue	1,404	3,252

### ii) Segment net operating profit after tax reconciliation to the statement of comprehensive income

The executive management committee meets on a monthly basis to assess the performance of each segment by analysing the segment's net operating profit after tax. A segment's net operating profit after tax excludes non operating income and expense such as dividends received, fair value gains and losses, gains and losses on disposal of assets and impairment charges. Income tax expenses are calculated as 30% (2008:30%) of the segment's net operating profit.

Reconciliation of segment net operating profit after tax to net profit/loss before tax	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Segment net operating loss after tax	(5,623)	(6,038)
Income tax benefit at 30%	-	20,790
Other operating loss from continuing activities	(2,840)	(23,187)
Impairment of intangible assets	-	(69,300)
Impairment of goodwill	-	(34,261)
Net loss on disposal of plant and equipment	(38)	-
Total net profit before tax per the statement of comprehensive income	(8,501)	(111,996)

### iii) Segment assets reconciliation to the statement of financial position

In assessing the segment performance on a monthly basis, the executive management committee analyses the segment as described above and its relation to the segment assets. Segment assets are those operating assets of the entity that the management committee views as directly attributing to the performance of the segment. These assets include plant and equipment, receivables, inventory and intangibles and exclude available-for-sale assets, derivative assets and deferred tax assets.

Reconciliation of segment operating assets to total assets	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Segment operating assets	67,364	69,189
Total assets per the statement of financial position	67,364	69,189

## 18. OPERATING SEGMENTS (continued)

The analysis of the location of non-current assets other than financial instruments, deferred tax assets, pension assets is as follows

Non-current assets by geographical location	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Australia	55,817	55,679
United States	-	-
Other foreign countries	-	-
Total assets	55,817	55,679

### iv) Segment liabilities reconciliation to the statement of financial position

Segment liabilities include trade and other payables and debt. The Group has a centralised finance function that is responsible for raising debt and capital for the entire operations. Each entity or business uses this central function to invest excess cash or obtain funding for its operations.

Reconciliation of segment operating liabilities to total liabilities	CONSOLIDATED	
	2009 \$'000	2008 \$'000
Segment operating liabilities	810	896
Other operating liabilities from continuing activities	16,560	16,740
Total liabilities per the statement of financial position	17,375	17,636

## 19. RELATED PARTY DISCLOSURE

The consolidated financial statements include the financial statements of Phosphagenics Limited and the subsidiaries listed in the following table.

Entity	Country of Incorporation	2009 Equity Interest	2008 Equity Interest	2009 Investment \$'000	2008 Investment \$'000
Vital Health Sciences Pty Ltd	Australia	100%	100%	27,111	27,111
Preform Technologies Pty Ltd	Australia	100%	100%	-	-
Adoil Pty Ltd	Australia	100%	100%	-	-
Phosphagenics Inc.	USA	100%	100%	-	-

### Other transactions with key management personnel

The loss from operations includes no items of revenue and expense that resulted from transactions other than remuneration or equity holdings, with specified directors or their personally-related entities. Communicate Pty Ltd provided services to the Group during the year on behalf of the board. Professor Vizard is a consultant to Communicate P/L. These services were provided on normal commercial terms.

### Transactions with other related parties

During the year, Vital Health Sciences Pty Ltd borrowed \$5,428,761 (2008: \$4,340,835) and Phosphagenics Inc. \$544,432 (2008: \$224,812) from Phosphagenics Ltd (the parent entity). No part of these funds has been repaid. The loan is non trading and non current in nature.

Phosphagenics Inc has insufficient net assets to repay the inter company loan balance to Phosphagenics Ltd (the

**19. RELATED PARTY DISCLOSURE (continued)**

parent entity). At 31 December 2009 Phosphagenics Ltd recognised an impairment of \$743,000 (2008: \$0) against the inter company loan with Phosphagenics Inc.  
No amounts were provided for doubtful debts relating to debts due from related parties at reporting date (2008: Nil).

**20. SUBSEQUENT EVENTS**

There have been no significant events subsequent to reporting date.

**21. NOTES TO THE CASH FLOW STATEMENT****(a) Reconciliation of cash and cash equivalents**

For the purposes of the statement of cash flows, cash and cash equivalents includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and cash equivalents at the end of the financial year, as shown in the statement of cash flows, is reconciled to the related items in the statement of financial position as follows:

	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
Cash at Bank	2,198	2,896	2,089	2,097
Short Term Deposits	8,670	10,000	8,670	10,000
	<u>10,868</u>	<u>12,896</u>	<u>10,759</u>	<u>12,097</u>

**(b) Reconciliation of net loss after tax to net cash flows from operations**

	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
Net Loss after tax	(8,501)	(91,206)	(3,036)	(1,621)
<i>Adjustments for:</i>				
Depreciation, disposal, impairment and amortisation of non-current assets	505	858	63	28
ESOP Expense	366	178	366	178
Capitalisation of development expenses	(555)	(715)	-	-
Impairment of acquired intangible assets	-	69,300	-	-
Impairment of goodwill	-	34,261	-	-
Impairment of intercompany loans	-	-	743	-
Interest received	(430)	(913)	(418)	(867)
<i>Changes in assets and liabilities:</i>				
(Increase)/ decrease in trade receivables and other receivables	(60)	1,345	(10)	80
(Increase)/decrease in inventories	154	(197)	-	-
(Increase)/decrease in prepayments	(159)	(106)	(47)	(106)
(Decrease)/increase in trade payables and other payables	(281)	613	(44)	4
(Decrease)/increase in deferred tax liability	-	(20,790)	-	-
(Decrease)/increase in provisions	(2)	140	16	99
Net cash (used in) operating activities	<u>(8,963)</u>	<u>(7,232)</u>	<u>(2,367)</u>	<u>(2,205)</u>

## 22. FINANCIAL INSTRUMENTS

### (a) Financial risk management objectives and policies

The Group's principal financial instruments comprise of cash and short-term deposits. Various financial instruments such as trade receivables and trade payables arise directly from operations. The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates.

The Group does not enter into, or trade, financial instruments including derivative financial instruments, for speculative purposes and manages its exposure to key financial risks, including interest rate and currency risk in accordance with the principals of prudent financial management. The objective of this is to support the delivery of the Group's financial targets whilst protecting future financial security.

Primary responsibility for identification and control of financial risks rests with the Audit Committee under the authority of the Board. The Board reviews and agrees policies for managing each of the risks including foreign exchange risk, interest rate risk and future cash flow forecast projections.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 1 to the financial statements.

### (b) Risk exposures and responses

#### *Interest rate risk*

The consolidated entity is only exposed to interest rate risk relating to cash at bank as it has no borrowings. At reporting date the Group has the following financial assets (no financial liabilities at 31 December 2009 or 31 December 2008) exposed to Australian Variable Interest Rates:

	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>Financial Assets</b>				
Cash and cash equivalents	10,868	12,896	10,759	12,096

The following sensitivity analysis is based on the interest rate risk exposures in existence at 31 December 2009. If interest rates had moved, as illustrated in the table below, with all other variables held constant, post tax loss and equity would have been affected as follows:

	Post Tax Profit Higher/(Lower)		Equity Higher/(Lower)	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>Judgements of reasonably possible movements:</b>				
<b>Consolidated</b>				
+ 1% (100 basis points)	109	129	-	-
-.5% (50 basis points)	(54)	(64)	-	-
<b>Parent</b>				
+ 1% (100 basis points)	108	121	-	-
-.5% (50 basis points)	(54)	(60)	-	-

The movements in profit are due to higher/lower interest income from variable rate term deposits and cash balances. There is no equity movement as there are no financial assets or financial liabilities which are designated as cash flow hedges. The sensitivity is lower in 2009 in comparison to 2008 due to the lower cash and cash equivalents balance.

#### *Foreign Currency Risk*

The Group has transactional currency exposures principally due to its operations in the United States. Such exposure arises from sales or purchases by an operating unit in currencies, principally US dollars, other than the Groups presentation currency.

**22. FINANCIAL INSTRUMENTS (continued)**

Approximately 48% of sales and royalties (2008: 30%) are denominated in currencies other than the presentation currency of the Group (Australian dollars), whilst 94% (2008: 90%) of costs are denominated in the Groups presentation currency. At 31 December 2009 the Group had the following exposure to US dollar foreign currency not designated in cash flow hedges:

	CONSOLIDATED		PARENT	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>Financial Assets</b>				
Cash and cash equivalents	25	50	-	-
Trade and other receivables	-	-	-	-
	25	50	-	-
<b>Financial Liabilities</b>				
Trade and other payables	-	-	-	-
	-	-	-	-
<b>Net Exposure</b>	25	50	-	-

At 31 December 2009, had the Australian Dollar moved, as illustrated in the table below, with all other variables held constant, post tax profit and equity would have been affected as follows;

	Post Tax Profit Higher/(Lower)		Equity Higher/(Lower)	
	2009 \$'000	2008 \$'000	2009 \$'000	2008 \$'000
<b>Judgements of reasonably possible movements:</b>				
<b>Consolidated</b>				
AUD/USD +10%	(2)	(5)	-	-
AUD/USD -5%	1	3	-	-
<b>Parent</b>				
AUD/USD +10%	(2)	(5)	-	-
AUD/USD -5%	1	3	-	-

*Credit risk management*

Credit risk arises from the financial assets of the Group comprising cash and cash equivalents and trade and other receivables. Credit risk refers to the risk a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults.

Group exposure to, and the credit ratings of, counterparties are continuously monitored and the aggregate value of transactions concluded are with approved counterparties. The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The credit risk on liquid funds and financial instruments is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies. The Group measures credit risk on a fair value basis.

The carrying value of financial assets recorded in the financial statements, net of any allowances for losses, represents the Groups maximum exposure to credit risk. Maturity analysis of financial assets and liabilities based on management's expectations as follows;

## 22. FINANCIAL INSTRUMENTS (continued)

Year Ended 31 December 2009	≤ 6 Months \$'000	6-12 Months \$'000	1-5 Years \$'000	>5 Years \$'000	Total \$'000
<b>Consolidated</b>					
<b>Financial Assets</b>					
Cash and cash equivalents	10,868	-	-	-	10,868
Trade and other receivables	292	-	-	-	292
	11,160	-	-	-	11,160
<b>Consolidated</b>					
<b>Financial Liabilities</b>					
Trade and other payables	1,151	-	-	-	1,151
	1,151	-	-	-	1,151
<b>Net Exposure</b>	<b>10,009</b>	-	-	-	<b>10,009</b>

*Liquidity risk management*

The Group continuously monitors cash flows and matches the maturity profiles of financial assets and liabilities.

*Capital Management*

Management's objective is to ensure the entity continues as a going concern with the ability to fund future research and development requirements and commercialise the Groups products. Management also aim to maintain a capital structure that ensures the lowest cost of capital available and deliver optimal long term returns to shareholders.

## Directors' Declaration

The Directors declare that:

- (a) in the Directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;
- (b) in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the *Corporations Act 2001*, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity; and
- (c) the Directors have been given the declarations required by s.295A of the *Corporations Act 2001*

Signed in accordance with a resolution of the Directors made pursuant to s.295(5) of the *Corporations Act 2001*.

On behalf of the Board



Andrew Lancelot Vizard  
Chairman

19 February 2010

Melbourne



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## Independent auditor's report to the members of Phosphagenics Limited

### Report on the Financial Report

We have audited the accompanying financial report of Phosphagenics Limited, which comprises the statement of financial position as at 31 December 2009, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

### *Directors' Responsibility for the Financial Report*

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

### *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 and International Standards on Auditing. 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 our judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

### *Independence*

In conducting our audit we have met the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report. The Auditor's Independence Declaration would have been expressed in the same terms if it had been given to the directors at the date this auditor's report was signed. In addition to our audit of the financial report, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

**Auditor's Opinion**

In our opinion:

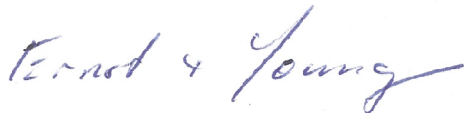
1. the financial report of [name of entity] is in accordance with the *Corporations Act 2001*, including:
  - i giving a true and fair view of the financial position of Phosphagenics Limited and the consolidated entity at 31 December 2009 and of their performance for the year ended on that date; and
  - ii complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.
2. the financial report also complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

**Report on the Remuneration Report**

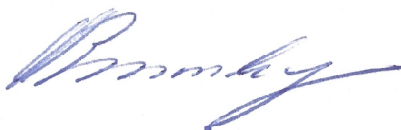
We have audited the Remuneration Report included on pages 9 to 15 of the directors' report for the year ended 31 December 2009. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

**Auditor's Opinion**

In our opinion the Remuneration Report of Phosphagenics Limited for the year ended 31 December 2009, complies with section 300A of the *Corporations Act 2001*.



Ernst & Young



Don Brumley  
Partner  
Melbourne  
19 February 2010