

# 2006 FINANCIAL REPORT

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*at 30 June 2006*

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## INCOME STATEMENT

for the year ended 30 June 2006

|   | NOTES | CONSOLIDATED   |                | PARENT         |                |
|---|-------|----------------|----------------|----------------|----------------|
|   |       | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>CONTINUING OPERATIONS</b>  |       |                |                |                |                |
| <b>Revenue</b>  |       |                |                |                |                |
| Sale of goods   |       | 141,397        | 138,382        | –              | –              |
| Rental income   | 3(a)  | 3,424          | 3,150          | 1,148          | 1,057          |
| Finance income  | 3(b)  | 511            | 1,023          | 108            | 377            |
| Dividends   | 3(c)  | 3              | 13             | 9,666          | 9,025          |
| Total revenue   |       | 145,335        | 142,568        | 10,922         | 10,459         |
| Cost of sales   |       | (111,124)      | (107,986)      | –              | –              |
| Gross profit  |       | 34,211         | 34,582         | 10,922         | 10,459         |
| Other income  | 3(d)  | 978            | 3,318          | 47             | 1,752          |
| Rental property expenses  | 3(a)  | (1,744)        | (1,510)        | (393)          | (347)          |
| Marketing expenses  |       | (4,737)        | (4,450)        | –              | –              |
| Administrative expenses   |       | (12,347)       | (14,299)       | (1,917)        | (1,635)        |
| <b>Profit from continuing operations before tax and finance costs</b>                   |       | <b>16,361</b>  | <b>17,641</b>  | <b>8,659</b>   | <b>10,229</b>  |
| Finance costs   | 3(b)  | (3,934)        | (3,845)        | (351)          | (308)          |
| <b>Profit before income tax</b>   |       | <b>12,427</b>  | <b>13,796</b>  | <b>8,308</b>   | <b>9,921</b>   |
| Income tax expense  | 5     | (3,997)        | (3,689)        | (109)          | (225)          |
| <b>Net profit for the period</b>  |       | <b>8,430</b>   | <b>10,107</b>  | <b>8,199</b>   | <b>9,696</b>   |
| Profit attributable to minority interest  |       | (286)          | (703)          | –              | –              |
| <b>Profit attributable to members of the parent</b>                                     |       | <b>8,144</b>   | <b>9,404</b>   | <b>8,199</b>   | <b>9,696</b>   |
| Earnings per share (cents per share)  | 31    |                |                |                |                |
| – basic for profit for the year attributable to ordinary equity holders of the parent   |       | 57.8           | 66.8           |                |                |
| – diluted for profit for the year attributable to ordinary equity holders of the parent |       | 57.8           | 66.8           |                |                |
| Dividends per share (cents per share)   | 6     | 50.0           | 120.0          |                |                |

The income statement should be read in conjunction with the accompanying notes.

**BALANCE SHEET***as at 30 June 2006*

|   | NOTES | CONSOLIDATED   |                | PARENT         |                |
|---|-------|----------------|----------------|----------------|----------------|
|   |       | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>ASSETS</b>                                       |       |                |                |                |                |
| <b>CURRENT ASSETS</b>                               |       |                |                |                |                |
| Cash and cash equivalents                           | 4     | 13,596         | 12,737         | 2,560          | 6,398          |
| Trade and other receivables                         | 7     | 26,004         | 28,123         | 397            | 811            |
| Inventories   | 8     | 38,243         | 35,107         | –              | –              |
| Available-for-sale financial assets                 | 9     | 304            | 83             | 304            | 83             |
| Prepayments and deposits                            | 10    | 1,076          | 868            | 379            | 13             |
| <b>TOTAL CURRENT ASSETS</b>                         |       | <b>79,223</b>  | <b>76,918</b>  | <b>3,640</b>   | <b>7,305</b>   |
| <b>NON CURRENT ASSETS</b>                           |       |                |                |                |                |
| Trade and other receivables                         | 11    | –              | –              | 6,919          | 8,411          |
| Other financial assets                              | 12    | –              | –              | 19,664         | 19,664         |
| Property, plant and equipment                       | 13    | 39,834         | 41,657         | 5,334          | 5,308          |
| Investment properties                               | 14    | 12,325         | 11,038         | 5,036          | 3,762          |
| Deferred income tax asset                           | 5     | 2,321          | 2,564          | 263            | 447            |
| Goodwill  | 15    | 1,299          | 1,299          | –              | –              |
| <b>TOTAL NON CURRENT ASSETS</b>                     |       | <b>55,779</b>  | <b>56,558</b>  | <b>37,216</b>  | <b>37,592</b>  |
| <b>TOTAL ASSETS</b>                                 |       | <b>135,002</b> | <b>133,476</b> | <b>40,856</b>  | <b>44,897</b>  |
| <b>LIABILITIES</b>                                  |       |                |                |                |                |
| <b>CURRENT LIABILITIES</b>                          |       |                |                |                |                |
| Trade and other payables                            | 16    | 16,710         | 13,705         | 455            | 395            |
| Interest bearing loans and borrowings               | 17    | 1,519          | 3,139          | 8,437          | 11,388         |
| Income tax payable                                  |       | 1,825          | 1,213          | 1,825          | 1,213          |
| Provisions  | 18    | 4,403          | 4,348          | 367            | 374            |
| <b>TOTAL CURRENT LIABILITIES</b>                    |       | <b>24,457</b>  | <b>22,405</b>  | <b>11,084</b>  | <b>13,370</b>  |
| <b>NON CURRENT LIABILITIES</b>                      |       |                |                |                |                |
| Interest bearing loans and borrowings               | 19    | 56,485         | 53,292         | 6,119          | 4,217          |
| Deferred income tax liabilities                     | 5     | 2,142          | 2,151          | 172            | 127            |
| Provisions  | 20    | 1,812          | 1,793          | 148            | 202            |
| <b>TOTAL NON CURRENT LIABILITIES</b>                |       | <b>60,439</b>  | <b>57,236</b>  | <b>6,439</b>   | <b>4,546</b>   |
| <b>TOTAL LIABILITIES</b>                            |       | <b>84,896</b>  | <b>79,641</b>  | <b>17,523</b>  | <b>17,916</b>  |
| <b>NET ASSETS</b>                                   |       | <b>50,106</b>  | <b>53,835</b>  | <b>23,333</b>  | <b>26,981</b>  |
| <b>EQUITY</b>                                       |       |                |                |                |                |
| Equity attributable to equity holders of the parent |       |                |                |                |                |
| Issued capital                                      | 21    | 17,034         | 17,034         | 16,086         | 16,086         |
| Reserves  | 22    | 2,976          | 2,820          | 2,525          | 2,394          |
| Retained earnings                                   | 22    | 26,388         | 30,222         | 4,722          | 8,501          |
| Total parent entity interest in equity              |       | 46,398         | 50,076         | 23,333         | 26,981         |
| Minority interests                                  | 30    | 3,708          | 3,759          | –              | –              |
| <b>TOTAL EQUITY</b>                                 |       | <b>50,106</b>  | <b>53,835</b>  | <b>23,333</b>  | <b>26,981</b>  |

The balance sheet should be read in conjunction with the accompanying notes.

## STATEMENT OF CHANGES IN EQUITY

*for the year ended 30 June 2006*

|   | ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT |                             |                                       |                 | MINORITY INTEREST<br>\$'000 | TOTAL EQUITY<br>\$'000 |
|---|--|-----------------------------|---------------------------------------|-----------------|-----------------------------|------------------------|
|   | ISSUED CAPITAL<br>\$'000                     | RETAINED EARNINGS<br>\$'000 | OTHER RESERVES<br>(NOTE 22)<br>\$'000 | TOTAL<br>\$'000 |                             |                        |
| <b>CONSOLIDATED</b>   |  |                             |                                       |                 |                             |                        |
| <b>At 1 July 2004</b>   | 15,916                                       | 39,077                      | 2,673                                 | 57,666          | 4,874                       | 62,540                 |
| Profit for the year   | –  | 9,404                       | –                                     | 9,404           | 703                         | 10,107                 |
| Exercise of options   | 1,118  | –                           | –                                     | 1,118           | –                           | 1,118                  |
| Cost of share-based payments  | –  | –                           | 147                                   | 147             | –                           | 147                    |
| Equity dividends  | –  | (18,259)                    | –                                     | (18,259)        | (1,818)                     | (20,077)               |
| <b>At 30 June 2005</b>  | <b>17,034</b>                                | <b>30,222</b>               | <b>2,820</b>                          | <b>50,076</b>   | <b>3,759</b>                | <b>53,835</b>          |
| 1 July 2005   |  |                             |                                       |                 |                             |                        |
| Transitional adjustment relating to the application of AASB 132 and 139 | –  | –                           | 6                                     | 6               | –                           | 6                      |
| Profit for the year   | –  | 8,144                       | –                                     | 8,144           | 286                         | 8,430                  |
| Unrealised gain on available-for-sale investments net of tax            | –  | –                           | 121                                   | 121             | –                           | 121                    |
| Cost of share-based payments  | –  | –                           | 80                                    | 80              | –                           | 80                     |
| Foreign currency translation reserve                                    | –  | –                           | (51)                                  | (51)            | –                           | (51)                   |
| Equity dividends  | –  | (11,978)                    | –                                     | (11,978)        | (337)                       | (12,315)               |
| <b>At 30 June 2006</b>  | <b>17,034</b>                                | <b>26,388</b>               | <b>2,976</b>                          | <b>46,398</b>   | <b>3,708</b>                | <b>50,106</b>          |
| <b>PARENT</b>   |  |                             |                                       |                 |                             |                        |
| <b>At 1 July 2004</b>   | 14,968                                       | 17,064                      | 2,313                                 | 34,345          | –                           | 34,345                 |
| Profit for the year   | –  | 9,696                       | –                                     | 9,696           | –                           | 9,696                  |
| Exercise of options   | 1,118  | –                           | –                                     | 1,118           | –                           | 1,118                  |
| Cost of share-based payments  | –  | –                           | 81                                    | 81              | –                           | 81                     |
| Equity dividends  | –  | (18,259)                    | –                                     | (18,259)        | –                           | (18,259)               |
| <b>At 30 June 2005</b>  | <b>16,086</b>                                | <b>8,501</b>                | <b>2,394</b>                          | <b>26,981</b>   | <b>–</b>                    | <b>26,981</b>          |
| 1 July 2005   |  |                             |                                       |                 |                             |                        |
| Transitional adjustment relating to the application of 132 and 139      | –  | –                           | 6                                     | 6               | –                           | 6                      |
| Profit for the year   | –  | 8,199                       | –                                     | 8,199           | –                           | 8,199                  |
| Unrealised gain on available-for-sale investments net of tax            | –  | –                           | 121                                   | 121             | –                           | 121                    |
| Cost of share-based payments  | –  | –                           | 4                                     | 4               | –                           | 4                      |
| Equity dividends  | –  | (11,978)                    | –                                     | (11,978)        | –                           | (11,978)               |
| <b>At 30 June 2006</b>  | <b>16,086</b>                                | <b>4,722</b>                | <b>2,525</b>                          | <b>23,333</b>   | <b>–</b>                    | <b>23,333</b>          |

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

**CASH FLOW STATEMENT***for the year ended 30 June 2006*

|   | NOTES | CONSOLIDATED   |                 | PARENT         |                |
|---|-------|----------------|-----------------|----------------|----------------|
|   |       | 2006<br>\$'000 | 2005<br>\$'000  | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                   |       |                |                 |                |                |
| Receipts from customers                                       |       | 153,060        | 145,201         | 1,723          | 939            |
| Payments to suppliers and employees                           |       | (129,203)      | (136,301)       | (2,227)        | (2,356)        |
| Other revenue   |       | 90             | 15              | –              | 60             |
| Government scheme income                                      |       | 348            | 369             | –              | –              |
| Interest paid   |       | (3,934)        | (3,846)         | (343)          | (303)          |
| Income taxes paid   |       | (2,946)        | (6,124)         | (2,660)        | (2,657)        |
| Goods and services tax paid                                   |       | (496)          | (314)           | (76)           | (65)           |
| Research and development expenditure                          |       | (800)          | (450)           | –              | –              |
| <b>NET CASH FLOWS FROM/(USED IN) OPERATING ACTIVITIES</b>     | 4(b)  | <b>16,119</b>  | <b>(1,450)</b>  | <b>(3,583)</b> | <b>(4,382)</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                   |       |                |                 |                |                |
| Interest income   |       | 511            | 1,023           | 108            | 377            |
| Acquisition of property, plant and equipment                  |       | (4,481)        | (4,792)         | (1,487)        | (207)          |
| Proceeds on sale of property, plant and equipment             |       | 13             | 4,090           | –              | 2,437          |
| Proceeds on disposal of joint venture interests               | 4(e)  | –              | 1,188           | –              | 1,188          |
| Net cash impact on disposal of controlled entity              | 4(d)  | 37             | 714             | 37             | 836            |
| Proceeds on disposal/(purchase) of equity securities          |       | (30)           | 736             | (30)           | 736            |
| Dividends received  |       | 3              | 13              | 9,666          | 9,025          |
| Deposits paid   |       | (352)          | –               | (352)          | –              |
| <b>NET CASH FLOWS FROM/(USED IN) INVESTING ACTIVITIES</b>     |       | <b>(4,299)</b> | <b>2,972</b>    | <b>7,942</b>   | <b>14,392</b>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                   |       |                |                 |                |                |
| Receipts from controlled entities                             |       | –              | –               | 1,879          | 8,919          |
| Finance lease principal payments                              |       | (176)          | (845)           | –              | (2)            |
| Dividends paid  | 6(a)  | (12,315)       | (20,077)        | (11,978)       | (18,259)       |
| Proceeds from share issue                                     |       | –              | 1,118           | –              | 1,118          |
| (Repayment of)/proceeds from borrowings                       |       | 4,502          | (442)           | 1,902          | 146            |
| <b>NET CASH FLOWS USED IN FINANCING ACTIVITIES</b>            |       | <b>(7,989)</b> | <b>(20,246)</b> | <b>(8,197)</b> | <b>(8,078)</b> |
| <b>NET INCREASE/(DECREASE) IN CASH &amp; CASH EQUIVALENTS</b> |       | <b>3,831</b>   | <b>(18,724)</b> | <b>(3,838)</b> | <b>1,932</b>   |
| Cash and cash equivalents at the beginning of the year        |       | 9,765          | 28,489          | 6,398          | 4,466          |
| <b>CASH &amp; CASH EQUIVALENTS AT THE END OF THE YEAR</b>     | 4(a)  | <b>13,596</b>  | <b>9,765</b>    | <b>2,560</b>   | <b>6,398</b>   |

The cash flow statement should be read in conjunction with the accompanying notes.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 1 CORPORATE INFORMATION

The financial report of Schaffer Corporation Limited (the Group) for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors on 22 September 2006.

Schaffer Corporation Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange.

The nature of the operations and principal activities of the Group are described in note 28.

### NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of preparation

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 been prepared on an historical cost basis, except for derivative financial instruments and available-for-sale investments which have been measured at fair value.

The financial report is presented in Australian dollars and all values are rounded to the nearest thousand dollars (\$'000) unless otherwise stated under the option available to the Company under ASIC Class Order 98/100. The Company is an entity to which the class order applies.

#### (b) Statement of compliance

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

This is the first annual financial report prepared based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly except for the adoption of AASB 132 *Financial Instruments: Disclosure and Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement*. The Company has adopted the exemption under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* from having to apply AASB 132 and AASB 139 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report and at transition to AIFRS are detailed in note 34.

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

| AASB REFERENCE | TITLE   | SUMMARY   | APPLICATION DATE OF STANDARD* | IMPACT  | APPLICATION DATE FOR GROUP |
|----------------|---|---|-------------------------------|---|----------------------------|
| 2004-3         | Amendments to Australian Accounting Standards   | Consequential amendments made to AASB 1, AASB 101 and AASB 124 as a result of the revised AASB 119.   | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-1         | Amendments to Australian Accounting Standard  | Amendment to AASB 139 to allow the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in certain circumstances.  | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-3         | Amendments to Australian Accounting Standard [AASB 119]   | Amendment relates to the treatment of future taxes of defined benefit plans.  | 31 December 2005              | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-4         | Amendments to Australian Accounting Standards [AASB 139, AASB 132, AASB 1, AASB 1023 & AASB 1038] | Amendments relate to the restriction on designating financial instruments through profit and loss.  | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-5         | Amendments to Australian Accounting Standards [AASB 1 & AASB 139]                                 | Consequential amendments made to AASB 1 due to the issue of UIG Interpretations 4 'Determining whether an Arrangement contains a Lease'. Consequential amendments also made to AASB 139 due to the issue of UIG Interpretations 5 'Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds'. | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-6         | Amendments to Australian Accounting Standards [AASB 3]  | The definition of 'contribution by owners' is removed and the AASB 3 scope exclusion for business combinations involving entities or businesses under common control is adopted.  | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

NOTE 2  
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

| AASB REFERENCE               | TITLE  | SUMMARY   | APPLICATION DATE OF STANDARD* | IMPACT  | APPLICATION DATE FOR GROUP |
|------------------------------|--|---|-------------------------------|---|----------------------------|
| 2005-9                       | Amendments to Australian Accounting Standards [AASB 4, AASB 1023, AASB 139 & AASB 132]   | The amendments to all four standards provide guidance as to which standard applies to financial guarantee contracts under certain circumstances.  | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 2005-10                      | Amendments to Australian Accounting Standards [AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 123 & AASB 1038] | Amendments are a consequence of the issue of AASB 7 and ensure that all disclosures relating to financial instruments are removed from other standards and are all now within AASB 7.   | 1 January 2007                | No change to accounting policy required. Therefore no impact. | 1 July 2007                |
| 2006-1                       | Amendments to Australian Accounting Standards [AASB 121]   | The amendment clarifies the requirements relating to an entity's investment in foreign operations and assists the financial reporting of entities with investments in operations that have a different functional currency.   | 31 December 2006              | No change to accounting policy required. Therefore no impact. | 1 July 2007                |
| 2006-2                       | Amendments to Australian Accounting Standards [AASB 1]   | The amendment allows not-for-profit entities experiencing extreme difficulty in complying with some AASBs due to information deficiencies to use AASB 1, subject to certain disclosures.  | 30 June 2006                  | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| AASB 7                       | Financial Instruments: Disclosures   | AASB 7 supersedes AASB 130 and the disclosure requirements of AASB 132.   | 1 January 2007                | No change to accounting policy required. Therefore no impact. | 1 July 2007                |
| UIG INTERPRETATION REFERENCE | TITLE  | SUMMARY   | APPLICATION DATE OF STANDARD* | IMPACT  | APPLICATION DATE FOR GROUP |
| 4                            | Determining whether an Arrangement contains a Lease  | Specifies criteria for determining whether an arrangement is, or contains, a lease.   | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 5                            | Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds   | Provides guidance on how a contributor should account for its interest in a decommissioning fund.   | 1 January 2006                | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 6                            | Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment  | Clarifies when a liability arises under the European Union's Directive on Waste Electrical and Electronic Equipment in relation to the cost of waste management for the decommissioning of electrical and electronic equipment that had been sold to private households up to 13 August 2005. | 1 December 2005               | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 7                            | Applying the Restatement Approach under AASB 129 Financial Reporting in Hyperinflationary Economies  | Specifies that when hyperinflation is first identified, AASB 129 applies as if the economy had always been hyperinflationary and provides guidance as to how to apply AASB 129, in particular in relation to deferred tax items.  | 1 March 2006                  | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 8                            | Scope of AASB 2  | Provides clarification on the scope of AASB 2, such that it includes transactions in which the entity cannot identify specifically some or all of the goods or services received as consideration for equity instruments of the entity or other share-based payments.                         | 1 May 2006                    | No change to accounting policy required. Therefore no impact. | 1 July 2006                |
| 9                            | Reassessment of Embedded Derivatives   | Clarifies when an entity should assess whether an embedded derivative is required to be separated from the host contract.   | 1 June 2006                   | No change to accounting policy required. Therefore no impact. | 1 July 2006                |

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

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

#### (c) Basis of consolidation

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

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

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

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

Minority interests represent the portion of profit or loss and net assets in Australian Leather Holdings Limited not held by the Group and are presented separately in the income statement and within equity in the consolidated balance sheet.

Investments in controlled entities are carried at cost by the Company.

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

##### (i) Significant accounting judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Operating lease commitments – Group as Lessor

The entity has entered into commercial property leases on its investment property portfolio. The entity has determined that it retains all the significant risks and rewards of ownership of these properties and has thus classified the leases as operating leases.

##### (ii) Significant accounting 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

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill is discussed in note 15(a).

Share based payment transactions

*Share options*

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by an external valuer using the binominal formula, using the assumptions detailed in the Directors' Report under directors' and executives disclosures.

*Employee participation units*

The Group measures the cost of cash-settled share-based payments at fair value at the grant date using the Black-Scholes formula taking into account the terms and conditions upon which the instruments were granted, as discussed in the Directors' Report under directors and executives disclosures.

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

#### (e) Interest in jointly controlled assets

In respect of the Group's interest in jointly controlled assets, the following are recognised in the financial statements:

- (i) the Group's share of the jointly controlled assets, classified according to the nature of the assets;
- (ii) any liabilities that the Group has incurred;
- (iii) the Group's share of any liabilities incurred jointly with the other venturers in relation to the joint venture;
- (iv) any income from the sale or use of the Group's share of the output of the joint venture, together with the Group's share of any expenses incurred by the joint venture; and
- (v) any expenses that the Group has incurred in respect of its interest in the joint venture.

#### (f) Foreign currency translation

Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Both the functional and presentation currency of Schaffer Corporation Limited and its Australian subsidiaries is Australian dollars (A\$).

Transactions in foreign currencies are initially recorded in the functional currency at 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. All exchange differences arising from the above procedures are taken to the income statement.

The functional currency of overseas subsidiaries is shown below:

|                                  |      |
|----------------------------------|------|
| Howe de Mexico SA de CV          | PESO |
| Howe Slovenko S.R.O.             | EURO |
| Howe Leather (Shanghai) Co. Ltd. | USD  |

As at the reporting date the assets and liabilities of these overseas subsidiaries are translated into the presentation currency of Schaffer Corporation Limited at the rate of exchange ruling at the balance sheet date and the income statements are translated at the average exchange rates for the year.

The exchange differences arising on the translation are taken directly to a separate component of equity.

On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

#### (g) Investment Properties

Investments properties are measured at cost less any accumulated depreciation.

Investment properties are derecognised either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in profit or loss in the year of retirement or disposal.

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

- buildings over 40 years
- land is not depreciated

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

#### (h) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts that are eligible for capitalisation when the cost of replacing the parts is incurred.

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

- Buildings – over 40 years
- Leasehold improvements – the shorter of the lease term and the asset's useful life
- Joint venture investment properties – over 40 years
- Plant and equipment – over 5 to 15 years

#### *Impairment*

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

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

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

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

#### (i) 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 identifiable assets, liabilities and contingent liabilities.

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

Goodwill is not amortised.

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

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

Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates.

Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

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

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

Impairment losses for goodwill are not subsequently reversed.

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

#### (j) Impairment of assets

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

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses relating to continuing operations are recognised in those expense categories consistent with the function of the impaired asset unless the asset is carried at revalued amount (in which case the impairment loss is treated as a revaluation decrease).

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

#### (k) Investments and other financial assets

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

#### *Accounting policies applicable for the year ended 30 June 2006*

Financial assets are classified as other loans and receivables or available-for-sale investments. When financial assets are recognised initially, they are measured at fair value plus directly attributable transaction costs.

#### (i) Available-for-sale investments

After initial recognition, these financial assets are measured at fair value. Gains or losses are recognised as a separate component of equity until the fixed asset is sold, collected or otherwise disposed of, or until the financial asset is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

For available-for-sale financial assets where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the financial asset.

Purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date i.e. the date that the Group commits to purchase the asset.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

#### (ii) Loans and receivables

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

#### *Accounting policies applicable for the year ended 30 June 2005*

Listed and unlisted shares held for trading were carried at the lower of cost and net realisable value. Changes in net realisable value were recognised as a revenue or expense in determining the net profit for the period.

#### (l) Inventories

Inventories 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.

Finished goods and work-in-progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs.

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

#### (m) Trade and other receivables

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

#### *Accounting policies applicable for the year ended 30 June 2006*

Trade receivable, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

An allowance for doubtful debts is made when there is objective evidence that the Group will not be able to collect the debts. Bad debts are written off when identified.

#### *Accounting policies applicable for the year ended 30 June 2005*

Trade receivables are recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred. Receivables from relating parties are recognised and carried at the nominal amount due less a provision for any uncollectible debts. Interest is taken up as income on an accrual basis.

#### (n) Cash and cash equivalents

For the purposes of the cash flow statement and balance sheet, cash and cash equivalents includes cash on hand and in banks, and money market investments readily convertible to cash within two working days, net of outstanding bank overdrafts.

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

#### (o) Interest-bearing loans and borrowings

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

#### *Accounting policies applicable for the year ended 30 June 2006*

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

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

Gains and losses are recognised in profit or loss when the liabilities are derecognised.

#### *Accounting policies applicable for the year ended 30 June 2005*

All loans are measured at the principal amount. Interest is charged as an expense as it accrues. Bills of exchange and promissory notes are carried at the principal amount.

#### (p) Provisions

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

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

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

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

#### *Restructure provisions*

Provisions relating to restructures are recognised when:

- the Group has a detailed formal plan for the restructuring; and
- has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement it or by announcing its main features to those affected.

#### (q) Employee entitlements

Provision is made for employee entitlement benefits accumulated as a result of employees rendering services up to the reporting date. These benefits include wages and salaries, annual leave and long service leave. Liabilities arising in respect of wages and salaries, annual leave and any other employee entitlements expected to be settled within twelve months of the reporting date are measured at the amounts expected to be settled. All other employee entitlement liabilities are measured at the present value of the estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. In determining the present value of future cash outflows, the interest rates attaching to national government bonds securities which have terms to maturity approximating the terms of the related liability are used. Employee entitlements, expenses and revenues arising in respect of the following categories:

- Wages and salaries, non monetary benefits, annual leave, long service leave and other leave entitlements; and
  - Other types of employee entitlements,
- are charged against profits on a net basis in their respective categories.

Contribution to defined contribution superannuation plans are expensed when incurred.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

#### (r) Executive share option arrangement

The directors of Schaffer Corporation Limited may grant in their absolute discretion, without payment, share options to employees under an employee share scheme approved by shareholders at the annual general meeting in November 1999. Each option is convertible into one ordinary share of Schaffer Corporation Limited on payment of the exercise price, after a vesting period, but prior to the expiry date.

The exercise price is determined at the grant date at the absolute discretion of the directors' but not less than the greater of:

- (1) the weighted average of the last sale price on the Australian Stock Exchange Limited of the shares in the Company for each of the five trading days on which a sale of the Company's shares was effected immediately preceding the date on which any options are issued to any participant; and
- (2) 20 cents.

The options hold no voting or dividend rights, and are not transferable. Schaffer Corporation Limited does not provide any loans or guarantees to enable executives to finance the exercise of their options. When an executive ceases to be employed by the entity any unexercised options automatically lapse and are forfeited and cancelled.

The cost of these equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by an external valuer using a Black-Scholes model.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Schaffer Corporation Limited ("market conditions").

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

The cumulative expense recognised for equity-settled transactions at each reporting date until vesting date reflects (i) the extent to which the vesting period has expired and (ii) the Group's best estimate of the number of equity instruments that will ultimately vest. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date. The income statement charge or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

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

If 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 modification that increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee, as measured at the date of modification.

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

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share (see note 31).

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

#### (s) Employee participation units

A controlled entity Australian Leather Holdings Limited may grant employee participation units (EPUs) in accordance with its Employee Incentive Plan adopted by ALH shareholders on 20 December 2001.

An EPU provides an employee with a right on termination of employment under certain conditions and in certain other-circumstances to receive a cash payment from Australian Leather Holdings Limited. Schaffer Corporation Limited has the option to compel the employee to use the whole or part of that cash payment to subscribe for Schaffer Corporation Limited shares.

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

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Schaffer Corporation Limited ("market conditions").

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

#### (t) Leases

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

##### (i) Group as Lessee

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

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised as an expense in profit or loss.

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

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

##### (ii) Group as Lessor

Leases where the Group retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same bases as the rental income.

#### (u) 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 is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be measured reliably. Risks and rewards are considered passed to the buyer at the time control of the goods has passed to the customer.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

#### *Interest income*

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

#### *Dividends*

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

#### *Rental income*

Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Contingent rental income is recognised as income in the periods in which it is earned.

#### *Sale of land*

Revenue on the sale of land is brought to account when the sale is unconditional.

#### (v) Government Grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

Claims are made under the Strategic Investment Program and are for either capital grants or for research and product development. Claims must meet the strict criteria set down by Ausindustry.

#### (w) Income Tax

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

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

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

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- where taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, and 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.

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

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 credits and unused tax losses can be utilised except:

- where the deferred income tax asset relating to the deductible temporary differences 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; or
- where the deductible temporary differences associated with investments in subsidiaries, or interests in joint ventures is, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent 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 balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

Income taxes relating to items recognised directly in equity are recognised in equity and not in the profit or loss.

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

The Company and all its wholly-owned Australian resident subsidiaries are part of a tax consolidated group. The Company, being the head entity in a tax consolidated group, assumes the current tax liability and any deferred tax assets arising from tax losses and other unused tax credits of the subsidiaries in the tax consolidated group. Deferred tax balances of the subsidiaries in the tax consolidated group are not assumed by the parent entity.

The Group allocates the tax balances for the period using a method that is systematic, rational and consistent with the broad principles of AASB 112, the group allocation approach, and a tax funding arrangement is in place to reimburse the parent entity for any liabilities of the subsidiaries it assumes and conversely, for the parent entity to reimburse the subsidiaries for any recognised tax losses it assumes.

#### (x) Other taxes

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

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

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

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

#### (y) Derivative financial instruments and hedging

The Group has elected to apply the option available under AASB 1 of adopting AASB 132 and AASB 139 from 1 July 2005. Outlined below are the relevant accounting policies for derivative financial instruments and hedging applicable for the years ended 30 June 2006 and 30 June 2005.

*Account policies applicable for the year ended 30 June 2006*

#### *Forward exchange contracts*

The Group uses derivative financial instruments such as forward currency contracts to hedge its risks associated with foreign currency fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured to fair value. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

The Group has determined that these derivatives do or qualify for hedge accounting and as such, any gains or losses arising from changes in fair value are taken directly to the income statement.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

*Accounting policies applicable for the year ended 30 June 2005*

The Group enters into forward exchange contracts where it agrees to sell specified amounts of foreign currencies in the future at a predetermined exchange rate. The objective is to match the contract with anticipated future cash flows from sales and purchases in foreign currencies, to protect the Group against the possibility of loss from future exchange rate fluctuations. The forward exchange contracts are usually for no longer than 12 months.

#### (z) 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.

#### (aa) Earnings per share

Basic earnings per share is calculated as net profit attributable to members of the parent adjusted to exclude costs of servicing equity (other than dividends) and preference share dividends, divided by the weighted average number of ordinary shares outstanding during the period, adjusted for any bonus element. Diluted earnings per share, is calculated as net profit attributable to members adjusted for:

- costs of servicing equity (other than dividends) and preference share dividends;
- the after tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and
- other non-discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares;

divided by the weighted average number of ordinary shares outstanding during the period and dilutive potential ordinary shares, adjusted for any bonus element.

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

#### (ab) Borrowing costs

Borrowing costs are recognised as an expense when incurred.

#### (ac) Trade and other payables

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

*Accounting policies applicable for the year ended 30 June 2006*

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

*Accounting policies applicable for the year ended 30 June 2005*

Liabilities for trade creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity. Payables to related parties are carried at the principal amount. Interest, when charged by the lender, is recognised as an expense on an accrual basis.

#### (ad) Research costs

Research costs are expenses as incurred.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|   | CONSOLIDATED   |                | PARENT       |              |
|---|----------------|----------------|--------------|--------------|
|   | 2006           | 2005           | 2006         | 2005         |
|   | \$'000         | \$'000         | \$'000       | \$'000       |
| <b>NOTE 3</b>   |                |                |              |              |
| <b>REVENUES AND EXPENSES</b>  |                |                |              |              |
| Revenue and expenses from continuing operations                       |                |                |              |              |
| <b>(a) Net rental income</b>  |                |                |              |              |
| Rent received/receivable from   |                |                |              |              |
| – controlled entities   | –              | –              | 87           | 84           |
| – other persons/corporations  | 3,424          | 3,150          | 1,061        | 973          |
|   | <u>3,424</u>   | <u>3,150</u>   | <u>1,148</u> | <u>1,057</u> |
| Rental property expenses  | (1,744)        | (1,510)        | (393)        | (347)        |
| Net rental income   | <u>1,680</u>   | <u>1,640</u>   | <u>755</u>   | <u>710</u>   |
| <b>(b) Finance (costs)/income</b>                                     |                |                |              |              |
| Bank and other loans and overdrafts – interest                        | (3,916)        | (3,532)        | (351)        | (308)        |
| Finance charges payable under finance leases                          | (18)           | (313)          | –            | –            |
| Total finance costs   | <u>(3,934)</u> | <u>(3,845)</u> | <u>(351)</u> | <u>(308)</u> |
| Bank interest received  | 511            | 1,023          | 108          | 377          |
| Total finance income  | <u>511</u>     | <u>1,023</u>   | <u>108</u>   | <u>377</u>   |
| <b>(c) Dividends</b>  |                |                |              |              |
| Dividends received/receivable from                                    |                |                |              |              |
| – controlled entities   | –              | –              | 9,663        | 9,012        |
| – other corporation   | 3              | 13             | 3            | 13           |
|   | <u>3</u>       | <u>13</u>      | <u>9,666</u> | <u>9,025</u> |
| <b>(d) Other income/(losses)</b>                                      |                |                |              |              |
| Gain/(loss) on sale of property, plant and equipment                  | (26)           | 1,400          | –            | 1,099        |
| Gain on sale of listed and unlisted shares                            | 10             | 218            | 10           | 218          |
| Net foreign currency gain   | 489            | 627            | –            | –            |
| Government grants   | 348            | 369            | –            | –            |
| Profit on disposal of controlled entity                               | 37             | 689            | 37           | 375          |
| Other   | 120            | 15             | –            | 60           |
|   | <u>978</u>     | <u>3,318</u>   | <u>47</u>    | <u>1,752</u> |
| <b>(e) Depreciation and amortisation included in income statement</b> |                |                |              |              |
| Included in cost of sales:  |                |                |              |              |
| Depreciation  | 4,493          | 4,341          | –            | –            |
| Included in rental property expenses:                                 |                |                |              |              |
| Depreciation  | 405            | 405            | 151          | 140          |
| Included in marketing and administrative expenses:                    |                |                |              |              |
| Depreciation  | 336            | 230            | 36           | 59           |
|   | <u>5,234</u>   | <u>4,976</u>   | <u>187</u>   | <u>199</u>   |

|  | CONSOLIDATED  |               | PARENT       |              |
|--|---------------|---------------|--------------|--------------|
|  | 2006          | 2005          | 2006         | 2005         |
|  | \$'000        | \$'000        | \$'000       | \$'000       |
| <b>NOTE 3</b>  |               |               |              |              |
| <b>REVENUES AND EXPENSES (CONTINUED)</b>               |               |               |              |              |
| <b>(f) Lease payments included in income statement</b> |               |               |              |              |
| Included in cost of sales:                             |               |               |              |              |
| Minimum lease payments                                 |               |               |              |              |
| – operating lease                                      | 1,228         | 1,221         | –            | –            |
| Included in marketing and administrative expenses:     |               |               |              |              |
| Minimum lease payments                                 |               |               |              |              |
| – operating lease                                      | 723           | 568           | 9            | 9            |
|  | <u>1,951</u>  | <u>1,789</u>  | <u>9</u>     | <u>9</u>     |
| <b>(g) Employee benefit expense</b>                    |               |               |              |              |
| Wages and salaries                                     | 30,023        | 33,915        | 863          | 1,103        |
| Long service leave provisions                          | 110           | 127           | (17)         | (17)         |
| Worker's compensation costs                            | 798           | 1,173         | 7            | 19           |
| Superannuation costs                                   | 2,786         | 3,073         | 153          | 96           |
| Expense of share-based payments                        | 80            | 147           | 4            | 81           |
|  | <u>33,797</u> | <u>38,435</u> | <u>1,010</u> | <u>1,282</u> |
| <b>(h) Other expenses/(gains)</b>                      |               |               |              |              |
| Research expenditure                                   | 800           | 450           | –            | –            |
| Inventory write down to net realisable value           | 336           | –             | –            | –            |
| Redundancy expenses                                    | 1,299         | 473           | –            | –            |
| Write back allowance for doubtful debts                | (270)         | (1,012)       | –            | –            |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED   |                | PARENT         |                |
|--|----------------|----------------|----------------|----------------|
|  | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>NOTE 4</b>  |                |                |                |                |
| <b>CASH AND CASH EQUIVALENTS</b>   |                |                |                |                |
| <b>(a) Reconciliation of cash</b>  |                |                |                |                |
| Cash balance comprises:  |                |                |                |                |
| Cash at bank and in hand   | 13,596         | 12,737         | 2,560          | 6,398          |
| Bank overdraft   | -              | (2,972)        | -              | -              |
| Closing cash balance per cash flow statement   | <u>13,596</u>  | <u>9,765</u>   | <u>2,560</u>   | <u>6,398</u>   |
| <b>(b) Reconciliation of operating profit after income tax to the net cash flows from operations</b> |                |                |                |                |
| Net profit   | 8,430          | 10,107         | 8,199          | 9,696          |
| Adjustment for –   |                |                |                |                |
| Depreciation and amortisation  | 5,234          | 4,976          | 187            | 199            |
| Interest received  | (511)          | (1,023)        | (108)          | (377)          |
| Dividends received   | (3)            | (13)           | (9,666)        | (9,025)        |
| Share-based payments expense   | 80             | 147            | 4              | 81             |
| (Provision for)/write back of employee entitlements  | (265)          | (1,946)        | (61)           | (25)           |
| Loss/(profit) on sale of property, plant & equipment   | 26             | (1,400)        | -              | (1,099)        |
| Gain on sale of listed and unlisted shares   | (10)           | (218)          | (10)           | (218)          |
| (Reversal of)/provision for non recovery of amounts owing by controlled entities                     | -              | -              | -              | (158)          |
| Profit on sale of shares in partly owned controlled entities   | (37)           | (689)          | (37)           | (375)          |
| Write back provision for diminution in value of shares in unlisted controlled entity                 | -              | -              | -              | (214)          |
| Changes in assets and liabilities  |                |                |                |                |
| (Increase)/decrease in trade and other receivables   | 2,119          | (1,773)        | (1,810)        | (351)          |
| (Increase)/decrease in inventories   | (3,136)        | (3,657)        | -              | -              |
| Decrease in deferred exchange loss   | -              | 296            | -              | -              |
| (Decrease)/increase in trade and other payables  | 3,256          | (3,586)        | (1,054)        | (2,185)        |
| (Decrease)/increase in income tax payable  | 612            | (2,485)        | 612            | (281)          |
| (Decrease)/increase in deferred income tax liabilities   | (63)           | (512)          | (9)            | (77)           |
| (Increase)/decrease in deferred income tax asset   | 243            | 563            | 184            | 22             |
| (Increase)/decrease in prepayments   | 144            | (237)          | (14)           | 5              |
| Net cash flows from/(used) operating activities  | <u>16,119</u>  | <u>(1,450)</u> | <u>(3,583)</u> | <u>(4,382)</u> |

(c) Bank facilities – refer note 19.

(d) Non cash financing activities

During the current financial year plant costing \$218,000 (2005 – Nil) was acquired under a finance lease.

NOTE 4  
CASH AND CASH EQUIVALENTS (CONTINUED)

(e) Disposal of interest in controlled entity

On 24 September 2004 the consolidated entity disposed of its 51% interest in Solco Industries Pty. Ltd.

The disposal details are:

|   | \$'000       |
|---|--------------|
| Consideration   |              |
| Cash  | 836          |
| Shares in Solar Energy Systems Ltd                          | 255          |
| Total proceeds on disposal of controlled entity             | <u>1,091</u> |
| Net assets disposed of                                      |              |
| Cash  | 122          |
| Receivables   | 478          |
| Inventories   | 204          |
| Plant and equipment   | 137          |
| Deferred tax asset  | 21           |
|   | <u>962</u>   |
| Trade creditors   | (514)        |
| Employee entitlements                                       | (46)         |
| Net assets disposed of                                      | <u>402</u>   |
| Net profit on disposal                                      | <u>689</u>   |
| Net cash impact on disposal of controlled entity comprises: |              |
| Consideration for sale of shares                            | 836          |
| Less cash assets of controlled entity                       | (122)        |
|   | <u>714</u>   |

A further \$37,000 was received in the current financial year.

(f) Disposal of joint venture interests

On 15 March 2004 the consolidated entity disposed of its interest in the GHD House Joint Venture.

The proceeds of \$1,188,000 were received in the 2005 financial year.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED |              | PARENT     |            |
|--|--------------|--------------|------------|------------|
|  | 2006         | 2005         | 2006       | 2005       |
|  | \$'000       | \$'000       | \$'000     | \$'000     |
| <b>NOTE 5</b>  |              |              |            |            |
| <b>INCOME TAX</b>  |              |              |            |            |
| The major components of income tax expense are:  |              |              |            |            |
| <b>Income Statement</b>  |              |              |            |            |
| <i>Current income tax</i>  |              |              |            |            |
| Current income tax charge  | 3,887        | 3,709        | (66)       | 197        |
| Adjustment in respect of current income tax of previous years  | (70)         | (90)         | -          | 61         |
| <i>Deferred income tax</i>   |              |              |            |            |
| Relating to origination and reversal of temporary differences  | 180          | 70           | 175        | (33)       |
| Income tax expense reported in the income statement  | <u>3,997</u> | <u>3,689</u> | <u>109</u> | <u>225</u> |
| <b>Statement of changes in equity</b>  |              |              |            |            |
| <i>Deferred income tax related to items charged or credited directly to equity</i>   |              |              |            |            |
| Unrealised gain on available-for-sale investments  | 54           | -            | 54         | -          |
| Income tax expense reported in equity  | <u>54</u>    | <u>-</u>     | <u>54</u>  | <u>-</u>   |
| A reconciliation between tax expenses and the product of accounting profit before income tax multiplied by the Group's applicable income tax rate is as follows: |              |              |            |            |
| Accounting profit before income tax  | 12,427       | 13,796       | 8,308      | 9,921      |
| At the Group's statutory income tax rate of 30% (2005 - 30%)   | 3,728        | 4,139        | 2,492      | 2,976      |
| - tax on dividends received  | 499          | (13)         | -          | -          |
| - dividends received from controlled entities  | -            | -            | (2,400)    | (2,708)    |
| - expenses not allowable for income tax purposes   | 67           | 21           | 34         | 36         |
| - other items  | (167)        | (113)        | (17)       | (140)      |
| - disposal of controlled entity  | -            | (123)        | -          | -          |
| - research and development   | (60)         | (132)        | -          | -          |
| - under/(over) provision of current income tax of previous years   | (70)         | (90)         | -          | 61         |
| Income tax expense reported in the consolidated income statement   | <u>3,997</u> | <u>3,689</u> | <u>109</u> | <u>225</u> |

NOTE 5  
INCOME TAX (CONTINUED)

## Deferred income tax

Deferred income tax at 30 June relates to the following:

|   | BALANCE SHEET |              | INCOME STATEMENT |             |
|---|---------------|--------------|------------------|-------------|
|   | 2006          | 2005         | 2006             | 2005        |
|   | \$'000        | \$'000       | \$'000           | \$'000      |
| <b>CONSOLIDATED</b>   |               |              |                  |             |
| <i>Deferred tax liabilities</i>   |               |              |                  |             |
| Accelerated depreciation for tax purposes   | 1,452         | 1,905        | 453              | 184         |
| Leased assets to be amortised for accounting purposes   | 115           | 124          | 9                | 16          |
| Expenses deducted for income tax purposes but deferred for accounting purposes                        | 85            | 59           | (26)             | 42          |
| Income taken up for accounting purposes currently not assessable for income tax purposes              | 358           | 56           | (302)            | -           |
| Unrealised gain on available-for-sale listed investments  | 54            | -            | -                | -           |
| Deferred gains and losses on foreign exchange contracts and translations                              | 71            | -            | (71)             | -           |
| Deferred gain for income tax purposes on available-for-sale investments on script for script rollover | 7             | 7            | -                | 82          |
| Gross deferred income tax liabilities   | <u>2,142</u>  | <u>2,151</u> |                  |             |
| <b>CONSOLIDATED</b>   |               |              |                  |             |
| <i>Deferred tax assets</i>  |               |              |                  |             |
| Employee entitlements   | 1,288         | 1,413        | (125)            | 191         |
| Allowance for doubtful debts  | 132           | 60           | 72               | 30          |
| Accelerated depreciation for accounting purposes  | 123           | 83           | 40               | 50          |
| Deferred gains and losses on foreign exchange contracts and translations                              | 427           | 303          | 124              | (156)       |
| Deferred loss on available-for-sale investments   | 80            | 236          | (156)            | -           |
| Expenses not immediately deductible for income tax purposes   | 176           | 387          | (211)            | (467)       |
| Lease liability deductible for income tax purposes  | 95            | 82           | 13               | (42)        |
| Gross deferred income tax assets  | <u>2,321</u>  | <u>2,564</u> |                  |             |
| Deferred tax expense  |               |              | <u>(180)</u>     | <u>(70)</u> |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

| BALANCE SHEET |        | INCOME STATEMENT |        |
|---------------|--------|------------------|--------|
| 2006          | 2005   | 2006             | 2005   |
| \$'000        | \$'000 | \$'000           | \$'000 |

NOTE 5  
INCOME TAX (CONTINUED)

## PARENT

*Deferred tax liabilities*

|   |     |     |   |      |
|---|-----|-----|---|------|
| Accelerated depreciation for tax purposes   | 111 | 120 | 9 | (26) |
| Unrealised gain on available-for-sale listed investments  | 54  | -   | - | -    |
| Deferred gain for income tax purposes on available-for-sale investments on script for script rollover | 7   | 7   | - | 82   |
| Gross deferred income tax liabilities   | 172 | 127 |   |      |

## PARENT

*Deferred tax assets*

|   |     |     |       |      |
|---|-----|-----|-------|------|
| Employee entitlements                                       | 154 | 173 | (19)  | (7)  |
| Deferred loss on available-for-sale investments             | 80  | 236 | (156) | -    |
| Expenses not immediately deductible for income tax purposes | 29  | 38  | (9)   | (16) |
| Gross deferred income tax assets                            | 263 | 447 |       |      |
| Deferred tax income/(expense)                               |     |     | (175) | 33   |

**Tax consolidation**

The Company and its wholly-owned Australian resident subsidiaries have formed a tax-consolidated group with effect from 1 July 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Schaffer Corporation Limited.

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

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

NOTE 5  
INCOME TAX (CONTINUED)**Tax consolidation contributions by (or distributions to) equity participants**

The net amount recognised for the period under tax consolidation contributions by (or distributions to) equity participants, its major components and the accounts affected are as follows:

|   | PARENT       |         |
|---|--------------|---------|
|   | 2006         | 2005    |
|   | \$'000       | \$'000  |
| <i>Major components of tax consolidation contributions by (or distributions to) equity participants</i> |              |         |
| Net assumptions of tax liabilities of members of the tax-consolidated group                             | 3,338        | 2,096   |
| Tax funding contribution receivable from controlled entities  | (3,338)      | (2,096) |
| Excess of tax funding contributions over tax liabilities assumed  | -            | -       |
|   |              |         |
|   | CONSOLIDATED |         |
|   | 2006         | 2005    |
|   | \$'000       | \$'000  |
|   | PARENT       |         |
|   | 2006         | 2005    |
|   | \$'000       | \$'000  |

NOTE 6  
DIVIDENDS PROVIDED FOR OR PAID

## (a) Dividends paid

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Final 2005 – 25¢ per share paid in September 2005 (2005 – 50¢)             | 3,523  | 7,014  | 3,523  | 7,014  |
| Special final 2005 – 35¢ per share paid September 2005 (2005 – 20¢)        | 4,932  | 2,805  | 4,932  | 2,805  |
| Interim 2006 – 25¢ per share paid in March 2006 (2005 – 50¢)               | 3,523  | 7,033  | 3,523  | 7,033  |
| Special interim 2006 – Nil¢ per share (2005 – 10¢)                         | -      | 1,407  | -      | 1,407  |
| Fully franked dividends paid by parent                                     | 11,978 | 18,259 | 11,978 | 18,259 |
| Dividend paid by controlled entity to minority shareholder (refer note 30) | 337    | 1,818  | -      | -      |
| Total fully franked dividends paid   | 12,315 | 20,077 | 11,978 | 18,259 |

## (b) Proposal for approval at AGM (not recognised as a liability as at 30 June)

|  |       |       |       |       |
|--|-------|-------|-------|-------|
| Dividends on ordinary shares                       |       |       |       |       |
| Final franked dividend for 2006 – 25¢ (2005 – 25¢) | 3,523 | 3,523 | 3,523 | 3,523 |

## (c) The tax rate at which dividends have or will be franked is Interim 30% (2005 – 30%), Final 30% (2005 – 30%)

*Franking account balance*

The amount of franking credits available for the subsequent financial year are detailed below:

The franking account balance disclosures have been calculated using the franking rate at 30 June 2006

|   |         |         |
|---|---------|---------|
| Franking account balance brought forward  | 3,684   | 4,987   |
| Fully franked dividends paid  | (5,133) | (7,825) |
| Tax paid  | 2,662   | 2,655   |
| Franked dividends received from controlled entities   | -       | 3,862   |
| Franked dividends received from other corporations  | 1       | 5       |
| Franking account balance at the end of the financial year   | 1,214   | 3,684   |
| Franking credits that will arise from the payment of income tax payable as at the end of the financial year by the parent | 1,825   | 1,213   |
| Franking credits available  | 3,039   | 4,897   |

The above franking account is expressed on a tax paid basis

|   |       |        |
|---|-------|--------|
| Fully franked dividends which can be paid from the above franking credits available amount to | 7,091 | 11,426 |
|---|-------|--------|

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED  |               | PARENT     |            |
|--|---------------|---------------|------------|------------|
|  | 2006          | 2005          | 2006       | 2005       |
|  | \$'000        | \$'000        | \$'000     | \$'000     |
| <b>NOTE 7</b>                                |               |               |            |            |
| <b>TRADE AND OTHER RECEIVABLES (CURRENT)</b> |               |               |            |            |
| Trade debtors (see notes (i) and (ii))       | 23,923        | 25,722        | -          | -          |
| Allowance for doubtful debts                 | (689)         | (959)         | -          | -          |
|  | <u>23,234</u> | <u>24,763</u> | -          | -          |
| Sundry debtors (see note (ii))               | 2,770         | 3,360         | 397        | 811        |
|  | <u>26,004</u> | <u>28,123</u> | <u>397</u> | <u>811</u> |

Terms and conditions relating to the above financial instruments

- (i) Trade debtors are non interest bearing and generally on 30 days terms. An allowance for doubtful debts is made when there is objective evidence that a trade receivable is impaired. An allowance of \$689,000 (2005 – \$959,000) has been recognised for the current year for specific debtors for which such evidence exists. The amount of the allowance has been measured as the difference between the carrying amount of the trade receivables and the estimated future cash flows expected to be received from the relevant debtors.
- (ii) Sundry debtors and other receivables are non interest bearing and have repayment terms between 30 and 90 days.
- (iii) Included in trade debtors are non hedged foreign currency receivables amounting to:

|       | 2006   |                    | 2005   |                    |
|-------|--------|--------------------|--------|--------------------|
|       | \$'000 | AUST \$ EQUIVALENT | \$'000 | AUST \$ EQUIVALENT |
| US \$ | 2,826  | 3,799              | 8,153  | 10,684             |
| Euro  | 3,391  | 5,723              | 3,415  | 5,397              |
| RMB   | 17,368 | 2,940              | 2,683  | 401                |

Payment terms vary from letter of credit arrangement to terms of 30 to 60 days.

### NOTE 8 INVENTORIES

|  | CONSOLIDATED  |               | PARENT |       |
|--|---------------|---------------|--------|-------|
|  | 2006          | 2005          | 2006   | 2005  |
|  | \$000         | \$000         | \$000  | \$000 |
| Work in progress – at net realisable value | 2,975         | 4,416         | -      | -     |
| Finished goods – at cost                   | 12,946        | 10,229        | -      | -     |
| Raw materials – at cost                    | 21,110        | 19,404        | -      | -     |
|  | <u>37,031</u> | <u>34,049</u> | -      | -     |
| Land held for resale                       |               |               |        |       |
| Cost of acquisition                        | 244           | 286           | -      | -     |
| Development expenses capitalised           | 968           | 772           | -      | -     |
| Carrying value of land                     | 1,212         | 1,058         | -      | -     |
|  | <u>38,243</u> | <u>35,107</u> | -      | -     |

Inventory write downs recognised as an expense totalled \$336,000 (2005 – \$Nil).

|  | CONSOLIDATED |           | PARENT     |           |
|--|--------------|-----------|------------|-----------|
|  | 2006         | 2005      | 2006       | 2005      |
|  | \$'000       | \$'000    | \$'000     | \$'000    |
| <b>NOTE 9</b>                                  |              |           |            |           |
| <b>AVAILABLE-FOR-SALE FINANCIAL ASSETS</b>     |              |           |            |           |
| At fair value                                  |              |           |            |           |
| Shares – unlisted                              | 15           | -         | 15         | -         |
| Shares – listed                                | 289          | -         | 289        | -         |
| At cost  |              |           |            |           |
| Shares – listed                                | -            | 37        | -          | 37        |
| At cost less allowance for diminution in value |              |           |            |           |
| Shares – unlisted                              | -            | 46        | -          | 46        |
|  | <u>304</u>   | <u>83</u> | <u>304</u> | <u>83</u> |

Available-for-sale investments consist of investments in ordinary shares, and therefore have no fixed maturity date or coupon rate.

The fair value of the unlisted available-for-sale investments has been estimated using valuation techniques based on assumptions that are not supported by observable market prices or rates. Management believes the estimated fair values resulting from the valuation techniques and recorded in the balance sheet and the related changes in fair values recorded in the income statement are reasonable and the most appropriate at the balance sheet date.

### NOTE 10 PREPAYMENTS AND DEPOSITS

|             |              |            |            |           |
|-------------|--------------|------------|------------|-----------|
| Deposits    | 352          | -          | 352        | -         |
| Prepayments | 724          | 868        | 27         | 13        |
|             | <u>1,076</u> | <u>868</u> | <u>379</u> | <u>13</u> |

Deposits relate to property, plant and equipment acquisition commitments.

Prepayments comprise insurance, advertising and raw materials.

### NOTE 11 TRADE AND OTHER RECEIVABLES (NON CURRENT)

|   |   |   |       |       |
|---|---|---|-------|-------|
| Amount owed by wholly owned controlled entities     | - | - | 6,919 | 8,411 |
| Terms and conditions – refer related party Note 29. |   |   |       |       |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  |              |        |        |        |
|--|--------------|--------|--------|--------|
|  | CONSOLIDATED |        | PARENT |        |
|  | 2006         | 2005   | 2006   | 2005   |
|  | \$'000       | \$'000 | \$'000 | \$'000 |

|  |                          |        |
|--|--------------------------|--------|
|  | SCHAFFER<br>CLOSED GROUP |        |
|  | 2006                     | 2005   |
|  | \$'000                   | \$'000 |

## NOTE 12

## OTHER FINANCIAL ASSETS (NON CURRENT)

Controlled entities at cost

|                 |   |   |        |        |
|-----------------|---|---|--------|--------|
| Unlisted shares | - | - | 19,664 | 19,664 |
|-----------------|---|---|--------|--------|

| CONTROLLED ENTITY                       | BENEFICIAL PERCENTAGE HELD BY THE GROUP |       | PLACE OF INCORPORATION     | AMOUNT OF PARENT'S INVESTMENT |        |
|---|---|-------|----------------------------|-------------------------------|--------|
|   | 2006                                    | 2005  |                            | 2006                          | 2005   |
|   | %                                       | %     |                            | \$000                         | \$000  |
| Schaffer Properties Pty Ltd*            | 100                                     | 100   | Australia                  | -                             | -      |
| Delta Corporation Limited*              | 100                                     | 100   | Australia                  | 5,066                         | 5,066  |
| Urbanstone Pty Ltd*                     | 100                                     | 100   | Australia                  | -                             | -      |
| Gosh Holdings Pty Ltd                   | 83.17                                   | -     | Australia                  | -                             | -      |
| Limestone Resources Australia Pty Ltd   | 100                                     | -     | Australia                  | -                             | -      |
| Limestone Pavcrete Pty Ltd              | 100                                     | -     | Australia                  | -                             | -      |
| Australian Leather Holdings Limited**   | 83.17                                   | 83.17 | Australia                  | 14,598                        | 14,598 |
| Gosh Leather Pty Ltd**                  | 83.17                                   | 83.17 | Australia                  | -                             | -      |
| Rosedale Leather Pty Ltd**              | 83.17                                   | 83.17 | Australia                  | -                             | -      |
| Darkan Wet Blue Tanning Pty Ltd #       | -                                       | 83.17 | Australia                  | -                             | -      |
| Australian Leather Upholstery Pty Ltd** | 83.17                                   | 83.17 | Australia                  | -                             | -      |
| Howe & Co Pty Ltd**                     | 83.17                                   | 83.17 | Australia                  | -                             | -      |
| Howe de Mexico SA de CV                 | 83.17                                   | 83.17 | Mexico                     | -                             | -      |
| Howe Slovensko S.R.O.                   | 83.17                                   | 83.17 | Slovakia                   | -                             | -      |
| Howe Leather (Shanghai) Co. Ltd.        | 83.17                                   | -     | People's Republic of China | -                             | -      |
|   |   |       |                            | 19,664                        | 19,664 |

\* Pursuant to Class Order 98/1418 relief has been granted to various controlled entities from the Corporations Act 2001 requirements for preparation, audit and lodgement of their financial reports. As a condition of the Class Order Schaffer Corporation Limited and the controlled entities subject to the Class Order (the Schaffer 'Closed Group') entered into Deeds of Cross Guarantee at various dates. The effect of the deeds is that Schaffer Corporation Limited has guaranteed to pay any deficiency in the event of winding up of the controlled entities. The controlled entities have also given a similar guarantee in the event that Schaffer Corporation Limited is wound up.

\*\* Pursuant to Class Order 98/1418 relief has been granted to various controlled entities from the Corporations Act 2001 requirements for preparation, audit and lodgement of their financial reports. As a condition of the Class Order Australian Leather Holdings Limited and the controlled entities subject to the Class Order (the ALH 'Closed Group') entered into Deeds of Cross Guarantee at various dates. The effect of the deeds is that Australian Leather Holdings Limited has guaranteed to pay any deficiency in the event of winding up of the controlled entities. The controlled entities have also given a similar guarantee in the event that Australian Leather Holdings Limited is wound up.

# The company was deregistered on 17 July 2005. It had no assets or liabilities at the date of deregistration.

## NOTE 12

OTHER FINANCIAL ASSETS (NON CURRENT)  
(CONTINUED)

The consolidated income statement and balance sheet of the entities which are members of the Schaffer 'Closed Group' are as follows:

## CONSOLIDATED INCOME STATEMENT

|   |          |          |
|---|----------|----------|
| Profit from continuing operations before income tax | 12,010   | 17,005   |
| Income tax expense                                  | (3,612)  | (2,192)  |
| Net profit for the year                             | 8,398    | 14,813   |
| Retained earnings at the beginning of the year      | 27,313   | 30,759   |
| Dividends provided for or paid                      | (11,978) | (18,259) |
| Retained earnings at the end of the year            | 23,733   | 27,313   |

## CONSOLIDATED BALANCE SHEET

## ASSETS

## CURRENT ASSETS

|                                     |               |               |
|-------------------------------------|---------------|---------------|
| Cash and cash equivalents           | 10,411        | 12,737        |
| Trade and other receivables         | 7,460         | 4,348         |
| Inventories                         | 4,524         | 5,010         |
| Available-for-sale financial assets | 304           | 83            |
| Prepayments and deposits            | 689           | 278           |
| <b>TOTAL CURRENT ASSETS</b>         | <b>23,388</b> | <b>22,456</b> |

## NON CURRENT ASSETS

|                                 |               |               |
|---------------------------------|---------------|---------------|
| Receivables                     | 31            | -             |
| Other financial assets          | 14,598        | 14,598        |
| Property, plant and equipment   | 20,125        | 20,530        |
| Investment properties           | 12,325        | 11,038        |
| Goodwill                        | 84            | 84            |
| Deferred income tax assets      | 1,062         | 1,529         |
| <b>TOTAL NON CURRENT ASSETS</b> | <b>48,225</b> | <b>47,779</b> |
| <b>TOTAL ASSETS</b>             | <b>71,613</b> | <b>70,235</b> |

## LIABILITIES

## CURRENT LIABILITIES

|                                       |              |              |
|---------------------------------------|--------------|--------------|
| Trade and other payables              | 4,816        | 3,895        |
| Interest bearing loans and borrowings | 131          | 167          |
| Income tax payable                    | 1,825        | 1,213        |
| Provisions                            | 1,479        | 1,344        |
| <b>TOTAL CURRENT LIABILITIES</b>      | <b>8,251</b> | <b>6,619</b> |

## NON CURRENT LIABILITIES

|                                       |               |               |
|---------------------------------------|---------------|---------------|
| Interest bearing loans and borrowings | 17,831        | 14,638        |
| Deferred income tax liabilities       | 1,161         | 1,233         |
| Provisions                            | 776           | 702           |
| <b>TOTAL NON CURRENT LIABILITIES</b>  | <b>19,768</b> | <b>16,573</b> |
| <b>TOTAL LIABILITIES</b>              | <b>28,019</b> | <b>23,192</b> |

## NET ASSETS

## EQUITY

|                     |               |               |
|---------------------|---------------|---------------|
| Issued capital      | 17,034        | 17,034        |
| Reserves            | 2,827         | 2,696         |
| Retained profits    | 23,733        | 27,313        |
| <b>TOTAL EQUITY</b> | <b>43,594</b> | <b>47,043</b> |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED |          | PARENT |        |
|--|--------------|----------|--------|--------|
|  | 2006         | 2005     | 2006   | 2005   |
|  | \$'000       | \$'000   | \$'000 | \$'000 |
| <b>NOTE 13</b>                             |              |          |        |        |
| <b>PROPERTY, PLANT AND EQUIPMENT</b>       |              |          |        |        |
| Freehold land                              |              |          |        |        |
| At cost                                    | 6,535        | 6,518    | 3,954  | 3,954  |
| Buildings on freehold land                 |              |          |        |        |
| At cost                                    | 13,004       | 12,767   | 263    | 263    |
| Accumulated depreciation                   | (4,478)      | (4,093)  | (54)   | (47)   |
|  | 8,526        | 8,674    | 209    | 216    |
| Leasehold improvements                     |              |          |        |        |
| At cost                                    | 711          | 662      | -      | -      |
| Accumulated amortisation                   | (567)        | (511)    | -      | -      |
|  | 144          | 151      | -      | -      |
| Net carrying amount of land and buildings  | 15,205       | 15,343   | 4,163  | 4,170  |
| Plant and equipment                        |              |          |        |        |
| At cost                                    | 62,297       | 59,669   | 2,078  | 2,042  |
| Accumulated depreciation                   | (38,052)     | (33,718) | (907)  | (904)  |
| Net carrying amount                        | 24,245       | 25,951   | 1,171  | 1,138  |
| Plant and equipment under lease            |              |          |        |        |
| At cost                                    | 593          | 573      | -      | -      |
| Accumulated amortisation                   | (209)        | (210)    | -      | -      |
|  | 384          | 363      | -      | -      |
| Net carrying amount of plant and equipment | 24,629       | 26,314   | 1,171  | 1,138  |
| Total property, plant and equipment        |              |          |        |        |
| At cost                                    | 83,140       | 80,189   | 6,295  | 6,259  |
| Accumulated depreciation and amortisation  | (43,306)     | (38,532) | (961)  | (951)  |
| Total net carrying amount                  | 39,834       | 41,657   | 5,334  | 5,308  |

The directors do not consider there is any impairment loss on property, plant and equipment at 30 June 2006.

**Assets pledged as security**

Included in the balances of property, plant and equipment are assets over which first mortgages have been granted as security over government loans (see Note 19) and bank facilities (see Note 4(c)). The terms of the first mortgages preclude the assets being sold or being used as security for further mortgages without the permission of the first mortgage holder. The mortgage also requires buildings that form part of the security to be fully insured at all times.

Assets under lease are pledged as security for the associated lease liabilities (refer notes 17 and 19).

|  | CONSOLIDATED |         | PARENT |         |
|--|--------------|---------|--------|---------|
|  | 2006         | 2005    | 2006   | 2005    |
|  | \$'000       | \$'000  | \$'000 | \$'000  |
| <b>NOTE 13</b>                                   |              |         |        |         |
| <b>PROPERTY, PLANT AND EQUIPMENT (CONTINUED)</b> |              |         |        |         |
| The value of assets pledged as security are:     |              |         |        |         |
| Property, plant and equipment                    | 39,834       | 41,657  | 5,334  | 5,308   |
| <b>Reconciliations</b>                           |              |         |        |         |
| Freehold land                                    |              |         |        |         |
| Carrying amount at beginning                     | 6,518        | 8,920   | 3,954  | 5,154   |
| Additions  | 17           | -       | -      | -       |
| Disposals  | -            | (2,402) | -      | (1,200) |
|  | 6,535        | 6,518   | 3,954  | 3,954   |
| Buildings on freehold land                       |              |         |        |         |
| Carrying amount at beginning                     | 8,674        | 9,058   | 216    | 270     |
| Additions  | 237          | 103     | -      | -       |
| Disposals  | -            | (45)    | -      | (45)    |
| Depreciation expense                             | (385)        | (442)   | (7)    | (9)     |
|  | 8,526        | 8,674   | 209    | 216     |
| Leasehold improvements                           |              |         |        |         |
| Carrying amount at beginning                     | 151          | 171     | -      | -       |
| Additions  | 49           | 46      | -      | -       |
| Amortisation expense                             | (56)         | (66)    | -      | -       |
|  | 144          | 151     | -      | -       |
| Net carrying amount of land and buildings        | 15,205       | 15,343  | 4,163  | 4,170   |
| Plant and equipment                              |              |         |        |         |
| Carrying amount at beginning                     | 25,951       | 24,294  | 1,138  | 1,140   |
| Additions  | 2,725        | 4,736   | 132    | 207     |
| Transfers from leased plant                      | 149          | 1,378   | -      | -       |
| Depreciation expense                             | (4,541)      | (4,214) | (99)   | (116)   |
| Disposals  | (39)         | (243)   | -      | (93)    |
|  | 24,245       | 25,951  | 1,171  | 1,138   |
| Plant and equipment under lease                  |              |         |        |         |
| Carrying amount at beginning                     | 363          | 1,795   | -      | -       |
| Additions  | 218          | -       | -      | -       |
| Transfers to plant and equipment                 | (149)        | (1,378) | -      | -       |
| Depreciation expense                             | (48)         | (54)    | -      | -       |
|  | 384          | 363     | -      | -       |
| Total carrying amount of plant and equipment     | 24,629       | 26,314  | 1,171  | 1,138   |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED |        | PARENT |        |
|--|--------------|--------|--------|--------|
|  | 2006         | 2005   | 2006   | 2005   |
|  | \$'000       | \$'000 | \$'000 | \$'000 |

NOTE 14  
INVESTMENT PROPERTIES

|  |         |         |       |       |
|--|---------|---------|-------|-------|
| Investment properties                        |         |         |       |       |
| At cost                                      | 13,883  | 12,393  | 5,510 | 4,156 |
| Accumulated amortisation                     | (1,558) | (1,355) | (474) | (394) |
| Net carrying amount of investment properties | 12,325  | 11,038  | 5,036 | 3,762 |

The directors do not consider there is any impairment loss on investment properties at 30 June 2006.

## Assets pledged as security

Included in the balances of investment properties are assets over which first mortgages have been granted as security over bank loans (see Note 19). The terms of the first mortgages preclude the assets being sold or being used as security for further mortgages without the permission of the first mortgage holder. The mortgage also requires investment properties that form part of the security to be fully insured at all times.

The value of assets pledged as security are:

|  | CONSOLIDATED |        | PARENT |        |
|--|--------------|--------|--------|--------|
|  | 2006         | 2005   | 2006   | 2005   |
|  | \$'000       | \$'000 | \$'000 | \$'000 |

|                              |        |        |       |       |
|------------------------------|--------|--------|-------|-------|
| Investment properties        | 12,325 | 11,038 | 5,036 | 3,762 |
| <b>Reconciliations</b>       |        |        |       |       |
| Carrying amount at beginning | 11,038 | 11,331 | 3,762 | 3,836 |
| Additions                    | 1,491  | -      | 1,355 | -     |
| Reclassification             | -      | (93)   | -     | -     |
| Depreciation expense         | (204)  | (200)  | (81)  | (74)  |
| Total carrying amount        | 12,325 | 11,038 | 5,036 | 3,762 |

NOTE 15  
GOODWILL

|                  |       |       |   |   |
|------------------|-------|-------|---|---|
| Goodwill at cost | 1,299 | 1,299 | - | - |
|------------------|-------|-------|---|---|

As from 1 July 2004, goodwill is no longer amortised but is now subject to impairment testing (see note 15(a)).

No impairment loss was recognised in the 2006 financial year.

## At 1 July 2004

|                              |       |       |   |   |
|------------------------------|-------|-------|---|---|
| Cost (gross carrying amount) | 1,299 | 1,299 | - | - |
| Net carrying amount          | 1,299 | 1,299 | - | - |

## Year ended 30 June 2005

|                                    |       |       |   |   |
|------------------------------------|-------|-------|---|---|
| At 1 July 2004 net carrying amount | 1,299 | 1,299 | - | - |
|------------------------------------|-------|-------|---|---|

|                                     |       |       |   |   |
|-------------------------------------|-------|-------|---|---|
| At 30 June 2005 net carrying amount | 1,299 | 1,299 | - | - |
|-------------------------------------|-------|-------|---|---|

## At 30 June 2005

|                              |       |       |   |   |
|------------------------------|-------|-------|---|---|
| Cost (gross carrying amount) | 1,299 | 1,299 | - | - |
| Net carrying amount          | 1,299 | 1,299 | - | - |

## At 30 June 2006

|                              |       |       |   |   |
|------------------------------|-------|-------|---|---|
| Cost (gross carrying amount) | 1,299 | 1,299 | - | - |
| Net carrying amount          | 1,299 | 1,299 | - | - |

NOTE 15  
GOODWILL (CONTINUED)

## (a) Impairment testing of goodwill

Goodwill acquired through business combinations have been allocated to two individual cash generating units, which are reportable segments, for impairment testing as follows:

- Leather
- Investment Properties

*Leather*

The recoverable amount of the Leather unit has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management over a five-year period.

The discount rate applied to cash flow projections is 15.5% per annum (2005: 15.5% per annum) and cash flows beyond the five-year period are not extrapolated.

*Investment properties*

The recoverable amount of the Investment property unit has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management over a five-year period.

The discount rate applied to cash flow projections is 14.5% per annum (2005: 14.5% per annum) and cash flows beyond the five-year period are not extrapolated.

## Carrying amount of goodwill, allocated to each of the cash generating units

|                             | CONSOLIDATED |        |                       |        |        |        | PARENT TOTAL |      |
|-----------------------------|--------------|--------|-----------------------|--------|--------|--------|--------------|------|
|                             | LEATHER      |        | INVESTMENT PROPERTIES |        | TOTAL  |        | 2006         | 2005 |
|                             | 2006         | 2005   | 2006                  | 2005   | 2006   | 2005   |              |      |
| \$'000                      | \$'000       | \$'000 | \$'000                | \$'000 | \$'000 | \$'000 | \$'000       |      |
| Carrying amount of goodwill | 1,215        | 1,215  | 84                    | 84     | 1,299  | 1,299  | -            | -    |

|  | CONSOLIDATED |        | PARENT |        |
|--|--------------|--------|--------|--------|
|  | 2006         | 2005   | 2006   | 2005   |
|  | \$'000       | \$'000 | \$'000 | \$'000 |

NOTE 16  
TRADE AND OTHER PAYABLES  
(CURRENT)

|                            |        |        |     |     |
|----------------------------|--------|--------|-----|-----|
| Trade creditors            | 15,820 | 13,105 | 164 | 171 |
| Goods and services tax net | 612    | 406    | 13  | 30  |
| Other creditors            | 278    | 194    | 278 | 194 |
|                            | 16,710 | 13,705 | 455 | 395 |

- Terms and conditions relating to the above financial instruments.
- All current payables are non interest bearing and are normally settled on 30 day terms.
- Included in trade creditors are non hedged payables amounting to:

|       | 2006   |                    | 2005   |                    |
|-------|--------|--------------------|--------|--------------------|
|       |        | AUST \$ EQUIVALENT |        | AUST \$ EQUIVALENT |
|       | \$'000 | \$'000             | \$'000 | \$'000             |
| US \$ | 3,793  | 5,098              | 1,793  | 2,349              |
| RMB   | 1,543  | 261                | -      | -                  |
| SKK   | 2,111  | 92                 | -      | -                  |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED |              | PARENT       |               |
|--|--------------|--------------|--------------|---------------|
|  | 2006         | 2005         | 2006         | 2005          |
|  | \$'000       | \$'000       | \$'000       | \$'000        |
| <b>NOTE 17</b>   |              |              |              |               |
| <b>INTEREST BEARING LOANS AND BORROWINGS (CURRENT)</b> |              |              |              |               |
| Bank overdraft – secured                               | –            | 2,972        | –            | –             |
| Lease liability (refer note 25(c)) – secured           | 131          | 167          | –            | –             |
| Amount owing by wholly owned controlled entities       | –            | –            | 8,437        | 11,388        |
| Working capital revolver facility                      | 1,388        | –            | –            | –             |
|  | <u>1,519</u> | <u>3,139</u> | <u>8,437</u> | <u>11,388</u> |

- (a) The bank overdraft is secured by first registered mortgage over all the assets and undertakings of controlled entities. The lease liability is secured by a charge over the leased assets.
- (b) Terms and conditions relating to the above financial instruments
- (i) Finance leases have an average lease term of 4 years. The average discount rate implicit in the leases is 7.5% per annum (2005 – 8% per annum).
- (c) Financing facilities available – refer note 19(c).
- (d) Working capital revolver facility

The facility refinances existing working capital to facilitate the acquisition of raw materials and to support foreign exchange hedging arrangements. Trade receivables and inventory are the relevant working capital terms.

The facility has two revolving credit sub-facilities (AUD and USD) which increases and decreases on a daily basis based on collections of receipts of trade receivable accounts and advances placed for the payment of daily expenditure items.

Each facility has a maximum borrowing limit in terms of availability and this is updated on a daily basis, depending on the daily working capital levels.

Under the facility agreement Australian Leather Holdings Limited has granted security over all of its assets and undertakings. Weighted average interest for the year was 8.63% per annum (2005 – \$Nil).

- (e) Amounts owing by wholly owned controlled entities
- These loans are interest free and repayable on demand.

|  | CONSOLIDATED |              | PARENT     |            |
|--|--------------|--------------|------------|------------|
|  | 2006         | 2005         | 2006       | 2005       |
|  | \$'000       | \$'000       | \$'000     | \$'000     |
| Redundancies                             | 339          | –            | –          | –          |
| Employee entitlements (refer note 26(a)) | 4,064        | 4,348        | 367        | 374        |
|  | <u>4,403</u> | <u>4,348</u> | <u>367</u> | <u>374</u> |

**NOTE 18**  
**PROVISIONS (CURRENT)**

|  |              |              |            |            |
|--|--------------|--------------|------------|------------|
| Redundancies                             | 339          | –            | –          | –          |
| Employee entitlements (refer note 26(a)) | 4,064        | 4,348        | 367        | 374        |
|  | <u>4,403</u> | <u>4,348</u> | <u>367</u> | <u>374</u> |

Movement in provision for employee entitlements

|                         | REDUNDANCIES | EMPLOYEE ENTITLEMENTS | TOTAL        |
|-------------------------|--------------|-----------------------|--------------|
|                         | \$'000       | \$'000                | \$'000       |
| <b>CONSOLIDATED</b>     |              |                       |              |
| At 1 July 2005          | –            | 4,348                 | 4,348        |
| Arising during the year | 339          | 142                   | 481          |
| Utilised                | –            | (426)                 | (426)        |
| At 30 June 2006         | <u>339</u>   | <u>4,064</u>          | <u>4,403</u> |
| <b>PARENT</b>           |              |                       |              |
| At 1 July 2005          | –            | 374                   | 374          |
| Utilised                | –            | (7)                   | (7)          |
| At 30 June 2006         | <u>–</u>     | <u>367</u>            | <u>367</u>   |

**Redundancy provisions**

The redundancy provisions relates to the closure of the Gosh Leather facility.

**NOTE 19**  
**INTEREST BEARING LOANS AND BORROWINGS (NON CURRENT)**

|  | CONSOLIDATED  |               | PARENT       |              |
|--|---------------|---------------|--------------|--------------|
|  | 2006          | 2005          | 2006         | 2005         |
|  | \$'000        | \$'000        | \$'000       | \$'000       |
| Lease liability (refer note 25(c)) – secured (b) | 186           | 108           | –            | –            |
| Government loan – secured (c)                    | 38,654        | 38,654        | –            | –            |
| Bank loan – secured (a)                          | 17,645        | 14,530        | 6,119        | 4,217        |
|  | <u>56,485</u> | <u>53,292</u> | <u>6,119</u> | <u>4,217</u> |

**(a) Bank loan**

The bank loans are secured by first registered mortgage over all the assets and undertakings of controlled entities. Included in bank loans is the consolidated entity's share of joint venture borrowings. The lease liability is secured by a charge over the leased assets. The government loans are secured by a second mortgage over the assets and undertakings of a controlled entity.

**(b) Finance leases**

Finance leases have an average lease term of 4 years. The average discount rate implicit in the leases is 7.5% per annum (2005 – 8% per annum).

**(c) Government loans:**

An amount of \$25,000,000 has interest payable at 2% per annum over the long term bond rate. The facility expires in February 2012. An amount of \$13,654,000 bears a fixed interest rate of 4.4% per annum until February 2012.

**Financing facilities available***Bank overdrafts*

The bank overdrafts are secured by a floating charge over certain of the Group's assets, including its land and buildings.

The bank overdraft facilities may be drawn at any time and may be terminated by the bank without notice. Subject to the continuance of satisfactory credit ratings, the bank facilities may be drawn at any time and have an average maturity of 1 year (2005: 1 year).

Interest is at the rate of 8.95% per annum.

*Bank loans*

This is the Group's share of jointly controlled borrowings. Refer note 25(f). The loans are repayable within one to four years and are secured by the assets of the joint venture.

Interest rates vary from 6.61% per annum to 7.48% per annum (2005 – 6.80% per annum to 8.58% per annum).

|   | CONSOLIDATED  |               | PARENT        |              |
|---|---------------|---------------|---------------|--------------|
|   | 2006          | 2005          | 2006          | 2005         |
|   | \$'000        | \$'000        | \$'000        | \$'000       |
| At reporting date, the following financing facilities had been negotiated and were available: |               |               |               |              |
| Total facilities  |               |               |               |              |
| – bank overdraft  | 500           | 500           | 400           | 400          |
| – bankers undertaking   | 3,794         | 2,830         | 154           | 310          |
| – commercial bills  | 12,520        | 2,500         | 10,020        | 2,500        |
| – finance leases  | 500           | 275           | –             | –            |
| – bank loans  | 17,644        | 14,530        | 6,119         | 4,217        |
| – working capital revolver facility   | 17,522        | 14,575        | –             | –            |
|   | <u>52,480</u> | <u>35,210</u> | <u>16,693</u> | <u>7,427</u> |

At reporting date, the following financing facilities had been negotiated and were available:

## Total facilities

|                                     |               |               |               |              |
|-------------------------------------|---------------|---------------|---------------|--------------|
| – bank overdraft                    | 500           | 500           | 400           | 400          |
| – bankers undertaking               | 3,794         | 2,830         | 154           | 310          |
| – commercial bills                  | 12,520        | 2,500         | 10,020        | 2,500        |
| – finance leases                    | 500           | 275           | –             | –            |
| – bank loans                        | 17,644        | 14,530        | 6,119         | 4,217        |
| – working capital revolver facility | 17,522        | 14,575        | –             | –            |
|                                     | <u>52,480</u> | <u>35,210</u> | <u>16,693</u> | <u>7,427</u> |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|  | CONSOLIDATED   |                | PARENT         |                |
|--|----------------|----------------|----------------|----------------|
|  | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>NOTE 19</b>   |                |                |                |                |
| <b>INTEREST BEARING LOANS AND BORROWINGS<br/>(NON CURRENT) (CONTINUED)</b> |                |                |                |                |
| Facilities used at reporting date  |                |                |                |                |
| - bank overdraft   | -              | -              | -              | -              |
| - bankers undertaking<br>(refer note 25(e))                                | 1,369          | 1,670          | -              | -              |
| - commercial bills   | -              | -              | -              | -              |
| - finance leases   | 317            | 275            | -              | -              |
| - bank loans   | 17,644         | 14,530         | 6,119          | 4,217          |
| - working capital revolver facility  | 1,388          | 2,972          | -              | -              |
|  | <u>20,718</u>  | <u>19,447</u>  | <u>6,119</u>   | <u>4,217</u>   |
| Facilities unused at reporting date  |                |                |                |                |
| - bank overdraft   | 500            | 500            | 400            | 400            |
| - bankers undertaking  | 2,425          | 1,160          | 154            | 310            |
| - commercial bills   | 12,520         | 2,500          | 10,020         | 2,500          |
| - finance leases   | 183            | -              | -              | -              |
| - bank loans   | -              | -              | -              | -              |
| - working capital revolver facility  | 16,134         | 11,603         | -              | -              |
|  | <u>31,762</u>  | <u>15,763</u>  | <u>10,574</u>  | <u>3,210</u>   |
| Total facilities   |                |                |                |                |
| Facilities used at reporting date  | 20,718         | 19,447         | 6,119          | 4,217          |
| Facilities unused at reporting date  | 31,762         | 15,763         | 10,574         | 3,210          |
|  | <u>52,480</u>  | <u>35,210</u>  | <u>16,693</u>  | <u>7,427</u>   |

**NOTE 20**  
**PROVISIONS (NON CURRENT)**

|   |                                 |              |                 |            |
|---|---------------------------------|--------------|-----------------|------------|
| Employee entitlements<br>(refer note 26(a)) | <u>1,812</u>                    | <u>1,793</u> | <u>148</u>      | <u>202</u> |
|   | EMPLOYEE ENTITLEMENTS<br>\$'000 |              | TOTAL<br>\$'000 |            |
| CONSOLIDATED                                |                                 |              |                 |            |
| At 1 July 2005                              | 1,793                           |              | 1,793           |            |
| Arising during the year                     | 151                             |              | 151             |            |
| Utilised                                    | (132)                           |              | (132)           |            |
| At 30 June 2006                             | <u>1,812</u>                    |              | <u>1,812</u>    |            |
| PARENT                                      |                                 |              |                 |            |
| At 1 July 2005                              | 202                             |              | 202             |            |
| Utilised                                    | (54)                            |              | (54)            |            |
| At 30 June 2006                             | <u>148</u>                      |              | <u>148</u>      |            |

**NOTE 21**  
**CONTRIBUTED EQUITY**

|  | CONSOLIDATED   |                | PARENT         |                |
|--|----------------|----------------|----------------|----------------|
|  | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>a) Issued and paid up capital</b>                         |                |                |                |                |
| As at 30 June 2006   |                |                |                |                |
| 14,091,935 ordinary fully paid<br>shares (2005 - 14,091,935) | 17,034         | 17,034         | 16,086         | 16,086         |

|  | PARENT                  |               | PARENT                  |               |
|--|-------------------------|---------------|-------------------------|---------------|
|  | 2006<br>NO OF<br>SHARES | \$'000        | 2005<br>NO OF<br>SHARES | \$'000        |
| <b>NOTE 21</b>   |                         |               |                         |               |
| <b>CONTRIBUTED EQUITY (CONTINUED)</b>  |                         |               |                         |               |
| <b>b) Movement in ordinary<br/>shares on issue</b>   |                         |               |                         |               |
| At the beginning of<br>the financial year  | 14,091,935              | 17,034        | 13,939,185              | 15,916        |
| On 1 July 2004 1,250 options<br>converted to ordinary shares<br>under employee share scheme          | -                       | -             | 1,250                   | 12            |
| On 25 August 2004<br>86,500 options converted<br>to ordinary shares under<br>employee share scheme   | -                       | -             | 86,500                  | 712           |
| On 18 February 2005<br>40,000 options converted<br>to ordinary shares under<br>employee share scheme | -                       | -             | 40,000                  | 216           |
| On 31 March 2005<br>25,000 options converted<br>to ordinary shares under<br>employee share scheme    | -                       | -             | 25,000                  | 178           |
| Total capital issued<br>during the year  | -                       | -             | 152,750                 | 1,118         |
| At the end of the<br>financial year  | <u>14,091,935</u>       | <u>17,034</u> | <u>14,091,935</u>       | <u>17,034</u> |

For details of movement in options and details of employee share options plan refer to Note 24.

**(c) Terms and conditions of contributed equity***Ordinary shares*

Ordinary shares have the right to receive dividends as declared and, in the event of winding up the company, to participate in the proceeds from the sale of all surplus assets in proportion to the number of and amounts paid up on shares held. Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the company.

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

*Share options*

The Company has a share based payment option scheme under which options to subscribe for the company's shares have been granted to certain executives and other employees (refer note 26). The share option holders carry no rights to dividends and no voting rights.

|   | CONSOLIDATED   |                | PARENT         |                |
|---|----------------|----------------|----------------|----------------|
|   | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>NOTE 22</b>                          |                |                |                |                |
| <b>RESERVES AND RETAINED PROFITS</b>    |                |                |                |                |
| Reserves                                |                |                |                |                |
| Asset revaluation                       | 2,585          | 2,585          | 2,283          | 2,283          |
| Share based payment                     | 200            | 124            | -              | -              |
| Option premium                          | 115            | 111            | 115            | 111            |
| Net unrealised gains reserve            | 127            | -              | 127            | -              |
| Foreign currency<br>translation reserve | (51)           | -              | -              | -              |
|   | <u>2,976</u>   | <u>2,820</u>   | <u>2,525</u>   | <u>2,394</u>   |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 22 RESERVES AND RETAINED PROFITS (CONTINUED)

#### Nature and purpose of reserve

##### Asset revaluation

The asset revaluation reserve was used to record increments and decrements in the value of non current assets. Currently the accounting policy is to record all assets at cost. The reserve can be used to pay dividends in limited circumstances.

##### Share based payment

This reserve is used to record the value of equity benefits provided to employees and directors as part of their remuneration. Refer to note 26(c) for further details of this plan.

##### Option Premium

This reserve represents the amount expended for the value of options issued. Refer to note 26(b) for further details of this plan.

##### Foreign currency translation reserve

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the effect of hedging net investments in foreign operations.

| MOVEMENT IN RESERVES  | CONSOLIDATED      |                     |                |                   |                              |       | PARENT            |                |                   |       |
|---|-------------------|---------------------|----------------|-------------------|------------------------------|-------|-------------------|----------------|-------------------|-------|
|   | ASSET REVALUATION | SHARE BASED PAYMENT | OPTION PREMIUM | UN-REALISED GAINS | FOREIGN CURRENCY TRANSLATION | TOTAL | ASSET REVALUATION | OPTION PREMIUM | UN-REALISED GAINS | TOTAL |
| At 1 July 2004  | 2,585             | 58                  | 30             | –                 | –                            | 2,673 | 2,283             | 30             | –                 | 2,313 |
| Expensed for year   | –                 | 66                  | 81             | –                 | –                            | 147   | –                 | 81             | –                 | 81    |
| At 30 June 2005   | 2,585             | 124                 | 111            | –                 | –                            | 2,820 | 2,283             | 111            | –                 | 2,394 |
| At 1 July 2005  |                   |                     |                |                   |                              |       |                   |                |                   |       |
| Transitional adjustment relating to the application of AASB 132 and 139 | –                 | –                   | –              | 6                 | –                            | 6     | –                 | –              | 6                 | 6     |
| Expensed for year   | –                 | 76                  | 4              | –                 | (51)                         | 29    | –                 | 4              | –                 | 4     |
| Unrealised gain on available-for-sale investments                       | –                 | –                   | –              | 121               | –                            | 121   | –                 | –              | 121               | 121   |
| At 30 June 2006   | 2,585             | 200                 | 115            | 127               | (51)                         | 2,976 | 2,283             | 115            | 127               | 2,525 |

|   | CONSOLIDATED   |                | PARENT         |                |
|---|----------------|----------------|----------------|----------------|
|   | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| Retained profits  |                |                |                |                |
| Balance 1 July  | 30,222         | 39,077         | 8,501          | 17,064         |
| Net profit attributable to members of the parent entity | 8,144          | 9,404          | 8,199          | 9,696          |
| Dividends provided for or paid                          | (11,978)       | (18,259)       | (11,978)       | (18,259)       |
| Balance 30 June   | 26,388         | 30,222         | 4,722          | 8,501          |

### NOTE 23 AUDITORS REMUNERATION

Amounts received or due and receivable by Ernst & Young (Australia) for an audit or review of the financial report of the parent and any other entity in the consolidated group

|  | CONSOLIDATED | PARENT | CONSOLIDATED | PARENT |
|--|--------------|--------|--------------|--------|
|  | 2006         | 2005   | 2006         | 2005   |
|  | \$           | \$     | \$           | \$     |
| Amounts received or due and receivable by non-Ernst & Young audit firms for review of the financial report | 37,759       | 20,232 | –            | –      |

Amounts received or due and receivable by non-Ernst & Young audit firms for review of the financial report

|   | CONSOLIDATED |            | PARENT     |            |
|---|--------------|------------|------------|------------|
|   | 2006<br>\$   | 2005<br>\$ | 2006<br>\$ | 2005<br>\$ |
| Amounts received or due and receivable by Ernst & Young (Australia) for an audit or review of the financial report of the parent and any other entity in the consolidated group | 266,300      | 210,572    | 111,000    | 69,772     |
| Other services – tax compliance   | 26,204       | 12,690     | 8,066      | 1,450      |
|   | 292,504      | 223,262    | 119,066    | 71,222     |

### NOTE 24 DIRECTORS AND EXECUTIVES DISCLOSURES

#### (a) Details of Key Management Personnel

##### (i) Directors

|              |                          |
|--------------|--------------------------|
| J M Schaffer | Managing Director        |
| D E Blain    | Director (non-executive) |
| A K Mayer    | Director (executive)     |
| DJ Schwartz  | Director (non-executive) |
| MD Perrott   | Director (non-executive) |

##### (ii) Executives

|              |  |
|--------------|--|
| M Falconer   | General Manager Urbanstone Pty. Ltd. and Limestone Resources Pty. Ltd.     |
| N Filipovic  | General Manager Howe & Company Pty. Ltd.                                   |
| G V Davieson | Chief Financial Officer and Company Secretary Schaffer Corporation Limited |

##### (iii) Remuneration of Key Management Personnel (KMP)

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

##### (iv) Remuneration by category: Key Management Personnel

|                      | CONSOLIDATED |            | PARENT     |            |
|----------------------|--------------|------------|------------|------------|
|                      | 2006<br>\$   | 2005<br>\$ | 2006<br>\$ | 2005<br>\$ |
| Short term           | 1,815,412    | 2,002,222  | 917,974    | 1,436,804  |
| Post employment      | 242,320      | 151,174    | 21,849     | 83,687     |
| Termination benefits | –            | 224,207    | –          | –          |
| Share based payment  | 22,546       | 140,765    | 2,413      | 79,739     |
|                      | 2,080,278    | 2,518,368  | 942,236    | 1,600,230  |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

NOTE 24  
DIRECTORS AND EXECUTIVES DISCLOSURES (CONTINUED)

## (b) Option holdings of Key Management Personnel

| 30 JUNE 2006 | DIRECTORS/<br>EXECUTIVES | BALANCE AT<br>BEGINNING<br>OF PERIOD | GRANTED<br>AS REMUN-<br>ERATION | OPTIONS<br>EXERCISED | NET<br>CHANGE<br>OTHER | BALANCE<br>AT END<br>OF PERIOD | VESTED AS AT 30 JUNE 2006 |                    |             |
|--------------|--------------------------|--------------------------------------|---------------------------------|----------------------|------------------------|--------------------------------|---------------------------|--------------------|-------------|
|              |                          |                                      |                                 |                      |                        |                                | TOTAL                     | NOT<br>EXERCISABLE | EXERCISABLE |
|              | M Falconer               | 12,500                               | -                               | -                    | -                      | 12,500                         | 7,500                     | -                  | 7,500       |
|              | G V Davieson             | 10,000                               | -                               | -                    | -                      | 10,000                         | 6,250                     | -                  | 6,250       |
|              | Total                    | 22,500                               | -                               | -                    | -                      | 22,500                         | 13,750                    | -                  | 13,750      |

| 30 JUNE 2005 | DIRECTORS/<br>EXECUTIVES | BALANCE AT<br>BEGINNING<br>OF PERIOD | GRANTED<br>AS REMUN-<br>ERATION | OPTIONS<br>EXERCISED | NET<br>CHANGE<br>OTHER | BALANCE<br>AT END<br>OF PERIOD | VESTED AS AT 30 JUNE 2005 |                    |             |
|--------------|--------------------------|--------------------------------------|---------------------------------|----------------------|------------------------|--------------------------------|---------------------------|--------------------|-------------|
|              |                          |                                      |                                 |                      |                        |                                | TOTAL                     | NOT<br>EXERCISABLE | EXERCISABLE |
|              | M Falconer               | 27,500                               | 20,000                          | (15,000)             | (20,000)               | 12,500                         | 2,500                     | -                  | 2,500       |
|              | G V Davieson             | 22,500                               | 15,000                          | (12,500)             | (15,000)               | 10,000                         | 2,500                     | -                  | 2,500       |
|              | Total                    | 50,000                               | 35,000                          | (27,500)             | (35,000)               | 22,500                         | 5,000                     | -                  | 5,000       |

| 30 JUNE 2006 | DIRECTORS/<br>EXECUTIVES | VESTED<br>NO. | GRANTED<br>NO. | GRANT<br>DATE | TERMS AND CONDITIONS FOR EACH GRANT                  |   |                |                           |                         |
|--------------|--------------------------|---------------|----------------|---------------|--|---|----------------|---------------------------|-------------------------|
|              |                          |               |                |               | FAIR VALUE<br>PER OPTION<br>AT<br>GRANT DATE<br>(\$) | EXERCISE<br>PRICE<br>PER OPTION<br>(\$) | EXPIRY<br>DATE | FIRST<br>EXERCISE<br>DATE | LAST<br>VESTING<br>DATE |
|              | G V Davieson             | 10,000        | 10,000         | 20 Jun 02     | \$1.89   | \$ 9.49                                 | 20 Jun 07      | 20 Jun 02                 | 20 Jun 05               |
|              | G V Davieson             | 11,250        | 15,000         | 15 Jul 03     | \$1.82   | \$12.31                                 | 15 Jul 08      | 15 Jul 03                 | 15 Jul 06               |
|              | M Falconer               | 10,000        | 10,000         | 20 Jun 02     | \$1.89   | \$ 9.49                                 | 20 Jun 07      | 20 Jun 02                 | 20 Jun 05               |
|              | M Falconer               | 15,000        | 20,000         | 15 Jul 03     | \$1.82   | \$12.31                                 | 15 Jul 08      | 15 Jul 03                 | 15 Jul 06               |
|              | Total                    | 46,250        | 55,000         |               |  |   |                |                           |                         |

| 30 JUNE 2005 | EXECUTIVES   | VESTED<br>NO. | GRANTED<br>NO. | GRANT<br>DATE | TERMS AND CONDITIONS FOR EACH GRANT                  |   |                |                           |                         |
|--------------|--------------|---------------|----------------|---------------|--|---|----------------|---------------------------|-------------------------|
|              |              |               |                |               | FAIR VALUE<br>PER OPTION<br>AT<br>GRANT DATE<br>(\$) | EXERCISE<br>PRICE<br>PER OPTION<br>(\$) | EXPIRY<br>DATE | FIRST<br>EXERCISE<br>DATE | LAST<br>VESTING<br>DATE |
|              | G V Davieson | 10,000        | 10,000         | 20 Jun 02     | \$1.89   | \$ 9.49                                 | 20 Jun 07      | 20 Jun 02                 | 20 Jun 05               |
|              | G V Davieson | 7,500         | 15,000         | 15 Jul 03     | \$1.82   | \$12.31                                 | 15 Jul 08      | 15 Jul 03                 | 15 Jul 06               |
|              | M Falconer   | 10,000        | 10,000         | 20 Jun 02     | \$1.89   | \$ 9.49                                 | 20 Jun 07      | 20 Jun 02                 | 20 Jun 05               |
|              | M Falconer   | 10,000        | 20,000         | 15 Jul 03     | \$1.82   | \$12.31                                 | 15 Jul 08      | 15 Jul 03                 | 15 Jul 06               |
|              | Total        | 37,500        | 55,000         |               |  |   |                |                           |                         |

## (c) Shareholdings of Key Management Personnel

Economic interests in the shares of Schaffer Corporation Limited held by directors of the reporting entity and their director related entities.

| AS AT 30 JUNE 2006 | BALANCE AT<br>BEGINNING<br>OF YEAR | ON<br>EXERCISE<br>OF OPTIONS | NET<br>CHANGE<br>OTHER | BALANCE AT<br>END OF<br>YEAR | AS AT 30 JUNE 2005 | BALANCE AT<br>BEGINNING<br>OF YEAR | ON<br>EXERCISE<br>OF OPTIONS | NET<br>CHANGE<br>OTHER | BALANCE AT<br>END OF<br>YEAR |
|--------------------|------------------------------------|------------------------------|------------------------|------------------------------|--------------------|------------------------------------|------------------------------|------------------------|------------------------------|
| <b>Directors</b>   |                                    |                              |                        |                              | <b>Directors</b>   |                                    |                              |                        |                              |
| D E Blain          | 1,562,360                          | -                            | -                      | 1,562,360                    | D E Blain          | 1,562,360                          | -                            | -                      | 1,562,360                    |
| A K Mayer          | 347,185                            | -                            | -                      | 347,185                      | A K Mayer          | 347,185                            | -                            | -                      | 347,185                      |
| M D Perrott        | 1,000                              | -                            | -                      | 1,000                        | M D Perrott        | -                                  | -                            | 1,000                  | 1,000                        |
| J M Schaffer       | 2,619,927                          | -                            | -                      | 2,619,927                    | J M Schaffer       | 2,619,927                          | -                            | -                      | 2,619,927                    |
| D J Schwartz       | 586,210                            | -                            | -                      | 586,210                      | D J Schwartz       | 586,210                            | -                            | -                      | 586,210                      |
| <b>Executives</b>  |                                    |                              |                        |                              | <b>Executives</b>  |                                    |                              |                        |                              |
| M Falconer         | 20,000                             | -                            | -                      | 20,000                       | M Falconer         | 55,000                             | 15,000                       | (50,000)               | 20,000                       |
| G V Davieson       | 36,745                             | -                            | (25,745)               | 11,000                       | G P Monkhouse      | 89,736                             | 91,250                       | (155,986)              | 25,000                       |
| Total              | 5,173,427                          | -                            | (25,745)               | 5,147,682                    | C A Nunis          | 1,500                              | -                            | (1,500)                | -                            |
|                    |                                    |                              |                        |                              | G V Davieson       | 64,750                             | 12,500                       | (40,545)               | 36,745                       |
|                    |                                    |                              |                        |                              | Total              | 5,326,668                          | 118,750                      | (247,031)              | 5,198,427                    |

Change in directors' shareholdings is the result of on or off market transactions.

There have been no other transactions concerning shares between entities in the reporting entity and directors of the reporting entity of their director related entities.

Mr A K Mayer has a 16.83% interest in a controlled entity Australian Leather Holdings Limited.

All equity transactions with specified directors and specified executives other than those arising from the exercise of remuneration options have been entered into under terms and conditions no more favourable than those the entity would have adopted if dealing at arm's length.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

| CONSOLIDATED |        | PARENT |        |
|--------------|--------|--------|--------|
| 2006         | 2005   | 2006   | 2005   |
| \$'000       | \$'000 | \$'000 | \$'000 |

## NOTE 25

## CONTINGENT LIABILITIES AND EXPENDITURE COMMITMENTS

## (a) Termination benefits under Service agreements

No of service agreements – 1

Maximum liability at

30 June 2006

|     |     |     |     |
|-----|-----|-----|-----|
| 617 | 588 | 617 | 588 |
|-----|-----|-----|-----|

## (b) Commitments under lease agreements

The Group has entered into commercial leases on certain motor vehicles and office and retail premises. These leases have an average life of between 1 and 6 years with no renewal option included in the contracts. There are no restrictions placed upon the lessee by entering into these leases. In return for the lease payments a fully maintained vehicle is provided.

Future minimum rentals payable under non-cancellable operating leases as at 30 June are as follows:

Operating leases – office, factory and retail premises

|  |       |       |   |   |
|--|-------|-------|---|---|
| – payable not later than 1 year                              | 1,768 | 1,692 | – | – |
| – later than 1 year and not later than 5 years               | 2,834 | 4,524 | – | – |
| – later than 5 years   | 787   | 261   | – | – |
| – aggregate lease expenditure contracted for at balance date | 5,389 | 6,477 | – | – |

Operating leases – motor vehicles

|  |     |     |    |    |
|--|-----|-----|----|----|
| – payable not later than 1 year                              | 223 | 208 | 9  | 9  |
| – later than 1 year and not later than 5 years               | 289 | 277 | 2  | 11 |
| – aggregate lease expenditure contracted for at balance date | 512 | 485 | 11 | 20 |

Other terms and conditions

## (c) Finance leases and hire purchase commitments

The Group has finance leases and hire purchase contracts for various items of plant and machinery. These leases have no terms of renewal but purchase options.

Future minimum lease payments under finance leases and hire purchase contracts together with the present value of the minimum lease payments are as follows:

|   | 2006                  |                                 | 2005                   |                                 |
|---|-----------------------|---------------------------------|------------------------|---------------------------------|
|   | MINIMUM LEASE PAYMENT | PRESENT VALUE OF LEASE PAYMENTS | MINIMUM LEASE PAYMENTS | PRESENT VALUE OF LEASE PAYMENTS |
|   | \$'000                | \$'000                          | \$'000                 | \$'000                          |
| CONSOLIDATED                                      |                       |                                 |                        |                                 |
| Within one year                                   | 146                   | 146                             | 180                    | 180                             |
| After one year but not more than five years       | 224                   | 224                             | 109                    | 109                             |
| Total minimum lease payments                      | 370                   | 370                             | 289                    | 289                             |
| Less amounts representing unearned finance income | (53)                  | (53)                            | (14)                   | (14)                            |
| Present value of minimum lease payments           | 317                   | 317                             | 275                    | 275                             |

Finance leases have an average lease term of 4 years and an average implicit interest rate of 7.5% per annum. Assets that are the subject of finance leases include motor vehicles and large items of plant and machinery (refer notes 17 and 19).

| CONSOLIDATED |        | PARENT |        |
|--------------|--------|--------|--------|
| 2006         | 2005   | 2006   | 2005   |
| \$'000       | \$'000 | \$'000 | \$'000 |

## NOTE 25

## CONTINGENT LIABILITIES AND EXPENDITURE COMMITMENTS (CONTINUED)

## (d) Expenditure commitments

Estimated expenditure contracted for at balance date but not provided for:

– payable not later than 1 year

Property, plant and equipment

|       |   |       |   |
|-------|---|-------|---|
| 7,500 | – | 7,500 | – |
|-------|---|-------|---|

(e) A first mortgage has been registered over the assets and undertakings of a controlled entity by a bank which has issued performance guarantees to third parties on behalf of the consolidated entity. The aggregate of the performance guarantees issued by the bank amounted to:

|       |       |    |    |
|-------|-------|----|----|
| 1,369 | 1,670 | 10 | 85 |
|-------|-------|----|----|

(f) The consolidated entity has a several liability only for borrowings made to finance the following joint ventures:

|  |        |        |       |       |
|--|--------|--------|-------|-------|
| Mindarie Keys Joint Venture              | 1,455  | 390    | –     | –     |
| IBM Centre Joint Venture                 | 3,234  | 3,182  | –     | –     |
| 616 St Kilda Road Joint Venture          | 3,646  | 3,551  | –     | –     |
| Hometown Joint Venture                   | 4,663  | 3,659  | 4,663 | 3,659 |
| Queens Road Joint Venture                | 574    | 558    | 574   | 558   |
| Crosslands Shopping Centre Joint Venture | 1,920  | 1,920  | –     | –     |
| 89 St Georges Tce Joint Venture          | 1,270  | 1,270  | –     | –     |
| Sentiens Joint Venture                   | 882    | –      | 882   | –     |
|  | 17,644 | 14,530 | 6,119 | 4,217 |

The consolidated entity's share of all liabilities has been included in the financial statements (refer note 27). For further information on borrowings refer note 32(b).

## NOTE 26

## EMPLOYEE BENEFITS AND SUPERANNUATION COMMITMENTS

## (a) Employee entitlements and superannuation commitments

The consolidated entity has established certain defined contribution superannuation plans. Employees contribute to these plans at various percentages of their wages and salaries and the end benefit is determined by accumulation of contributions and earnings of the plans.

The consolidated entity also contributes to the plan, generally at the rate of 9% of gross salaries and wages.

These contributions are not legally enforceable other than those payable in terms of a ratified award obligation or to comply with the Superannuation Guarantee Charge.

At balance date the assets of the plans are sufficient to satisfy all accumulated benefits that have vested under the plan in the event of termination of the plan and voluntary or compulsory termination of each employee.

|  | CONSOLIDATED |        | PARENT |        |
|--|--------------|--------|--------|--------|
|  | 2006         | 2005   | 2006   | 2005   |
|  | \$'000       | \$'000 | \$'000 | \$'000 |

The aggregate employee entitlement liability is comprised of:

|  |       |       |     |     |
|--|-------|-------|-----|-----|
| Accrued wages, salaries and on costs     | 218   | 308   | –   | –   |
| Provisions (current) – refer note 18     | 4,064 | 4,348 | 367 | 374 |
| Provisions (non current) – refer note 20 | 1,812 | 1,793 | 148 | 202 |
|  | 6,094 | 6,449 | 515 | 576 |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 26

#### EMPLOYEE BENEFITS AND SUPERANNUATION COMMITMENTS (CONTINUED)

##### b) Employee share option plan

An employee share option plan has been established. The plan was approved by shareholders at the AGM in November 1999. The plan permits the granting of options (at the absolute discretion of the Board) to group employees to acquire ordinary shares in Schaffer Corporation Limited. The options issued for nil consideration, are issued in accordance with performance guidelines established by the Directors of Schaffer Corporation Limited. The options cannot be transferred and will not be quoted on the ASX. The number of options which can be issued is limited to 5% of the number of shares on issue. There are currently twenty three employees eligible for the plan.

Options may be exercised as follows:

- (1) during the first 12 months of each option period and including each date of issue, no more than 25% of the options issued to that participant on that date of issue
- (2) during the period of 24 months from and including each date of issue exercise no more than 50% of the options issued to that participant on that date of issue
- (3) during the period of 36 months from and including each date of issue exercise no more than 75% of the options issued to that participant on that date of issue.
- (4) After 36 months 100% of the options may be exercised.

Options issued over ordinary shares as part of an employee share scheme are as follows.

| DATE ISSUED | NO. ON<br>ISSUE<br>30 JUNE 2005 | ISSUED<br>DURING<br>THE YEAR | FORFEITED<br>DURING<br>THE YEAR | CANCELLED<br>DURING<br>THE YEAR | EXERCISED<br>DURING<br>THE YEAR | NO. ON<br>ISSUE<br>30 JUNE 2006 | EXERCISE<br>PRICE | EXERCISABLE<br>ON OR<br>BEFORE | NO. VESTED<br>BUT NOT<br>EXERCISED<br>30 JUNE 2006 |
|-------------|---------------------------------|------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|-------------------|--------------------------------|--|
| 20 Jun 2002 | 42,850                          | –                            | (2,500)                         | –                               | –                               | 40,350                          | \$9.49            | 20 Jun 2007                    | 40,350   |
| 15 Jul 2003 | 27,500                          | –                            | –                               | –                               | –                               | 27,500                          | \$12.31           | 15 Jul 2008                    | 15,000   |
|             | 70,350                          | –                            | (2,500)                         | –                               | –                               | 67,850                          |                   |                                | 55,350   |

The Company has calculated the value as at the respective grant dates of all share options in the Company issued to executives and employees pursuant to the Company's Employee Share Option Plan (refer note 26(b)) pursuant to the methodology set out in AASB 2 *Share Based Payments*. To do this, the Company has used the Black-Scholes options valuation method. Inputs into the Black-Scholes model, as applied include:

- (1) the Company's closing share price on the grant date
- (2) the exercise price of the options as established under the Employee Share Option Plan
- (3) the volatility of the Company's share over the 12 months ended immediately prior to the grant date
- (4) the option's expiry date (typically five years after the grant date)
- (5) the risk-free rate over the life of the option, estimated by the yield on 5 year Commonwealth Government Bonds on the grant date; and
- (6) an estimate of the Company's dividend yield, based on historical dividends per share and the Company's share price on the grant date.

The historical volatility measure is used in the absence of any exchange-traded options issued by the Company and from which the market's assessment of future volatility can be inferred.

The table below summarises, for each issue made since the plans were instituted, the inputs into the model used to assess the options' values. The table also gives the valuation placed on each option when they were first granted.

| GRANT DATE | EXPIRY<br>DATE | CURRENT<br>PRICE | EXERCISE<br>PRICE | VOLATILITY | 5 YEAR<br>BONDS | DIVIDEND<br>YIELD | VALUATION<br>PER ED108 |
|------------|----------------|------------------|-------------------|------------|-----------------|-------------------|------------------------|
| 24 Aug 01  | 24 Aug 06      | \$4.00           | \$3.77            | 33%        | 5.42%           | 6.75%             | \$0.83                 |
| 4 Feb 02   | 4 Feb 07       | \$5.65           | \$5.42            | 36%        | 5.63%           | 4.78%             | \$1.53                 |
| 26 Mar 02  | 26 Mar 07      | \$7.00           | \$7.11            | 33%        | 6.12%           | 7.14%             | \$1.32                 |
| 20 Jun 02  | 20 Jun 07      | \$9.50           | \$9.49            | 34%        | 5.66%           | 6.84%             | \$1.89                 |
| 15 Jul 03  | 15 Jul 08      | \$12.29          | \$12.31           | 31%        | 5.01%           | 8.14%             | \$1.82                 |

The company has adopted the fair value measurement provisions of AASB 2 *Share Based Payments* prospectively for all options granted to directors and relevant executives, which have not vested as at 1 January 2005. The fair value of such grants is being amortised and disclosed as part of director and executive emoluments on a straight-line basis over the vesting period.

##### (c) Employee participation units

A controlled entity Australian Leather Holdings Limited (ALH) has established an ALH shareholder approved employee incentives plan which permits the granting of employee participation units (EPUs) at the discretion of its shareholders' up to an EPU limit. The EPU limit is 10% of the fully diluted share capital of Australian Leather Holdings Limited, which is calculated as if each EPU already issued was deemed to be one issued Australian Leather Holdings Limited share.

An EPU provides an employee with a right to receive a cash payment from Australian Leather Holdings Limited in the following circumstances:

- (a) If an employee dies or becomes permanently disabled at any time after the grant date.
- (b) If an employee ceases employment after the three year initial vesting period.
- (c) Upon a liquidity event (trade sale or listing on an Australian or overseas stock exchange).
- (d) On issue of a compulsory payment notice by Schaffer Corporation Limited.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 26

#### EMPLOYEE BENEFITS AND SUPERANNUATION COMMITMENTS (CONTINUED)

The amount of the cash payment is dependant on vesting and the financial performance of Australian Leather Holdings Limited. The vesting requirements are:

- (a) up to 3 years – nil
- (b) 3 years to 4 years – 33.3%
- (c) 4 years to 5 years – 66.7%
- (d) over 5 years – 100%

Note: Employees are ineligible to receive any payment in the following circumstances:

- (i) termination due to misconduct
- (ii) failure to provide 90 days written notice of intention to terminate employment
- (iii) acting in competition prior to the payment date (payment date is at least 12 months after termination)

The amount of payment is calculated in accordance with an equity valuation formula based on 5.5 times Australian Leather Holdings Limited's earnings before interest and tax minus net debt. The formula uses a three year average including one full year following termination.

Schaffer Corporation Limited has the option to compel the employee to use the whole or part of that cash payment in subscribing for Schaffer Corporation Limited shares based on the average Schaffer Corporation Limited share price for the same three year period.

| EPU TRANCHE | SERIES   | GRANT DATE  | NUMBER ISSUED | NUMBER VESTED | NUMBER REDEEMED | NUMBER CANCELLED | BALANCE OF EPU'S OUTSTANDING | BALANCE AS A % OF ALH'S CAPITAL |
|-------------|----------|-------------|---------------|---------------|-----------------|------------------|------------------------------|---------------------------------|
| Tranche 1   |          | 4 Oct 2000  | 3,383,634     | 1,150,435     | –               | (1,657,981)      | 1,725,653                    | 2.8%                            |
| Tranche 2   | Series 1 | 21 Dec 2001 | 2,884,434     | 526,632       | (236,394)       | (1,068,145)      | 1,579,895                    | 2.6%                            |
|             | Series 2 | 1 Jul 2002  | 120,000       | –             | –               | –                | 120,000                      | 0.2%                            |
|             | Series 3 | 1 Jul 2003  | 245,000       | –             | –               | –                | 245,000                      | 0.4%                            |
|             | Series 4 | 1 Jul 2004  | 57,672        | –             | –               | –                | 57,672                       | 0.1%                            |
|             | Series 5 | 16 May 2005 | 150,000       | –             | –               | –                | 150,000                      | 0.2%                            |
|             | Series 6 | 1 Jul 2005  | 1,350,000     | –             | –               | (250,000)        | 1,150,000                    | 1.8%                            |

The Company has calculated the value at the respective grant dates of all EPUs issued to directors, executives and employees pursuant to the Company's Employee Incentive Plan pursuant to the methodology set out in AASB 2 Share Based Payments. To do this the Company has used the Black-Scholes options valuation method. Inputs into the Black-Scholes model applied include:

- (1) the calculated unit price on the grant date;
- (2) the exercise price of the EPUs;
- (3) the volatility on Australian Leather Holdings Limited shares over the 12 months ended immediately prior to the grant date;
- (4) the options expected life (refer note 26(c) for explanation of vesting provisions);
- (5) zero dividend yield as EPUs participate in dividends paid by Australian Leather Holdings Limited; and
- (6) the risk-free rate over the life of the option, estimated from the yield of 5 year and 10 year Commonwealth Government Bonds on the grant date, and extrapolating to a 7 year term.

The historical volatility measure of Schaffer Corporation Limited is used in the absence of any exchange-traded options issued by Australian Leather Holdings Limited from which the market's assessment of future volatility can be inferred.

The table below summarises, for each issue made since the plans were instituted, the inputs into the model used to assess the options' values.

| GRANT DATE  | EXPIRY DATE (ESTIMATED) | CURRENT PRICE | EXERCISE PRICE | VOLATILITY | RISK FREE RATE (ESTIMATED) | VALUATION |
|-------------|-------------------------|---------------|----------------|------------|----------------------------|-----------|
| 4 Oct 2000  | 4 Oct 2007              | \$0.26        | \$0.26         | 36%        | 6.16%                      | \$0.13    |
| 20 Dec 2001 | 20 Dec 2008             | \$0.33        | \$0.26         | 33%        | 5.51%                      | \$0.18    |
| 1 Jul 2002  | 1 Jul 2009              | \$1.19        | \$0.26         | 33%        | 5.88%                      | \$1.02    |
| 1 Jul 2003  | 1 Jul 2010              | \$1.33        | \$0.26         | 31%        | 4.83%                      | \$1.14    |
| 15 Jan 2004 | 15 Jan 2011             | \$0.90        | \$0.26         | 25%        | 5.45%                      | \$0.72    |
| 16 May 2005 | 16 May 2012             | \$0.19        | \$0.26         | 40%        | 5.24%                      | \$0.08    |
| 1 Jul 2005  | 1 Jul 2012              | \$0.13        | \$0.26         | 39%        | 5.06%                      | \$0.04    |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 27 INTERESTS IN JOINTLY CONTROLLED ASSETS

#### Investment properties

Schaffer Properties Pty Ltd and Schaffer Corporation Limited have interests in a number of property joint ventures in Western Australia and Victoria.

|  | % INTEREST |       |
|--|------------|-------|
|  | 2006       | 2005  |
| IBM Centre Joint Venture                 | 22.10      | 22.10 |
| 616 St Kilda Road Joint Venture          | 20.00      | 20.00 |
| Hometown Joint Venture                   | 25.00      | 25.00 |
| Queens Road Joint Venture                | 9.00       | 9.00  |
| Crosslands Shopping Centre Joint Venture | 16.70      | 16.70 |
| 89 St. George's Terrace Joint Venture    | 20.00      | 20.00 |
| Sentiens Joint Venture                   | 11.00      | -     |

#### Property Developments

The following joint venture was established for the purposes of redeveloping, constructing and resale of residential and commercial properties.

|                             | % INTEREST |       |
|-----------------------------|------------|-------|
|                             | 2006       | 2005  |
| Mindarie Keys Joint Venture | 15.00      | 15.00 |

|                                       | CONSOLIDATED   |                | PARENT         |                |
|---------------------------------------|----------------|----------------|----------------|----------------|
|                                       | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>CURRENT ASSETS</b>                 |                |                |                |                |
| Cash and cash equivalents             | 796            | 355            | 78             | 5              |
| Trade and other receivables           | 2,324          | 198            | 372            | 39             |
| Prepayments                           | 79             | 38             | 22             | 11             |
| Inventories                           | 1,253          | 1,107          | -              | -              |
| <b>TOTAL CURRENT ASSETS</b>           | <b>4,452</b>   | <b>1,698</b>   | <b>472</b>     | <b>55</b>      |
| <b>NON CURRENT ASSETS</b>             |                |                |                |                |
| Plant and equipment                   | 2,720          | 2,736          | 1,110          | 1,051          |
| Investment properties                 | 12,325         | 11,038         | 5,036          | 3,368          |
| Goodwill                              | 84             | 84             | -              | -              |
| Deferred income tax assets            | 6              | 510            | -              | 494            |
| <b>TOTAL NON CURRENT ASSETS</b>       | <b>15,135</b>  | <b>14,368</b>  | <b>6,146</b>   | <b>4,913</b>   |
| <b>TOTAL ASSETS</b>                   | <b>19,587</b>  | <b>16,066</b>  | <b>6,618</b>   | <b>4,968</b>   |
| <b>CURRENT LIABILITIES</b>            |                |                |                |                |
| Trade and other payables              | 362            | 242            | 22             | 22             |
| <b>TOTAL CURRENT LIABILITIES</b>      | <b>362</b>     | <b>242</b>     | <b>22</b>      | <b>22</b>      |
| <b>NON CURRENT LIABILITIES</b>        |                |                |                |                |
| Interest bearing loans and borrowings | 17,644         | 14,530         | 6,119          | 4,217          |
| Deferred income tax liabilities       | 761            | 973            | 87             | 363            |
| <b>TOTAL NON CURRENT LIABILITIES</b>  | <b>18,405</b>  | <b>15,503</b>  | <b>6,206</b>   | <b>4,580</b>   |
| <b>TOTAL LIABILITIES</b>              | <b>18,767</b>  | <b>15,745</b>  | <b>6,228</b>   | <b>4,602</b>   |
| <b>NET ASSETS</b>                     | <b>820</b>     | <b>321</b>     | <b>390</b>     | <b>366</b>     |

The joint ventures have contributed to the after tax result of the consolidated entity as follows:

|                  |             |                      |
|------------------|-------------|----------------------|
| Profit after tax | \$1,984,000 | (2005 - \$1,638,000) |
| Revenue          | \$7,611,000 | (2005 - \$7,305,000) |

There are no contingent liabilities in respect of the joint ventures.

Capital expenditure commitments of \$Nil (2005 - \$Nil) payable within one year were contracted for at balance date.

### NOTE 28 SEGMENT INFORMATION

The Group's primary segment reporting format is business segments as the Group's risk and rates of return are affected predominantly by differences in the products and services produced. The Group operates predominantly in Australia. The leather business has three overseas cutting plants which are integral to the Australian operations.

The operating businesses are organised and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The leather segment is a manufacturer and supplier of leather in the automotive and furniture industries.

The building products segment comprises Delta Corporation Limited and Urbanstone Pty. Ltd. which produces and sells concrete paving and pre-cast and pre-stressed concrete elements.

The investment property segment leases offices and retail premises and represents the Group's share of jointly controlled operations.

Other investments comprise cash and cash equivalents, available-for-sale financial assets, surplus land and the Group's share of the Mindarie Keys joint venture land subdivision.

Transfer prices between business segments are set at an arms length basis in a manner similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments.

Those transfers are eliminated on consolidation.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 28 SEGMENT INFORMATION (CONTINUED)

#### Business segments

The following tables present revenue and profit information and certain asset and liability information regarding business segments for the years ended 30 June 2006 and 30 June 2005.

| BUSINESS SEGMENT<br>INFORMATION  | LEATHER        |                | BUILDING<br>PRODUCTS |                | INVESTMENT<br>PROPERTIES |                | OTHER<br>INVESTMENTS |                | CONSOLIDATED   |                |
|--|----------------|----------------|----------------------|----------------|--------------------------|----------------|----------------------|----------------|----------------|----------------|
|  | 2006<br>\$'000 | 2005<br>\$'000 | 2006<br>\$'000       | 2005<br>\$'000 | 2006<br>\$'000           | 2005<br>\$'000 | 2006<br>\$'000       | 2005<br>\$'000 | 2006<br>\$'000 | 2005<br>\$'000 |
| <b>Revenue</b>   |                |                |                      |                |                          |                |                      |                |                |                |
| Total revenue from ordinary activities external customers                                    | 98,111         | 105,412        | 39,043               | 28,844         | 4,236                    | 3,885          | 3,945                | 4,427          | 145,335        | 142,568        |
| Unallocated revenue  |                |                |                      |                |                          |                |                      |                | -              | -              |
| Total revenue  |                |                |                      |                |                          |                |                      |                | 145,335        | 142,568        |
| <b>Results</b>   |                |                |                      |                |                          |                |                      |                |                |                |
| Segment results  | 4,829          | 8,267          | 6,586                | 2,867          | 1,928                    | 1,601          | 2,001                | 3,064          | 15,344         | 15,799         |
| Interest and corporate overhead  |                |                |                      |                |                          |                |                      |                | (2,917)        | (2,003)        |
| Operating profit before income tax   |                |                |                      |                |                          |                |                      |                | 12,427         | 13,796         |
| Income tax expense   |                |                |                      |                |                          |                |                      |                | (3,997)        | (3,689)        |
| Profit after tax from continuing operations  |                |                |                      |                |                          |                |                      |                | 8,430          | 10,107         |
| <b>Assets</b>  |                |                |                      |                |                          |                |                      |                |                |                |
| Segment assets   | 74,802         | 78,080         | 22,885               | 22,082         | 15,930                   | 14,097         | 20,388               | 17,507         | 134,005        | 131,766        |
| Unallocated assets   |                |                |                      |                |                          |                |                      |                | 997            | 1,710          |
| Total assets   |                |                |                      |                |                          |                |                      |                | 135,002        | 133,476        |
| <b>Liabilities</b>   |                |                |                      |                |                          |                |                      |                |                |                |
| Segment liabilities  | 56,877         | 56,822         | 6,393                | 5,403          | 17,342                   | 15,321         | 2,098                | 617            | 82,710         | 78,163         |
| Unallocated liabilities  |                |                |                      |                |                          |                |                      |                | 2,186          | 1,478          |
| Total liabilities  |                |                |                      |                |                          |                |                      |                | 84,896         | 79,641         |
| <b>Other Segment Information</b>   |                |                |                      |                |                          |                |                      |                |                |                |
| Acquisition of property, plant and equipment, intangible assets and other non current assets | 1,819          | 2,881          | 1,205                | 1,747          | 1,675                    | 154            | -                    | -              | 4,699          | 4,782          |
| Unallocated  |                |                |                      |                |                          |                |                      |                | -              | 10             |
|  |                |                |                      |                |                          |                |                      |                | 4,699          | 4,792          |
| Depreciation   | 3,268          | 2,885          | 1,525                | 1,627          | 405                      | 405            | -                    | -              | 5,198          | 4,917          |
| Unallocated  |                |                |                      |                |                          |                |                      |                | 36             | 59             |
|  |                |                |                      |                |                          |                |                      |                | 5,234          | 4,976          |
| Non cash expenses other than depreciation and amortisation                                   | (448)          | (3,472)        | 270                  | 155            | -                        | -              | -                    | -              | (178)          | (3,317)        |
| Unallocated  |                |                |                      |                |                          |                |                      |                | (7)            | (43)           |
|  |                |                |                      |                |                          |                |                      |                | (185)          | (3,360)        |

### NOTE 29 RELATED PARTY DISCLOSURES

- (a) The directors of Schaffer Corporation Limited during the year were Messrs J M Schaffer, D J Schwartz, A K Mayer, M D Perrott and Mrs D E Blain.
- (b) The following related party transactions occurred during the financial year within the consolidated entity.

#### Disclosures relating to wholly owned group

Schaffer Corporation Limited has provided 100% controlled entities with working capital loans which are interest free and repayable on demand. The aggregate amounts owing from those controlled entities at year end is \$6,919,241 (2005 – \$8,410,977).

Wholly owned controlled entities have provided the Parent entity with loans which are interest free and repayable on demand. The aggregate amounts owing to those controlled entities at year end is \$8,437,062 (2005 – \$11,388,949).

#### Transactions with other related parties

Schaffer Corporation Limited holds 83.17% (2005 – 83.17%) of the share capital of Australian Leather Holdings Limited of which Mr J M Schaffer and Mr A K Mayer are directors. Schaffer Corporation Limited provided management services to Australian Leather Holdings Limited. Fees received during the year were \$Nil (2005 – \$60,000).

- (c) Schaffer Corporation Limited is the ultimate Australian holding company.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

|   | 2006<br>\$'000 | 2005<br>\$'000 |
|---|----------------|----------------|
| <b>NOTE 30</b>  |                |                |
| <b>MINORITY INTEREST</b>  |                |                |
| Reconciliation of outside equity interest in controlled entities: |                |                |
| At 1 July   | 3,759          | 4,874          |
| – Add share of operating profit                                   | 286            | 703            |
| – Dividends paid  | (337)          | (1,818)        |
| At 30 June  | <u>3,708</u>   | <u>3,759</u>   |

|                           | 2006<br>\$'000 | 2005<br>\$'000 |
|---------------------------|----------------|----------------|
| <b>NOTE 31</b>            |                |                |
| <b>EARNINGS PER SHARE</b> |                |                |

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The following reflects the income and share data used in the calculation of basic and diluted earnings per share:

|   |                     |                     |
|---|---------------------|---------------------|
| Net profit attributable to ordinary equity holders of the parent from continuing operations | 8,144               | 9,404               |
| Profit attributable to ordinary equity holders of the parent from discontinued operations   | –                   | –                   |
|   | <u>8,144</u>        | <u>9,404</u>        |
|   | NUMBER<br>OF SHARES | NUMBER<br>OF SHARES |
| Weighted average number of ordinary shares for basic earnings per share                     | <u>14,091,935</u>   | 14,069,712          |
| Weighted average number of ordinary shares adjusted for the effect of dilution              | <u>14,091,935</u>   | 14,069,712          |

There have been no other transactions involving ordinary shares. The potential ordinary shares at the reporting date are 67,850 (2005 – 70,850). These amounts have not been included in the calculation of diluted earnings per share as they are not considered to be dilutive. Since year end 21,316 shares were issued in accordance with the terms of the Australian Leather Holdings Limited employee incentives plan (refer note 26(c)).

**NOTE 32**  
**FINANCIAL INSTRUMENTS****Financial risk management, objectives and policies**

The Group's financial instruments, comprise bank, commonwealth government loans and overdrafts, finance leases and hire purchase contracts, and cash and short-term deposits.

The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The Group also enters into forward currency contracts. The purpose is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are cash flow interest rate risk, liquidity risk, foreign currency risk and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

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

*(a) Foreign currency risk*

In an effort to mitigate the risk of its structural currency exposure between 30% and 40% of foreign denominated revenue is covered by forward exchange contracts.

Transactional currency exposures also arise from the sales and purchases in currencies other than functional currency.

Approximately 90% of the leather division's sales are denominated in foreign currencies, consistent with the operating unit making the sale, whilst almost 50% of costs are denominated in foreign currencies.

Under the company's foreign exchange and treasury policy, forward exchange contracts are entered into to cover a percentage of firm foreign exchange sales and commitments.

*(b) Cash flow interest rate risk*

The Group's exposure to the risk of changes in market interest rates relate primarily to the Group's long term debt obligations with a floating interest rate.

In respect of the \$38,654,000 loan from the Commonwealth Government to Australian Leather Holdings Limited, \$25,000,000 attracts interest at 2% above the long-term bond rate. \$13,654,000 attracts interest at 4.4% fixed. This is set until maturity in February 2012. Borrowing from ALH's senior debt provider (GE Capital) are for working capital purposes and as such vary from time to time. Due to the short term nature of the GE Capital borrowings, it is not appropriate to enter into long term fixed interest rate contracts.

In respect of the Group's property borrowings, the funding and interest rate decision are managed externally. At balance date, \$12,256,000 of the total \$17,644,000 borrowings were not fixed.

In summary, at balance date, 33% of Group borrowings were at fixed interest rates and 67% at variable interest rates.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

NOTE 32  
FINANCIAL INSTRUMENTS

The following table sets out the carrying amount by maturity of the financial instruments exposed to interest rate risk.

| YEAR ENDED 30 JUNE 2006   | 1 YEAR<br>\$'000 | 1 - 2<br>YEARS<br>\$'000 | 2 - 3<br>YEARS<br>\$'000 | 3 - 4<br>YEARS<br>\$'000 | 4 - 5<br>YEARS<br>\$'000 | 5 - 6<br>YEARS<br>\$'000 | TOTAL<br>\$'000 | WEIGHTED<br>AVERAGE<br>EFFECTIVE<br>INTEREST<br>RATE<br>% |  |
|---|------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|-----------------|---|--|
| <b>CONSOLIDATED</b>   |                  |                          |                          |                          |                          |                          |                 |   |  |
| <b>FINANCIAL ASSETS</b>   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Floating rate   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Cash assets   | 13,596           | -                        | -                        | -                        | -                        | -                        | 13,596          | 5.40%   |  |
| Weighted average effective interest rate                        | 5.40%            |                          |                          |                          |                          |                          |                 |   |  |
| <b>FINANCIAL LIABILITIES</b>                                    |                  |                          |                          |                          |                          |                          |                 |   |  |
| Fixed rate  |                  |                          |                          |                          |                          |                          |                 |   |  |
| Obligations under finance leases<br>and hire purchase contracts | 131              | 25                       | 26                       | 28                       | 107                      | -                        | 317             | 7.40%   |  |
| Interest bearing loans and borrowings                           | -                | -                        | 2,189                    | 800                      | 2,400                    | -                        | 5,389           | 6.81%   |  |
| Government loan   | -                | -                        | -                        | -                        | -                        | 13,654                   | 13,654          | 4.40%   |  |
| Weighted average effective interest rate                        | 7.40%            | 7.20%                    | 6.80%                    | 6.63%                    | 6.89%                    | 4.40%                    |                 |   |  |
| Floating rate   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Interest bearing loans and borrowings                           | 1,455            | 1,429                    | 2,626                    | 470                      | 6,276                    | -                        | 12,256          | 7.18%   |  |
| Working capital revolver facility                               | 1,388            | -                        | -                        | -                        | -                        | -                        | 1,388           | 8.63%   |  |
| Government loan   | -                | 2,000                    | 2,000                    | 2,000                    | 2,000                    | 17,000                   | 25,000          | 7.34%   |  |
| Weighted average effective interest rate                        | 7.90%            | 7.30%                    | 7.23%                    | 7.28%                    | 7.18%                    | 7.34%                    |                 |   |  |
| <b>PARENT</b>   |                  |                          |                          |                          |                          |                          |                 |   |  |
| <b>FINANCIAL ASSETS</b>   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Floating rate   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Cash assets   | 2,560            | -                        | -                        | -                        | -                        | -                        | 2,560           | 5.40%   |  |
| Weighted average effective interest rate                        | 5.40%            |                          |                          |                          |                          |                          |                 |   |  |
| <b>FINANCIAL LIABILITIES</b>                                    |                  |                          |                          |                          |                          |                          |                 |   |  |
| Fixed rate  |                  |                          |                          |                          |                          |                          |                 |   |  |
| Interest bearing loans and borrowings                           | -                | 1,429                    | 2,626                    | -                        | -                        | -                        | 4,055           | 7.18%   |  |
| Weighted average effective interest rate                        |                  | 7.24%                    | 7.15%                    |                          |                          |                          |                 |   |  |
| Floating rate   |                  |                          |                          |                          |                          |                          |                 |   |  |
| Interest bearing loans and borrowings                           | -                | -                        | 2,064                    | -                        | -                        | -                        | 2,064           | 6.80%   |  |
| Weighted average effective interest rate                        |                  |                          | 6.80%                    |                          |                          |                          |                 |   |  |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

NOTE 32  
FINANCIAL INSTRUMENTS (CONTINUED)

| YEAR ENDED 30 JUNE 2005                                      | 1 YEAR | 1 - 2 YEARS | 2 - 3 YEARS | 3 - 4 YEARS | 4 - 5 YEARS | 5 - 6 YEARS | 6 - 7 YEARS | TOTAL  | WEIGHTED AVERAGE EFFECTIVE INTEREST RATE |
|--|--------|-------------|-------------|-------------|-------------|-------------|-------------|--------|--|
|  | \$'000 | \$'000      | \$'000      | \$'000      | \$'000      | \$'000      | \$'000      | \$'000 | %  |
| <b>CONSOLIDATED</b>  |        |             |             |             |             |             |             |        |  |
| <b>FINANCIAL ASSETS</b>                                      |        |             |             |             |             |             |             |        |  |
| Floating rate  |        |             |             |             |             |             |             |        |  |
| Cash assets  | 12,737 | -           | -           | -           | -           | -           | -           | 12,737 | 5.30%                                    |
| Weighted average effective interest rate                     | 5.30%  |             |             |             |             |             |             |        |  |
| <b>FINANCIAL LIABILITIES</b>                                 |        |             |             |             |             |             |             |        |  |
| Fixed rate   |        |             |             |             |             |             |             |        |  |
| Obligations under finance leases and hire purchase contracts |        |             |             |             |             |             |             |        |  |
|  | 167    | 108         | -           | -           | -           | -           | -           | 275    |  |
| Interest bearing loans and borrowings                        | 1,591  | -           | 2,553       | -           | 800         | 2,400       | -           | 7,344  | 7.07%                                    |
| Government loan  |        |             |             |             |             |             | 13,654      | 13,654 | 4.40%                                    |
| Weighted average effective interest rate                     | 7.32%  | 8.00%       | 7.14%       |             | 6.81%       | 7.03%       | 4.40%       |        |  |
| Floating rate  |        |             |             |             |             |             |             |        |  |
| Interest bearing loans and borrowings                        | 3,512  | 390         | 1,660       | -           | 470         | 1,154       | -           | 7,186  | 7.11%                                    |
| Bank overdraft   | 2,972  | -           | -           | -           | -           | -           | -           | 2,972  | 8.40%                                    |
| Government loan  | -      | -           | 2,000       | 2,000       | 2,000       | 2,000       | 17,000      | 25,000 | 7.49%                                    |
| Weighted average effective interest rate                     | 7.76%  | 7.25%       | 7.27%       | 7.49%       | 7.39%       | 7.31%       | 7.49%       |        |  |
| <b>PARENT</b>  |        |             |             |             |             |             |             |        |  |
| <b>FINANCIAL ASSETS</b>                                      |        |             |             |             |             |             |             |        |  |
| Floating rate  |        |             |             |             |             |             |             |        |  |
| Cash assets  | 6,398  | -           | -           | -           | -           | -           | -           | 6,398  | 5.30%                                    |
| Weighted average effective interest rate                     | 5.30%  |             |             |             |             |             |             |        |  |
| <b>FINANCIAL LIABILITIES</b>                                 |        |             |             |             |             |             |             |        |  |
| Fixed rate   |        |             |             |             |             |             |             |        |  |
| Interest bearing loans and borrowings                        |        |             |             |             |             |             |             |        |  |
|  | -      | -           | 2,557       | -           | -           | -           | -           | 2,557  | 7.14%                                    |
| Weighted average effective interest rate                     | 7.14%  |             |             |             |             |             |             |        |  |
| Floating rate  |        |             |             |             |             |             |             |        |  |
| Interest bearing loans and borrowings                        |        |             |             |             |             |             |             |        |  |
|  | -      | -           | 1,660       | -           | -           | -           | -           | 1,660  | 7.00%                                    |
| Weighted average effective interest rate                     | 7.00%  |             |             |             |             |             |             |        |  |

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 32 FINANCIAL INSTRUMENTS (CONTINUED)

#### (d) Net fair values

The carrying value of all financial assets and liabilities have been recognised at the balance date at amounts at approximate fair value except for the following:

|                                    | TOTAL CARRYING<br>AMOUNT AS PER<br>BALANCE SHEET |                | AGGREGATE<br>NET FAIR VALUE |                |
|------------------------------------|--|----------------|-----------------------------|----------------|
|                                    | 2006<br>\$'000                                   | 2005<br>\$'000 | 2006<br>\$'000              | 2005<br>\$'000 |
| Government loans<br>4.4% per annum | 13,654   | 13,654         | 11,509                      | 11,238         |

The following methods and assumptions are used to determine the net fair values of financial assets and liabilities.

#### Recognised financial instruments

Cash, cash equivalents and short term investments:

The carrying amount approximates fair value because of their short term to maturity.

Trade receivables and payables:

The carrying amount approximates fair value.

Short term borrowings:

The carrying amount approximates fair value because of their short term to maturity.

Long term loans receivable:

The fair values of long term loans receivable are estimated based on the amount likely to be recovered.

Long term borrowings:

Other than noted above the fair values of long term borrowings have been calculated using market interest rates.

Non current investments/securities:

For financial instruments traded in organised financial markets, fair value is the current quoted market bid price for an asset or offer price for a liability. The fair value of the unlisted available-for-sale investments has been estimated using valuation techniques based on assumptions that are not supported by observable market prices or rates. Management believes the estimated fair values resulting from the valuation techniques and recorded in the balance sheet and the related changes in fair values recorded in the income statement are reasonable and the most appropriate at the balance sheet date.

#### (e) Credit risk exposures

The consolidated entity's maximum exposure \* to credit risk at balance date in relation to each class of recognised financial assets, is the carrying amount of those assets as indicated in the balance sheet.

The Group trades only with recognised, creditworthy third parties.

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

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

#### Concentrations of credit risk

The consolidated entity minimises concentrations of credit risk in relation to trade receivables by undertaking transactions with a large number of customers within the specified industries both within Australia and overseas.

Refer also to Note 28 – Segment Information

### NOTE 32 FINANCIAL INSTRUMENTS (CONTINUED)

Concentration of credit risk on trade receivables arises in the following industry:

| Industry                                    | MAXIMUM CREDIT RISK EXPOSURE<br>CONSOLIDATED |           |                |                |
|---|--|-----------|----------------|----------------|
|   | TRADE DEBTORS                                |           | TRADE DEBTORS  |                |
|   | 2006<br>%                                    | 2005<br>% | 2006<br>\$'000 | 2005<br>\$'000 |
| Leather                                     | 71   | 86        | 17,070         | 22,138         |
| Building products                           | 22   | 14        | 5,101          | 3,506          |
| Other investments –<br>Property subdivision | 7  | –         | 1,752          | 78             |
| Total                                       | 100  | 100       | 23,923         | 25,722         |

Credit risk in trade receivables is managed in the following ways:

Leather and building products

- payment terms 30 days
- a risk assessment process is used for all new customers

Property subdivision

- amounts outstanding represent unconditional sales but are subject to completion of the project or the issue of Certificate of Title.
- title does not pass to the purchaser until payment is received in full.

\*The maximum credit risk exposure does not take into account the value of any collateral or other security held, in the event other entities/parties fail to perform their obligations under the financial instruments in question.

#### (e) Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through bank overdrafts, bank and other loans, finance leases and hire purchase contracts.

Debt associated with Australian Leather Holdings Limited and the Property division represents 99% of Group borrowings. At 30 June, 97% of Group debt was non-recourse to the Parent.

\$38,654,000 of Group debt is by way of a subordinated Commonwealth Government Loan to Australian Leather Holdings Limited. The long terms require principal repayments of \$2,000,000 per annum commencing February 2008 with repayment in full in February 2012.

Debt associated with the Property division total \$17,644,000. SFC's minority property interests are managed external to the Group. Accordingly SFC does not control the funding structure. SFC's objective is for property borrowing to predominantly be non-recourse to the Chief Entity. At 30 June, 90% of the property borrowings were non-recourse to the Parent.

### NOTE 33 SIGNIFICANT EVENTS AFTER BALANCE DATE

Following the end of the reporting period a final fully franked dividend of 25¢ per share has been declared payable on 19 September 2006.

On 31 May 2006 the Company entered into an agreement to acquire 100% of the assets of Limestone Resources Australia Pty. Ltd. for an amount approximating \$7.5 million. The acquisition was completed on 5 July 2006. The Company is in the process of allocating the purchase price over the fair value of assets, liabilities and contingent liabilities acquired.

On 3 July 2006 the Company entered into an agreement to acquire a 4,700 square metre piece of land in Frobisher Street, Osborne Park for a price of \$3.6 million. The purchase was completed on 18 August 2006.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 34 TRANSITION TO AIFRS

For all periods up to and including the year ended 30 June 2005, the Group prepared its financial statements in accordance with Australian Accounting Standards applicable to financial years commencing before 1 January 2005 ("AGAAP"). These financial statements for the year ended 30 June 2006 are the first the Group is required to prepare in accordance with Australian equivalents to International Financial Reporting Standards ("AIFRS").

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

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

#### AASB 1 TRANSITIONAL EXEMPTIONS

The Group has made its elections in relation to the transitional exemptions allowed by AASB 1 as follows:

##### Business combinations

AASB 3 *Business Combinations* was not applied retrospectively to past business combinations (i.e. business combinations that occurred before the date of transition to AIFRS).

##### Designation of previously recognised financial instruments

Certain financial assets were designated as available-for-sale at the date of transition to AIFRS.

##### Share-based payment transactions

AASB 2 *Share Based Payments* is applied only to equity instruments granted after 7 November 2002 that had not vested on or before 1 January 2005.

##### Comparative information for AASB 132 and AASB 139

The Group has elected to adopt this exemption and has not applied AASB 132 "Financial Instruments: Presentation and Disclosure" and AASB 139 "Financial Instruments: Recognition and Measurement" to its comparative information.

##### Property, Plant and Equipment

The Group has elected to use a previous AGAAP revaluation of property, plant and equipment before the date of transition to AIFRS as deemed cost at the date of revaluation.

#### IMPACT OF ADOPTION OF AIFRS

##### (a) Share-Based Payments

Under AASB 2, the Company is required to recognise the fair value of equity settled share based payment arrangements as an expense over the vesting period. The standard applies to all share-based payments granted after 7 November 2002 which had not vested as at 1 January 2005. This treatment results in a transitional adjustment through retained earnings on 1 July 2004 and subsequent expense recognition in the Income Statement, with corresponding adjustments to equity. No tax deduction is allowed for the amount expensed.

### NOTE 34 TRANSITION TO AIFRS (CONTINUED)

##### (b) Goodwill

Under AASB 3, goodwill is no longer amortised but instead is subject to annual impairment testing. This resulted in a change to the Group's previous accounting policy which amortised goodwill over its useful life (usually 20 years). Under the new policy, amortisation is no longer charged, but goodwill will be written down to the extent it is impaired. No transition adjustment was required as there was no impairment at 1 July 2004. In addition, the Group has determined that there is no impairment either at 30 June 2005 or 30 June 2006. The Group has not elected to apply AASB 3 retrospectively and hence prior year amortisation has not been written back as at the date of transition.

##### (c) Taxation

Under AASB 112 *Income Taxes*, deferred tax assets and deferred tax liabilities are recognised using the balance sheet approach, which resulted in a change to the Group's previous accounting policy that used the income statement approach. AASB 112 has a wider scope than the Group's previous accounting policy hence upon transition the amount of deferred taxes recognised in the balance sheet increased. Deferred tax liabilities have increased in relation to assets that are carried in the Balance Sheet at amounts greater than their tax cost base due to revaluations of assets in prior periods.

In the case of investment properties that were carried in the Balance Sheet at cost and not depreciated, an adjustment has been made to bring to account this depreciation and the associated deferred tax consequence.

##### Tax Consolidation

Adjustments are required to the parent entity financial information from the AIFRS transition date of 1 July 2004 in accordance with the application of UIG Interpretation 1052 *Tax Consolidation Accounting*.

Under UIG 1052, the head entity in a tax consolidated group assumes the current tax liability and any deferred tax assets arising from tax losses and other unused tax credits of the subsidiaries in the tax consolidated group. Deferred tax balances of the subsidiaries in the tax consolidated group are not assumed by the parent entity.

The Group allocates the tax balances for the period using the group allocation method and a tax funding arrangement is in place to reimburse the parent entity for any liabilities of the subsidiaries it assumes and conversely, for the parent entity to reimburse the subsidiaries for any recognised tax losses it assumes.

The transition from AGAAP to AIFRS resulted in a balance sheet reclassification in the parent entity between the deferred tax balances and the inter-company accounts.

##### (d) Investment Property

Under AGAAP, investment properties were not depreciated and the Group carried its investment property in the Balance Sheet at the lower of cost and net realisable value. AASB 140 *Investment Property* requires investment properties to be recorded by the Group at either fair value or depreciated cost. The Group has adopted the cost method. The carrying value of investment properties is \$12.3 million and associated plant and equipment is \$2.7 million in total of \$15.0 million whereas the current market value is approximately \$32.5 million.

## NOTES TO THE FINANCIAL STATEMENTS

year ended 30 June 2006

### NOTE 34 TRANSITION TO AIFRS (CONTINUED)

#### (e) Financial Assets and Liabilities

AASB 139 requires financial instruments to be classified into one of the following categories which in turn determine the accounting treatment for the item. The classifications are:

- Financial assets held for trading – which are to be measured at fair value and fair value changes applied through the Income Statement;
- Financial assets held to maturity – which are to be measured at amortised cost;
- Loans and receivables – which are to be measured at amortised cost;
- Available-for-sale financial assets – which are to be measured at fair value with fair value changes taken to equity; and
- Non-trading financial liabilities – which are to be measured at amortised cost.

This results in a change in the previous accounting policy that did not classify financial instruments in this way.

Listed Shares and Unlisted Shares – Available-for-Sale

Previously listed shares were valued at the lower of cost and net realisable value. AASB 139 requires listed shares to be valued at their market value at balance date and any increment or decrement from the previous balance date to be recognised in the Company's Balance Sheet at each balance date. The new AASB 139 applied from 1 July 2005. The impact at 1 July 2005 is \$6,181 being an increase in the carrying value to bring the carrying value up to market value under AIFRS.

#### (f) Impact of adoption of AIFRS

The impacts of adopting AIFRS on the total equity and profit after tax as reported under Australian Accounting Standards applicable before 1 January 2005 ("AGAAP") are illustrated below:

#### IMPACT OF ADOPTING AASB EQUIVALENTS TO IASB STANDARDS

|  | CONSOLIDATED        |                    | PARENT              |                    |
|--|---------------------|--------------------|---------------------|--------------------|
|  | 30 JUN 05<br>\$'000 | 1 JUL 04<br>\$'000 | 30 JUN 05<br>\$'000 | 1 JUL 04<br>\$'000 |
| <b>(i) Reconciliation of equity as presented under AGAAP to that under AIFRS</b> |                     |                    |                     |                    |
| <b>Total equity under AGAAP</b>  | 53,972              | 62,268             | 27,281              | 34,620             |
| <b>Adjustments to retained earnings (net of tax)</b>                             |                     |                    |                     |                    |
| Adjustments relating to share based payments (see note (a) above)                | 320                 | 848                | (111)               | (30)               |
| Write-back of goodwill amortisation (see note (b) above)                         | 110                 | –                  | –                   | –                  |
| Deferred taxation (see note (c) above)   | (40)                | (88)               | (24)                | (50)               |
| Accumulated depreciation of investment properties (see note (d) above)           | (870)               | (754)              | (276)               | (225)              |
|  | (480)               | 6                  | (411)               | (305)              |
| <b>Adjustments to reserves</b>   |                     |                    |                     |                    |
| Option premium reserve (see note (a) above)                                      | 111                 | 30                 | 111                 | 30                 |
| Share based payments reserve (see note (a) above)                                | 123                 | 57                 | –                   | –                  |
| <b>Adjustments to outside equity interests in controlled entities</b>            |                     |                    |                     |                    |
| Write-back of goodwill amortisation (see note (b) above)                         | 22                  | –                  | –                   | –                  |
| Share based payment (see note (a) above)   | 87                  | 178                | –                   | –                  |
| <b>Total equity under AIFRS</b>  | <u>53,835</u>       | <u>62,539</u>      | <u>26,981</u>       | <u>34,345</u>      |

\* This column represents the adjustments as at the date of transition to AIFRS

\*\*This column represents the cumulative adjustments as at the date of transition to AIFRS and those for the year ended 30 June 2005

### NOTE 34 TRANSITION TO AIFRS (CONTINUED)

The above changes will result in changes to the deferred income tax balances as follows:

|  | CONSOLIDATED        |                    | PARENT              |                    |
|--|---------------------|--------------------|---------------------|--------------------|
|  | 30 JUN 05<br>\$'000 | 1 JUL 04<br>\$'000 | 30 JUN 05<br>\$'000 | 1 JUL 04<br>\$'000 |

#### DEFERRED TAX LIABILITY

|   |              |            |             |             |
|---|--------------|------------|-------------|-------------|
| Adjustment in respect of capitalised finance leases                       | –            | 225        | –           | –           |
| Fixed asset cost base difference due to revaluations (see note (c) above) | 161          | 212        | 24          | 50          |
| Accumulated depreciation of investment properties (see note (c) above)    | (373)        | (323)      | (118)       | (96)        |
| (Decrease)/Increase in deferred income tax liability                      | <u>(212)</u> | <u>114</u> | <u>(94)</u> | <u>(46)</u> |

#### DEFERRED TAX ASSET

|  |              |              |          |          |
|--|--------------|--------------|----------|----------|
| Adjustment in respect of employee participation units (see note (a) above) | (275)        | (477)        | –        | –        |
| Adjustment in respect of capitalised financed leases                       | –            | 225          | –        | –        |
| Fixed asset cost base difference due to revaluations (see note (c) above)  | 121          | 125          | –        | –        |
| Decrease in deferred income tax asset                                      | <u>(154)</u> | <u>(127)</u> | <u>–</u> | <u>–</u> |

|  | CONSOLIDATED        |                     | PARENT              |                     |
|--|---------------------|---------------------|---------------------|---------------------|
|  | 30 JUN 05<br>\$'000 | 30 JUN 05<br>\$'000 | 30 JUN 05<br>\$'000 | 30 JUN 05<br>\$'000 |

#### (ii) Reconciliation of net profit under AGAAP to that under AIFRS

|  |              |              |
|--|--------------|--------------|
| Net profit after tax and minorities as reported under AGAAP  | 9,891        | 9,802        |
| Recognition of share-based payment expense (see note (a) above)  | (619)        | (81)         |
| Write-back of goodwill amortisation (see note (b) above)   | 132          | –            |
| Depreciation on investment properties (see note (d) above)   | (166)        | (73)         |
| Adjustment to income tax expense (see note (c) above)  | 98           | 48           |
| Adjustment to net profit attributable to outside equity interest relating to recognition of share based payment expense (see note (a) above) | 90           | –            |
| Adjustment to net profit attributable to outside equity interests relating to write-back of goodwill amortisation (see note (b) above)       | (22)         | –            |
| <b>Net profit under AIFRS</b>  | <u>9,404</u> | <u>9,696</u> |

#### (iii) Explanation of material adjustments to the cash flow statements

There are no material differences between the cash flow statements presented under AIFRS and those presented under AGAAP.

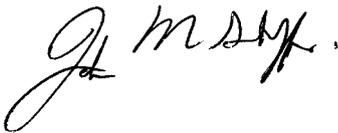
## DIRECTORS' DECLARATION

*year ended 30 June 2006*

In accordance with a resolution of the directors of Schaffer Corporation Limited, we state that:

- (1) In the opinion of the directors:
  - a) the financial statements, notes and additional disclosures included in the directors' report designate as audited, of the company and of the consolidated entity are in accordance with the Corporations Act 2001, including:
    - (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2006 and of their performance for the year ended on that date; and
    - (ii) complying with Accounting Standards and Corporations Regulations 2001; and
  - b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;
- (2) This declaration has been made after receiving the declarations required to be made to the directors in accordance with section 295A of the Corporations Act 2001 for the financial period ended 30 June 2006.
- (3) In the opinion of the directors, as at the date of this declaration, there are reasonable grounds to believe that the members of the Closed Group identified in Note 12 will be able to meet any obligation or liabilities to which they are or may become subject to, by virtue of the Deed of Cross Guarantee.

On behalf of the Board



J M Schaffer  
Chairman and Managing Director  
Perth, 22 September 2006

## INDEPENDENT AUDIT REPORT TO MEMBERS OF SCHAFFER CORPORATION LIMITED

year ended 30 June 2006

### SCOPE

#### *The financial report, remuneration disclosures and directors' responsibility*

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

The company has disclosed information as required by paragraphs Aus 25.4 to Aus 25.7.2 of Accounting Standard 124 Related Party Disclosures ("remuneration disclosures"), under the heading "Remuneration Report" on pages 51 to 57 forming part of the Directors' Report, as permitted by the Corporation Regulations 2M.6.04.

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

#### *Audit approach*

We conducted an independent audit of the financial report in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with Accounting Standard AASB 124 Related Party Disclosures.

The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

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

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

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

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

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

### INDEPENDENCE

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

### AUDIT OPINION

In our opinion:

1. the financial report of Schaffer Corporation Limited is in accordance with:
  - (a) the Corporations Act 2001, including:
    - (i) giving a true and fair view of the financial position of Schaffer Corporation Limited and the consolidated entity at 30 June 2006 and of their performance for the year ended on that date; and
    - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
  - (b) other mandatory financial reporting requirements in Australia.
2. the remuneration disclosures that are contained on pages 51 to 57 forming part of the Directors' Report comply with Accounting Standard AASB 124 Related Party Disclosures.



Ernst & Young



G H Meyerowitz

Partner

Perth

22 September 2006

## DIRECTORS' REPORT

year ended 30 June 2006

Your directors submit their report for the year ended 30 June 2006 made in accordance with a resolution of the directors.

### DIRECTORS

Details of the directors of the company during the financial year and up to the date of this report are:

|  |  |
|--|--|
| J M SCHAFFER<br>B Com (Hons) FCPA<br>Managing Director<br>Executive Director<br>since 6/9/72 | Mr John Schaffer joined the company in 1972. Mr Schaffer has held the position of Managing Director since 1988.  |
| D E BLAIN, BA<br>Non executive Director<br>Appointed 5/6/87                                  | Mrs Danielle Blain joined the company in 1987. Mrs Blain served as Managing Director of Gosh Leather Pty Ltd from 1993 to 2001.  |
| D J SCHWARTZ<br>Non executive Director<br>Appointed 29/6/99                                  | Mr David Schwartz is the chairman of Loftus Capital Partners Limited. He has over 20 years experience in manufacturing and distribution businesses. During the past three years Mr Schwartz has served as a director of the following listed companies:<br><br>Loftus Capital Partners Limited                      1 Oct 99 – current<br>HomeLeisure Limited                      26 Aug 04 – current   |
| A K MAYER<br>Executive Director<br>Appointed 21/11/01  | Mr Anton Mayer is the Managing Director of Australian Leather Holdings Limited. Mr Mayer has over 35 years of international leather experience, broad business skills and a global business perspective.   |
| M D PERROTT<br>Non Executive Director<br>Appointed 23/2/05                                   | Mr Michael Perrott joined the Board as a non-executive director in February 2005. Mr Perrott has over 35 years experience in the construction and contracting industry. During the past three years Mr Perrott has also served as a director of the following other listed companies:<br><br>Port Bouvard Ltd                      12 Mar 98 – current<br>GME Resources Ltd                      21 Nov 96 – current<br>Portman Ltd                      30 Jun 97 – current<br>Bone Medical Ltd                      31 May 01 – 1 Aug 05 |

Directors were in office for the entire period unless otherwise stated.

### COMPANY SECRETARY

|  |  |
|--|--|
| GEOFFREY V<br>DAVIESON<br>BSc(Hons), MA,<br>GDAFI, FCIS, F FIN | Mr Geoff Davieson joined Schaffer Corporation Limited as a Cost Analyst in 1993. He has been Company Secretary of Schaffer Corporation Limited since 1994 and was also appointed Chief Financial Officer in 2005. Prior to joining Schaffer Corporation Limited, Mr Davieson had been engaged in the development capital, importing and mining industries. Mr Davieson holds a Masters degree from Murdoch University majoring in development capital and a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia. Mr Davieson is a Fellow of the Financial Services Institute of Australasia and a Fellow of the Institute of Secretaries and Administrators. |
|--|--|

### ATTENDANCE AT BOARD MEETINGS

During the year ten directors meetings were held. The number of meetings attended by each director is as follows:

|              | MEETINGS ELIGIBLE<br>TO ATTEND | MEETINGS<br>ATTENDED |
|--------------|--------------------------------|----------------------|
| J M Schaffer | 10                             | 10                   |
| D E Blain    | 10                             | 9                    |
| D J Schwartz | 10                             | 10                   |
| A K Mayer    | 10                             | 10                   |
| M D Perrott  | 10                             | 8                    |

In accordance with the Articles of Association:

Mrs. D E Blain retires by rotation and being eligible, offers herself for re-election.

### ATTENDANCE AT AUDIT COMMITTEE MEETINGS

During the year two audit committee meetings were held. Mr D J Schwartz, Mr M D Perrott and Mrs D E Blain attended both meetings. All the above committee members are also directors of the company.

### ATTENDANCE AT NOMINATIONS AND REMUNERATIONS COMMITTEE MEETINGS

The SFC Board established the Nominations and Remuneration Committee on 23 February 2005. The members of this Board sub-committee are Mrs D E Blain, Mr M D Perrott and Mr D J Schwartz. Subsequent to its establishment, the Nominations and Remuneration Committee held one additional meeting prior to year end with all members being in attendance.

### INTERESTS IN THE SHARES OF THE COMPANY AND RELATED BODIES CORPORATE

At the date of this report the economic interest of the Directors in the shares of the Company were:

|              | SCHAFFER CORPORATION LIMITED |                                 |
|--------------|------------------------------|---------------------------------|
|              | ORDINARY<br>SHARES           | OPTIONS OVER<br>ORDINARY SHARES |
| J M Schaffer | 2,619,927                    | –                               |
| D E Blain    | 1,562,360                    | –                               |
| A K Mayer    | 347,185                      | –                               |
| M D Perrott  | 1,000                        | –                               |
| D J Schwartz | 586,210                      | –                               |

### PRINCIPAL ACTIVITIES

The principal activities of the entities within the consolidated entity, in the course of the financial year were automotive leather, paving and concrete product manufacture and property leasing.

### RESULTS

The consolidated entity's operating profit after tax for the financial year and after outside equity interests, was a profit of \$8,144,000 (2005 – \$9,404,000).

### OPERATING AND FINANCIAL REVIEW

Please refer to Managing Director's report for details.

### SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

In the opinion of the directors of the consolidated entity there has not arisen during the financial year or in the interval between the end of the financial year and the date of this report any matter or circumstance that has significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations of the state of affairs of the consolidated entity in subsequent financial years.

## DIRECTORS' REPORT

year ended 30 June 2006

### DIVIDENDS

The following dividends have been paid or declared by the company since the commencement of the financial year.

Out of profits, as recommended in the financial statements, for the year ended 30 June 2006:

|  | \$'000             |
|--|--------------------|
| On ordinary shares   |                    |
| – 60¢ per share final, paid on 19 September 2005                           | 8,455              |
| – 25¢ per share interim, paid on 21 March 2006                             | 3,523              |
|  | <hr/> 11,978 <hr/> |
| Out of profits for the year ended 30 June 2005                             |                    |
| On ordinary shares   |                    |
| – 70¢ per share final, paid on 16 September 2004                           | 9,819              |
| – 60¢ per share interim, paid on 21 March 2005                             | 8,440              |
|  | <hr/> 18,259 <hr/> |
| Proposal for approval at AGM (not recognised as a liability as at 30 June) |                    |
| Final franked dividend for 2006 – 25¢ (2005 – 25¢)                         | <hr/> 3,528 <hr/>  |

### REVIEW OF OPERATIONS

The consolidated entity's revenue increased by 2% from \$142,568,000 to \$145,335,000 this year. This resulted in a pre tax operating profit of \$12,427,000 compared to \$13,796,000 for last year. The net after tax consolidated entity profit, after minority interests decreased by 13% from \$9,404,000 to \$8,144,000. The corresponding decrease excluding investment property disposals was 7% from \$8,716,000 to \$8,144,000.

### LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Other than the discussion of the Company's operations and outlook already set out from pages 1-12 of this Annual Report, the Directors have no comment to make on likely developments in the operations of the consolidated entity and the expected results of those operations in subsequent financial years.

### ENVIRONMENTAL REGULATION AND PERFORMANCE

Schaffer Corporation Limited is subject to a range of environmental regulations. During the financial year Schaffer Corporation Limited met all reporting requirements under any relevant legislation. There were no incidents which required reporting. The Company aims to continually improve its environmental performance.

### SIGNIFICANT EVENTS AFTER BALANCE DATE

Following the end of the reporting period a final fully franked dividend of 25¢ per share has been declared payable on 19 September 2006.

On 31 May 2006 the Company entered into an agreement to acquire 100% of the assets of Limestone Resources Australia Pty. Ltd. for an amount approximating \$7.5 million. The acquisition was completed on 5 July 2006. The Company is in the process of allocating the purchase price over the fair value of assets, liabilities and contingent liabilities acquired.

On 3 July 2006 the Company entered into an agreement to acquire a 4,700 square metre piece of land in Frobisher Street, Osborne Park for a price of \$3.6 million. The purchase was completed on 18 August 2006.

### INDEMNIFICATION AND INSURANCE OF DIRECTORS

During or since the financial year the company has agreed to indemnify directors against a liability for costs and expenses incurred in defending proceedings brought against them for a liability incurred in their role as directors of the company other than in respect of any wilful misconduct. The total amount of insurance contract premiums paid is not disclosed due to a confidentiality clause within the insurance policy.

## REMUNERATION REPORT

### DIRECTORS' AND OTHER OFFICERS COMPENSATION

#### Remuneration of Key Management Personnel

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

#### Details of Key Management Personnel

##### Directors

|              |                          |
|--------------|--------------------------|
| J M Schaffer | Managing Director        |
| D E Blain    | Director (non-executive) |
| A K Mayer    | Director (executive)     |
| D J Schwartz | Director (non-executive) |
| M D Perrot   | Director (non-executive) |

##### Executives

|              |   |
|--------------|---|
| M Falconer   | General Manager, Urbanstone Pty Ltd and Limestone Resources Australia Pty Ltd |
| N Filipovic  | Deputy Managing Director Howe & Co Pty Ltd                                    |
| G V Davieson | Chief Financial Officer and Company Secretary, Schaffer Corporation Limited   |

This report outlines the remuneration arrangements in place for directors and executives of the Schaffer Corporation Limited group of companies ("SFC").

#### Remuneration Philosophy

SFC's remuneration policy is directed at attracting, motivating and retaining quality directors and executives. SFC's key internal performance measures at the business unit and consolidated levels are earnings before interest and tax ("EBIT") and return on capital employed. EBIT and ROCE have been chosen by the Group as measures of executive performance because they align the interests of management with those of all SFC shareholders.

#### Remuneration Committee

The SFC Board operates a Nominations and Remuneration Sub-Committee to support and advise the SFC Board in fulfilling its responsibility to shareholders to ensure that the company has remuneration policies and practices which enable it to attract and retain directors and executives who will best contribute towards achieving positive outcomes for shareholders. The committee determines the remuneration and other conditions of service of the chief executive officer and executive directors, if any. The committee makes recommendations to the board on the remuneration of non-executive directors within the aggregate approved by shareholders in general meeting from time to time. The committee considers individual performance, company performance, internal relativity and fairness in setting levels of remuneration and may seek appropriate independent external advice to assist in its decision making. The structure of non-executive director and executive remuneration are separate and distinct.

## DIRECTORS' REPORT

year ended 30 June 2006

### SENIOR MANAGER AND EXECUTIVE DIRECTOR REMUNERATION

#### Objective

SFC's remuneration policy aims to remunerate executives with a level and mix of remuneration commensurate with their position and responsibilities within the Group.

#### Structure

The remuneration of SFC's senior executive consists of fixed remuneration and variable remuneration (annual and long term incentives). The company aims to reward executives for Company, business unit and individual performance, align executive remuneration with the interests of shareholders, link rewards with the strategic goals of such as profitability or return on capital employed and ensure that total remuneration is effective in retaining and motivating senior executives and executive directors.

#### Fixed Remuneration –

This includes base salary and the statutory Superannuation Guarantee Contribution ("SGC") which comprises the cash component and other non-cash benefits such as a motor vehicle. Where non-cash benefits are elected, it is intended that cost to company is not greater than the cost that would otherwise have been incurred had that portion of the salary been provided as cash. The Schaffer Corporation Limited Superannuation Fund is available to executives for superannuation contributions and life insurance. Premiums for life insurance are deducted from member accounts. Executives can elect to have the company contribute superannuation beyond the statutory SGC level by way of a salary sacrifice in lieu of cash salary. Fixed remuneration is reviewed annually by the Nominations and Remuneration Committee in respect of each executive director. The fixed remuneration of executives is reviewed annually by the SFC Managing Director in case of Building Products and Corporate divisions and by the ALH Managing Director in the case of the Leather division. The review process considers companywide, business unit and individual performance in the context of any annual change during the preceding twelve month to the wages cost index as published by the Australian Bureau of Statistics. For the year beginning 1 July 2006, a review of 4% was applied for Group personnel.

#### Variable Remuneration – Short Term Incentive

The Group has performance-based incentive plans in place at each of its operations in which management and the labour force participate. The level of remuneration payable to participating executives is linked to the financial performance of their business. Executives are provided with cash incentives provided profitability thresholds are met. SFC's Managing Director and Chief Financial Officer/Company Secretary do not currently participate in any annual incentive program. A summary of the annual incentive schemes for the Building Products and Leather divisions is provided below:

##### *Building Products Division – Management Bonus Incentive Scheme*

The Company operates a Management Bonus Incentive Scheme (MBIS) for the management group of the Building Products division. Prior to the commencement of each financial year the Building Products division management submits an annual budget for consideration by SFC's Managing Director and the SFC Board. Upon approval of the budget by the Board, a cash bonus (as a percentage of each participants fixed remuneration) is payable on a tiered basis provided actual EBIT profitability thresholds are met/exceeded as at 31 December and 30 June balance dates. The MBIS payment for EBIT performance is subject to audited financials of each business unit and is payable at the discretion of the Managing Director. Actual EBIT performance versus Budgeted EBIT performance has been chosen as the relevant performance condition as this performance measure is readily monitored and available and EBIT performance aligns the interest of management with those of shareholders. The scheme may be discontinued at any time by the Managing Director without prior notice.

##### *Leather Division – Profit Participation Scheme*

ALH operates a profit participation scheme for the staff and management of the Leather division. Prior to the commencement of each financial year the Leather division management submits an annual budget for consideration and approval by ALH's Managing Director and the SFC Board. A cash bonus of 10% of actual EBIT (adjusted for a notional charge on capital employed within the business) becomes payable provided actual EBIT exceeds budgeted EBIT and a satisfactory return on capital employed ("ROCE") has been achieved as at 31 December and 30 June balance dates. The profit participation bonus is subject to audited financials of each business unit and approval by SFC's Managing Director and CFO. Actual EBIT performance versus Budgeted EBIT performance and a threshold ROCE have been chosen as the relevant performance conditions as these performance measures are readily monitored and available and EBIT and ROCE performance aligns the interest of management with those of shareholders. The scheme has been designed to incentivise a wide range of leather division workforce from top executive management to factory floor personnel.

#### Variable Remuneration – Long Term Incentive

SFC's senior executives (other than Mr Schaffer and Mr Mayer) participate in SFC's Employee Share Option Plan ("ESOP"). ALH operates the Employee Performance Unit ("EPU") Plan for its executives. The SFC ESOP and ALH EPU plans have long-term vesting provisions and are designed to align the interests of the participating executives with those of all SFC shareholders. As such long term incentive grants are typically made to executives who are able to influence the generation of shareholder wealth and thus have a direct impact on the Company's performance. A summary of the long-term incentive schemes for the Corporate, Building Products and Leather divisions is provided below:

##### *SFC Employee Share Option Plan ("ESOP")*

An employee share option plan has been established. The plan was approved by shareholders at the AGM in November 1999. The plan permits the granting of options (at the absolute discretion of the Board) to group employees to acquire ordinary shares in Schaffer Corporation Limited. The options issued for nil consideration, are issued in accordance with performance guidelines established by the Directors of Schaffer Corporation Limited. The options cannot be transferred and will not be quoted on the ASX. The number of options which can be issued is limited to 5% of the number of shares on issue. At the date of this report there were 67,850 ESOP options on issue representing 0.5% of the SFC's issued capital. The options on issue have an average exercise price of \$10.63/option (i.e. 40,350 options exercisable \$9.49/option and 27,500 options exercisable at \$12.31/option).

Options may be exercised as follows:

- (1) during the first 12 months of each option period and including each date of issue, no more than 25% of the options issued to that participant on that date of issue;
- (2) during the period of 24 months from and including each date of issue exercise no more than 50% of the options issued to that participant on that date of issue; and
- (3) during the period of 36 months from and including each date of issue exercise no more than 75% of the options issued to that participant on that date of issue.

After 36 months 100% of the options may be exercised.

While ESOP contains vesting conditions, the exercising of ESOP options is not dependent on a performance condition because: ESOP options have been issued with an exercise price at or above the share price on the issue date; ESOP options do not participate in dividends; and are not transferable or saleable. Accordingly, ESOP options only provide an economic benefit to the recipient in the event the share price (which adjusts for dividends paid) significantly exceeds the exercise price (which is not adjusted for dividends paid) over the option vesting period thereby aligning the interests of management with those of all shareholders.

## DIRECTORS' REPORT

year ended 30 June 2006

### ALH Employee Participation Units Plan

Australian Leather Holdings Limited (ALH) operates an employee incentives plan which permits the granting of employee participation units (EPUs) at the discretion of its shareholders' up to an EPU limit. The EPU limit is 10% of the fully diluted share capital of Australian Leather Holdings Limited, which is calculated as if each EPU already issued was deemed to be one issued Australian Leather Holdings Limited share. ALH dividends are applied on a fully diluted basis to the unpaid portion of each EPU's until the unpaid portion is reduced to nil. Once fully paid up, each EPU participates in ALH dividend payments on a fully diluted basis.

An EPU provides an employee with a right to receive a cash payment from Australian Leather Holdings Limited in the following circumstances:

- If an employee dies or becomes permanently disabled at any time after the grant date.
- If an employee ceases employment after the three year initial vesting period.
- Upon a liquidity event (trade sale or listing on an Australian or overseas stock exchange).
- On issue of a compulsory payment notice by Schaffer Corporation Limited.

The amount of the cash payment is dependant on vesting and the financial performance of Australian Leather Holdings Limited. The vesting requirements are:

- up to 3 years – nil
- 3 years to 4 years – 33.3%
- 4 years to 5 years – 66.7%
- over 5 years – 100%

Note: Employees are ineligible to receive any payment in the following circumstances:

- termination due to misconduct
- failure to provide 90 days written notice of intention to terminate employment
- acting in competition prior to the payment date (payment date is at least 12 months after termination)

The amount of payment is calculated in accordance with an equity valuation formula based on 5.5 times Australian Leather Holdings Limited's earnings before interest and tax minus net debt. The formula uses a three year average including one full year following termination. This formula is designed to incentivise EPU holders in respect of the building the long term value of ALH and provides a fair and readily calculable means for valuing that long term interest. Schaffer Corporation Limited has the option to compel the employee to use the whole or part of that cash payment in subscribing for Schaffer Corporation Limited shares based on the average Schaffer Corporation Limited share price for the same three year period.

The following information is provided in accordance with s300A(1)(e)(i) of the Corporation Act and details proportion of fixed remuneration and variable remuneration paid for the year ended 30 June 2006 as detailed in Note 25 of this report:

|                             | 2005/06 REMUNERATION STRUCTURE |            |
|-----------------------------|--------------------------------|------------|
|                             | % FIXED                        | % VARIABLE |
| <b>Specified Directors</b>  |                                |            |
| JM Schaffer                 | 100%                           | 0%         |
| AK Mayer                    | 82%                            | 18%        |
| DE Blain                    | 100%                           | 0%         |
| DJ Schwartz                 | 100%                           | 0%         |
| MD Perrott                  | 100%                           | 0%         |
| <b>Specified Executives</b> |                                |            |
| M Falconer                  | 75%                            | 25%        |
| N Filipovic                 | 73%                            | 27%        |
| G Davieson                  | 99%                            | 1%         |

### Non-Executive Director Remuneration

SFC's non-executive directors receive fees for their services (including statutory superannuation) and the reimbursement of reasonable expenses. The Constitution and the ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. An amount not exceeding that amount is then divided between the non-executive directors as agreed. The latest determination was at the Annual General Meeting held 19 November 2003 when shareholders approved an aggregate remuneration limit of \$250,000 per annum. The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is to be apportioned amongst the non-executive directors is reviewed annually. This limit is not currently fully utilised. The fee pool is payable only to non-executive directors. The amount payable to non-executive directors is set by the Board after having taken regard to the size of the Company and Board, the responsibilities, demands and accountabilities faced by those directors in discharging their duties and after seeking external advice to ensure the fees are in line with market standards. All three non-executive directors are members of the Audit Committee and the Nominations and Remuneration Committee and the fixed annual fee received by non-executive directors is inclusive of these sub-committee commitments. It is current SFC policy that non-executive directors do not receive shares, options or other securities and are not eligible to participate in SFC's Employee Share Option Plan. The only exception to this policy is that Mrs Blain receives remuneration from the ALH EPU Plan, an entitlement dating back to Mrs Blain's time as an executive of the ALH business. Payment of fees (including statutory superannuation) and the reimbursement of reasonable expenses are the only remuneration payable to Mr Schwartz and Mr Perrott.

It is not a requirement of the Constitution of the Company that directors hold shares in the Company. Non-executive directors appointed prior to July 2003 are entitled to a retirement benefit equivalent to one year's annual director's fees. The retirement benefit was reduced from three year's to one year's annual director's fees in July 2003 (a three year retirement benefit was in place at the time each director accepted their appointment to the Board). SFC considers the reduced benefit modest and appropriate given the benefit which historically existed. It is SFC's policy that no retirement benefit apply to new directors appointed after July 2003.

### RELATIONSHIP OF COMPANY PERFORMANCE ON SHAREHOLDER WEALTH

#### 5-Year Total Shareholder Return

Total shareholder return ("TSR") is a well accepted and understood measure of performance. SFC calculates TSR as follows:

- Movement in Share Price (including bonus issues)
- plus Dividends Paid
- plus Dividend Imputation Credits

In accordance with s300A(1AA) and (1AB) of the Companies Act, the chart below itemises the constituents to SFC's TSR by year for each of the past five years. SFC total TSR averages 19% per annum compounded over the past five years.

#### Dividends paid by SFC over the past 5 years

On an aggregate dollars paid basis, SFC has paid to shareholders a total of \$68.6 million in fully franked ordinary and special dividends over the past 5 years.

|                                | SEP-01 | SEP-02 | SEP-03 | SEP-04 | SEP-05 | SEP-06 | 5 YEAR TOTAL |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------------|
| Share Price (\$)               | 4.00   | 10.10  | 14.25  | 14.00  | 5.25   | 6.50   | *2.50        |
| Bonus Issue (\$)               |        | -      | -      | -      | -      | -      | -            |
| Ord Divs (\$)                  |        | 0.60   | 1.00   | 1.00   | 0.75   | 0.50   | 3.85         |
| Special Divs (\$)              |        | 0.10   | 0.20   | 0.40   | 0.45   | -      | 1.15         |
| Imputation Credit (\$)         |        | 0.30   | 0.51   | 0.60   | 0.51   | 0.21   | 2.13         |
| TSR                            |        | 7.10   | 5.86   | 1.75   | (7.04) | 1.96   | 9.63         |
| TSR%                           |        | 178%   | 58%    | 12%    | -50%   | 37%    | 235%         |
| <b>Annualised (Compounded)</b> |        |        |        |        |        |        | <b>19%</b>   |

\* Increase in share price over the last 5 years.

## DIRECTORS' REPORT

year ended 30 June 2006

### Remuneration of Key Management Personnel for the year ended 30 June 2006

| 30 JUNE 2006      | SHORT TERM                |                     |                                   | POST EMPLOYMENT           |                                   | OTHER | EQUITY                             | OTHER                                 | TOTAL     | PERFORM-<br>ANCE<br>RELATED |
|-------------------|---------------------------|---------------------|-----------------------------------|---------------------------|-----------------------------------|-------|------------------------------------|---------------------------------------|-----------|-----------------------------|
|                   | SALARY<br>&<br>FEES<br>\$ | CASH<br>BONUS<br>\$ | NON<br>MONETARY<br>BENEFITS<br>\$ | SUPER-<br>ANNUATION<br>\$ | RETIRE-<br>MENT<br>BENEFITS<br>\$ | \$    | TERMIN-<br>ATION<br>BENEFITS<br>\$ | SHARE<br>OPTIONS<br>AND EPU'S #<br>\$ | \$        |                             |
| <b>Directors</b>  |                           |                     |                                   |                           |                                   |       |                                    |                                       |           |                             |
| J M Schaffer      | *387,944                  | –                   | 54,907                            | 100,587                   | 5,968                             | –     | –                                  | –                                     | 549,406   | –                           |
| D E Blain         | 55,046                    | –                   | –                                 | 4,954                     | 5,957                             | –     | –                                  | –                                     | 65,957    | –                           |
| A K Mayer         | 356,725                   | **78,505            | –                                 | –                         | –                                 | –     | –                                  | –                                     | 435,230   | 18.04%                      |
| D J Schwartz      | 55,046                    | –                   | –                                 | 4,954                     | 3,273                             | –     | –                                  | –                                     | 63,273    | –                           |
| M D Perrott       | 60,000                    | –                   | –                                 | –                         | –                                 | –     | –                                  | –                                     | 60,000    | –                           |
| <b>Executives</b> |                           |                     |                                   |                           |                                   |       |                                    |                                       |           |                             |
| M Falconer        | 166,543                   | **87,309            | 48,534                            | 59,372                    | 3,401                             | –     | –                                  | 3,217                                 | 368,376   | 31.35%                      |
| N Filipovic       | 216,300                   | **72,107            | –                                 | 25,957                    | –                                 | –     | –                                  | 16,916                                | 331,280   | 23.73%                      |
| G V Davieson      | 151,231                   | –                   | 25,215                            | 24,511                    | 3,386                             | –     | –                                  | 2,413                                 | 206,756   | –                           |
|                   | 1,448,835                 | 237,921             | 128,656                           | 220,335                   | 21,985                            | –     | –                                  | 22,546                                | 2,080,278 |                             |

# Includes the value of share options and employee participation units ("EPUs") using the Black-Scholes model.

\* Includes a reduction of long service leave entitlement of \$128,585.

\*\* Cash bonus: Percentage paid during the year Percentage paid subsequent to year end

|                |        |        |
|----------------|--------|--------|
| Mr A K Mayer   | 0%     | 100%   |
| Mr M Falconer  | 28.63% | 71.37% |
| Mr N Filipovic | 46.50% | 53.50% |

No bonus was forfeited during the year.

### Remuneration of Key Management Personnel for the year ended 30 June 2005

| 30 JUNE 2005      | SHORT TERM                |                     |                                   | POST EMPLOYMENT           |                                   | OTHER                              | EQUITY | OTHER                                 | TOTAL     | PERFORM-<br>ANCE<br>RELATED |
|-------------------|---------------------------|---------------------|-----------------------------------|---------------------------|-----------------------------------|------------------------------------|--------|---------------------------------------|-----------|-----------------------------|
|                   | SALARY<br>&<br>FEES<br>\$ | CASH<br>BONUS<br>\$ | NON<br>MONETARY<br>BENEFITS<br>\$ | SUPER-<br>ANNUATION<br>\$ | RETIRE-<br>MENT<br>BENEFITS<br>\$ | TERMIN-<br>ATION<br>BENEFITS<br>\$ | \$     | SHARE<br>OPTIONS<br>AND EPU'S #<br>\$ | \$        |                             |
| <b>Directors</b>  |                           |                     |                                   |                           |                                   |                                    |        |                                       |           |                             |
| J M Schaffer      | 610,344                   | –                   | 20,919                            | 15,410                    | 10,872                            | –                                  | –      | –                                     | 657,545   | –                           |
| D E Blain         | 57,500                    | –                   | –                                 | 5,175                     | 956                               | –                                  | –      | –                                     | 63,631    | –                           |
| A K Mayer         | 347,433                   | –                   | –                                 | –                         | –                                 | –                                  | –      | –                                     | 347,433   | –                           |
| D J Schwartz      | 45,000                    | –                   | –                                 | 4,050                     | 2,024                             | –                                  | –      | –                                     | 51,074    | –                           |
| M D Perrott       | 17,067                    | –                   | –                                 | –                         | –                                 | –                                  | –      | –                                     | 17,067    | –                           |
| <b>Executives</b> |                           |                     |                                   |                           |                                   |                                    |        |                                       |           |                             |
| M Falconer        | 166,110                   | **49,640            | 36,790                            | 39,328                    | –                                 | –                                  | –      | * 44,110                              | 335,978   | 16.10%                      |
| N Filipovic       | 210,000                   | **43,561            | –                                 | 22,820                    | –                                 | –                                  | –      | 16,916                                | 293,297   | 16.19%                      |
| C Nunis           | 59,317                    | –                   | –                                 | 5,339                     | –                                 | 224,207                            | –      | –                                     | 288,863   | –                           |
| G Monkhouse       | 164,494                   | –                   | 6,815                             | 24,695                    | –                                 | –                                  | –      | 46,247                                | 242,251   | –                           |
| G V Davieson      | 147,082                   | –                   | 20,150                            | 18,687                    | 1,818                             | –                                  | –      | * 33,492                              | 221,229   | –                           |
|                   | 1,824,347                 | 93,201              | 84,674                            | 135,504                   | 15,670                            | 224,207                            | –      | 140,765                               | 2,518,368 |                             |

# Includes the value of share options and employee participation units ("EPUs") using the Black-Scholes model.

\* The following amounts appearing in the Share Options total in the table above relates entirely to options granted in July 2004 which were subsequently cancelled in full prior to the 2005 year end. Those options no longer exist and no economic benefit has been received by the grantee. However, AASB 2 Share Based Payments requires that in the event of a cancellation of options, the entity shall treat that cancellation as an acceleration of the vesting and shall disclose immediately as remuneration the amount that would have otherwise been disclosed over the remainder of the vesting period.

Mr. M Falconer \$33,000

Mr G V Davieson \$24,750

\*\* Cash bonus – percentage paid during the year

Mr M Falconer 100%

Mr N Filipovic 100%

No bonus was forfeited during the year.

The terms 'director' and 'officer' have been treated as mutually exclusive for the purposes of this disclosure. The elements of emoluments have been determined on the basis of the cost to the company and the consolidated entity.

Executives are those directly accountable and responsible for the operational management and strategic direction of the company and the consolidated entity.

## DIRECTORS' REPORT

year ended 30 June 2006

The following information is provided in relation to s300A(1)(e)(ii) – (vi) of the Corporations Act:

No options were issued, exercised or lapsed during the course of the financial year under review. For details of options currently issued refer notes 24 and 26.

### Compensation options: Granted and vested during the year.

30 JUNE 2006

| EXECUTIVES   | TERMS AND CONDITIONS FOR EACH GRANT |             |            |  |                                |             |                     |                   |
|--------------|-------------------------------------|-------------|------------|--|--------------------------------|-------------|---------------------|-------------------|
|              | VESTED NO.                          | GRANTED NO. | GRANT DATE | FAIR VALUE PER OPTION AT GRANT DATE (\$) | EXERCISE PRICE PER OPTION (\$) | EXPIRY DATE | FIRST EXERCISE DATE | LAST VESTING DATE |
| G V Davieson | 11,250                              | 15,000      | 15 Jul 03  | \$1.82                                   | \$12.31                        | 15 Jul 08   | 15 Jul 03           | 15 Jul 06         |
| M Falconer   | 15,000                              | 20,000      | 15 Jul 03  | \$1.82                                   | \$12.31                        | 15 Jul 08   | 15 Jul 03           | 15 Jul 06         |
| Total        | 26,250                              | 35,000      |            |  |                                |             |                     |                   |

30 JUNE 2005

| EXECUTIVES    | TERMS AND CONDITIONS FOR EACH GRANT |             |            |  |                                |             |                     |                   |
|---------------|-------------------------------------|-------------|------------|--|--------------------------------|-------------|---------------------|-------------------|
|               | VESTED NO.                          | GRANTED NO. | GRANT DATE | FAIR VALUE PER OPTION AT GRANT DATE (\$) | EXERCISE PRICE PER OPTION (\$) | EXPIRY DATE | FIRST EXERCISE DATE | LAST VESTING DATE |
| G V Davieson  | 10,000                              | 10,000      | 20 Jun 02  | \$1.89                                   | \$ 9.49                        | 20 Jun 07   | 20 Jun 02           | 20 Jun 05         |
| G V Davieson  | 7,500                               | 15,000      | 15 Jul 03  | \$1.82                                   | \$12.31                        | 15 Jul 08   | 15 Jul 03           | 15 Jul 06         |
| M Falconer    | 10,000                              | 10,000      | 20 Jun 02  | \$1.89                                   | \$ 9.49                        | 20 Jun 07   | 20 Jun 02           | 20 Jun 05         |
| M Falconer    | 10,000                              | 20,000      | 15 Jul 03  | \$1.82                                   | \$12.31                        | 15 Jul 08   | 15 Jul 03           | 15 Jul 06         |
| *G V Davieson | 3,750                               | 15,000      | 19 Jul 04  | \$1.65                                   | \$14.32                        | 19 Jul 09   | 19 Jul 04           | 19 Jul 07         |
| *M Falconer   | 5,000                               | 20,000      | 19 Jul 04  | \$1.65                                   | \$14.32                        | 19 Jul 09   | 19 Jul 04           | 19 Jul 07         |
| Total         | 46,250                              | 90,000      |            |  |                                |             |                     |                   |

\*These options were cancelled during the year.

### Shares issued on exercise of compensation options.

| DIRECTORS/ EXECUTIVES | SHARES ISSUED NO. | PRICE PER SHARE \$ | UNPAID PER SHARE \$ |
|-----------------------|-------------------|--------------------|---------------------|
| 30 June 2006          |                   |                    |                     |
| No shares issued      |                   |                    |                     |
| 30 June 2005          |                   |                    |                     |
| G Davieson            | 12,500            | 7.97               | –                   |
| M Falconer            | 15,000            | 8.12               | –                   |
| Total                 | 27,500            |                    |                     |

### Employment Contracts

Mr Schaffer, SFC's Managing Director is employed under a Service Agreement. The service agreement was entered into on 18 July 1984. Mr Schaffer's employment continues until terminated by Mr Schaffer or the Company.

Under the terms of the service agreement, the agreement may be terminated by the Company or Mr Schaffer after the expiration of one month's notice in writing given to one of them by the other. Upon termination of this agreement Mr Schaffer is entitled to receive from the Company a lump sum equal to the annual remuneration paid immediately preceding that termination except if the termination is for reasons of gross misconduct, fraud or dishonesty resulting in a material loss or injury to the Company or if Mr Schaffer is found guilty of wilful disobedience or any other conduct resulting in a material prejudice to the Company or such as to bring the Company into disrepute.

Mr Mayer, provides management services to the leather division pursuant to a Consultancy Agreement renewed for the period 1 July 2006 which terminates on 30 June 2009. The Consultancy Agreement may be terminated sooner:

- by the consultee without prior notice for Cause (i.e. wilful misconduct, wilfully wrongful act, gross negligence, criminal act or a prohibition by law in company management);
- by either party for any reason upon 90 days prior written notice to the other party;
- by the consultee 30 days after giving notice of termination to Mr Mayer for reason of his physical or mental incapacity on a permanent basis
- on the death of Mr Mayer.

The Consultancy agreement with Mr Mayer does not provide for a termination payment upon termination of the agreement.

## SHARE OPTIONS

### Unissued shares

As at the date of this report, there were 67,850 unissued ordinary shares under options (67,850 at reporting date). Refer to note 24(c) of the financial statements for further details of the options outstanding.

### Shares issued as a result of the exercise of options

No options have been exercised during the year.

## TAX CONSOLIDATION

Effective 1 July 2003, for purposes of income tax, Schaffer Corporation Limited and its 100% subsidiaries have formed a tax consolidated Group.

## ROUNDING

The amount contained in this report and in the financial statements has been rounded under the option available to the company under ASIC class order 98/0100.

## CORPORATE GOVERNANCE

In recognising the need for the highest standards of corporate behaviour and accountability, the directors of Schaffer Corporation Limited support the principles contained in the company's corporate governance statement in the corporate governance section of this annual report.

## AUDITOR'S INDEPENDENCE AND NON-AUDIT SERVICES

The directors received the following declaration from the auditor of Schaffer Corporation Limited.

## DIRECTORS' REPORT

*year ended 30 June 2006*

### AUDITOR'S INDEPENDENCE DECLARATION TO THE DIRECTORS OF SCHAFFER CORPORATION LIMITED

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



Ernst & Young



G H Meyerowitz  
Partner  
Perth  
22 September 2006

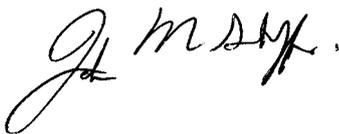
### NON-AUDIT SERVICES

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

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

Tax compliance services \$26,204

Signed in accordance with a resolution of the directors.



J M Schaffer  
Chairman and Managing Director  
Perth, 22 September 2006

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

year ended 30 June 2006

ASX Corporate Governance Council issued its Principles of Good Corporate Governance and Best Practice Recommendations in 2003.

*Corporate Governance is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed and how performance is optimised... What constitutes good corporate governance will evolve with the changing circumstances of a company and must be tailored to meet those circumstances... If a company considers that a recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it (ASX Corporate Governance Council, Principles of Good Corporate Governance and Best Practice Recommendations, March 2003).*

The Board of SFC is committed to best practice in corporate governance where the Board considers these practices are appropriate and add shareholder value to a company and board of SFC's size and structure.

This Corporate Governance Statement outlines the main corporate governance practices of Schaffer in the context of the Principles adopted by the ASX Corporate Governance Council ("Council"). Unless otherwise stated below, the Company has complied with the Council's Recommendations.

### COUNCIL PRINCIPLE 1:

#### Lay Solid Foundations for Management and Oversight

The strategic control of the business of the Group is vested with the Board. The Board's objective to create, build and sustain shareholder value is carried out in accordance with their duties and obligations to act honestly, fairly, diligently as are imposed upon them by the Constitution, regulatory authorities and ethical standards. Key matters reserved for the Board include the following:

- Approval of the Strategic Business Plan
- Approval of the Annual Budgets
- Review of the operating results and approval of the financial accounts
- Setting the Corporate Governance practices within the Group
- Determining SFC's dividend policies
- Approval of the Group financial policies
- Approval of the Group risk management strategies
- Review of Board nominations and composition
- Determining the terms and conditions for and evaluate the performance of the Managing Director
- Delegation of authority to the Managing Director and senior management on operational matters, or approval of matters in excess of any discretion which may have been delegated from time to time;
- Acquisition, establishment, disposal or cessation of any significant business of SFC
- Approving the issue of any securities in SFC;
- Approving the capital management strategy of SFC;
- Approving the appointment of SFC's External Auditor

The Board has delegated authority for the management of the Group through the Managing Director to executive management. Accordingly the Group's executive management team are charged with implementing Board directives and the day-to-day management and reporting of the Group's activities. The Board has a formal Charter setting out the roles of Board and Management. Consistent with Council Principle 1, the Board Charter has been posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

The Schaffer Board currently consists of five directors: two independent; one non-executive; and two executive directors namely the Managing Director of the Leather division and the Group Managing Director & Chairman. The Board considers that between them, the directors bring the range of skills, knowledge and experience (both local and international) necessary to successfully direct the Group's operations.

The Board of Directors consists of:

**John Schaffer** *Chairman and Managing Director*  
(Age 56)

John joined the Company in 1972 and has held the position of Chairman and Managing Director since 1988. John is also Chairman of Australian Leather Holdings Limited, UrbanStone Pty Ltd and Delta Corporation Limited. John holds a Bachelor of Commerce degree with honours from the University of Western Australia and is an FCPA.

**Anton Mayer** *Executive Director*  
(Age 64)

Anton joined the Board in 2001. Anton is the Managing Director of Australian Leather Holdings Limited, a position he has held since 1998. Anton is also a director of a number of the ALH group subsidiaries. Anton has over 35 years of international leather experience, broad business skills and a global business perspective.

**Danielle Blain** *Non-Executive Director*  
(Age 62)

Danielle joined the Board in 1987. Mrs Blain served as a director of Australian Leather Holdings Limited from 1993 to 2005 and as Managing Director of Gosh Leather Pty Ltd (the furniture division) from 1993 to 2001. Mrs Blain holds a Bachelor of Arts degree from the University of Western Australia. Mrs Blain is a member of the Board's Audit Committee and the Nominations & Remuneration Committee.

**Michael Perrott** *Independent Director*  
(Age 60)

Michael joined the Board as an independent director in Feb-05 and is a member of the Board's Audit Committee and the Nominations and Remuneration Committee. Michael has over 35 years experience in the construction and contracting industry. He was previously Managing Director of the Gardner Perrott Group Limited until that business was sold to Brambles in 1989. He is currently Chairman of Port Bouvard Limited, GME Resources Limited and Canning Vale Weaving Mills Limited and a director of Portman Limited. Mr Perrott holds a Bachelor of Commerce degree from the University of Western Australia and is a Fellow of the Australian Institute of Management.

**David Schwartz** *Independent Director*  
(Age 52)

David joined the Board in 1999 and is independent Chairman of the Board's Audit Committee and the Nominations & Remuneration Committee. David is Chairman of Loftus Capital Limited and Homeleisure Limited. David has many years experience in successfully managing manufacturing and distribution businesses in Australia and South Africa. He is Chairman of Pascoes Pty Limited, ToLife Technologies Pty Limited and Stefani Pure Water Australasia Pty Limited and a director of Betts Group Pty Ltd.

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

year ended 30 June 2006

The names of Schaffer's current directors, their year of appointment, status as non-executive, executive or independent directors, their economic interest in SFC and whether they retire at the next Annual General Meeting is summarised in the table below.

| DIRECTOR        | YEAR APPOINTED | CLASSIFICATION     | AUDIT COMMITTEE | NOMIN. & REMUN. COMMITTEE | ECONOMIC INTEREST IN SFC | RETIRING AT NEXT AGM | SEEKING RE-ELECTION |
|-----------------|----------------|--------------------|-----------------|---------------------------|--------------------------|----------------------|---------------------|
| John Schaffer   | 1972           | Chairman/Executive | –               | –                         | 18.3%                    | No                   | N/A                 |
| Danielle Blain  | 1987           | Non-executive      | Member          | Member                    | 11.1%                    | Yes                  | Yes                 |
| Anton Mayer     | 2001           | Executive          | –               | –                         | 2.5%                     | No                   | N/A                 |
| Michael Perrott | 2005           | Independent        | Member          | Member                    | 0.0%                     | No                   | N/A                 |
| David Schwartz  | 1999           | Independent        | Chairman        | Chairman                  | 4.2%                     | No                   | N/A                 |

### BOARD COMMITTEES

The Board may from time to time establish committees where the Board is of the belief that the establishment of such a committee will improve the performance of the Board in accomplishing its duties.

The Board operates an Audit Committee and a Nomination and Remuneration Committee. Both committees comply with Council guidelines. The Charter of each committee is summarised in the text relating to Principle's 4 and 9 which appear later in this section. Full details of SFC Audit Committee and Nominations and Remuneration Committee can be found on the Company's website. The Board does not believe the Board it is of sufficient size to warrant the establishment of additional dedicated Board Committees.

### BOARD MEETINGS

Management provides the Board with information in a form, timeframe and quality that facilitates the Board in effectively discharging its duties. The Board meets at least 8 times per year. Board papers are where possible provided to directors at least four days prior to the relevant meeting. The non-executive Board members are joined at Board meetings by the group's Managing Director, the Managing Director of Australian Leather Holdings Limited and the Company's Chief Financial Officer/Company Secretary.

### DIRECTOR INDEPENDENCE

The Board applies the Council's independence criteria in assessing director independence. Mr Schwartz and Mr Perrott are considered by the Board to be independent directors. In analysing Mr Schwartz's independence, the Board considered the materiality of Mr Schwartz's minority interests in the relevant joint venture property interests of the Company. Accordingly the Board confirms Mr Schwartz's independence on the basis that (i) operating revenue from SFC's property interests represent less than 10% of group revenue; (ii) SFC's core operations and principal earnings drivers have historically been the automotive leather and building products divisions; and (iii) no interest held by Mr Schwartz represents a controlling interest in any single property. While the Board considers Mr Schwartz independent for the above reasons, standard Board meeting procedures and governance principles apply whereby in respect of any property business where Mr Schwartz has an interest, Mr Schwartz does not receive the relevant Board papers and does not attend that part of the Board meeting where the matter is being discussed or considered.

Directors classified as not being independent directors are Mrs Blain, Mr Schaffer and Mr Mayer on the basis that:

- Mr Schaffer is an executive director, a substantial shareholder of SFC (with an economic interest of 18.6%) and has served on the Board in since 1972;
- Mrs Blain is a substantial shareholder of SFC (with an economic interest of 11.1%), served as an executive director of ALH from 1993 to 2001 and has served on the SFC Board since 1987; and
- Mr Mayer is an executive director of SFC by virtue of his role as Managing Director of ALH and is a substantial ALH shareholder with a 16.8% economic interest in the SFC subsidiary.

The Board does not currently comply with Council guidelines in respect of majority independence, Chairman independence and separation of the Chairman and Managing Director roles. However, the Board is currently of the view that having a competent, cohesive and functioning Board whose members have a balance of practical experience and skills relevant to SFC's business is more beneficial to maximising returns to shareholders than it would be to expand the Board by an two additional members simply for the purpose of achieving majority independence pursuant to the Council's definition. Further, the Board is not in entire agreement with the definition of independence as defined by the Council's guidelines. In the Board's view, independence is about having individuals on the Board whose interests are directly aligned with shareholders (i.e. they have a significant stake in the company) and have the capability to question and challenge management's decision making process. On this basis your Board is independent. Collectively the Board has a direct financial interest in approximately 37% of SFC's issued capital representing a large proportion of each directors personal asset base. When the shareholders gain, so does the Board; when shareholders lose, the Board loses significantly.

Similarly, based on the strong alignment of shareholders with the Chairman, it is not considered that having an Independent Chairman and separating the roles of Chairman and MD and would add shareholder value at this stage.

As a result of the Company's departure from the Council Recommendations contained in Principle 2, governance practices employed by the Board to support its objective and competent operation are:

### DISCLOSURE OF INTERESTS AND CONFLICTS

A director is required to disclose to all directors any material personal interest they may have, or may reasonably be perceived to have, in a matter which relates to the affairs of the Company. A director is expected to disclose their interest as soon as practicable after the director becomes aware of that interest.

In the event a potential material conflict of interest arises, the director concerned does not receive the relevant Board papers and leaves the Board meeting while the matter is discussed and considered. Directors must keep the Board advised on an ongoing basis of any interests which could cause, or may reasonably be perceived to cause, a conflict with the interests of the Company.

The minutes of the meeting should record the decision taken by those directors who do not have an interest in the matter.

### INDEPENDENT LEGAL ADVICE

With the consent of the Chairman, individual directors may seek independent professional advice at the Company's expense on any matter connected with the discharge of their responsibilities. The Chairman requires the submission of a cost estimate by a director in order to establish the reasonableness of the projected fee. The Chairman's consent will not be unreasonably withheld.

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

year ended 30 June 2006

### PERIOD OF OFFICE

Shareholders are given the opportunity to vote on the composition of the Board such that at each Annual General meeting, one third of the Directors (excluding the Managing Director) must retire but may stand for re-election. Each director who is required by the Constitution to retire can not hold office for more than three years without retiring within that time frame and standing for re-election. Any director who is appointed to the Board to fill a casual vacancy during a year may only hold office until the next Annual General meeting but may stand for re-election at that meeting.

Consistent with Council Principle 2, the Company's information relevant to Principle 2 is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

### COUNCIL PRINCIPLE 2: PROMOTE RESPONSIBLE AND ETHICAL DECISION MAKING

#### Conduct and Ethics

The Company operates under a Code of Conduct a copy of which is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

The Company's Code of Conduct describes how SFC relates to its employees, customers, suppliers, shareholders and the community. SFC is committed to promoting integrity and maintaining the highest standard of ethical conduct in all of its activities.

Our business success is dependent on the development and maintenance of trusting relationships, underpinned by the continuous demonstration of corporate integrity.

The purpose of this Code of Conduct is to provide a common behavioural framework for all SFC personnel which recognises social responsibility, complies with applicable laws and standards, and is in keeping with the spirit and rules of the Australian and international markets in which SFC operates. This Code of Conduct applies to SFC and its controlled affiliates.

SFC's directors and management team lead by example, demonstrating their commitment to this Code of Conduct at all times through their personal behaviour and through guidance provided to our personnel.

#### Securities Trading Policy

SFC's Securities Trading Policy regulates dealing by SFC Directors and senior executives in SFC securities. Restrictions imposed by law on prohibiting anyone dealing in SFC's securities if in possession of unpublished SFC price-sensitive information have been supplemented by Board imposed restrictions specific to SFC Directors and senior executives. Price sensitive information is information a reasonable person would expect to have a material effect on the price or value of SFC securities.

This policy provides that in addition to Directors and senior executives being prohibited from trading in the Company's securities at any time if they possess any unpublished price sensitive information, Directors and senior executives may buy or sell the Company's securities only within limited trading windows.

The periods within which a Director or senior executive may buy or sell SFC securities is:

- From 24 hours to 4 weeks after the Company has made any Scheduled Announcement. A scheduled announcement refers to the announcement by SFC of its (i) results for the half year, (ii) preliminary final year result, (iii) Chairman's Address to the AGM;
- From 24 hours to 4 weeks after the Company has made any Unscheduled Announcement. An unscheduled announcement refers to any other announcement of new information made by SFC pursuant to ASX Listing Rule 3.1.; and
- During the period when a prospectus for securities is released by SFC until the last day for acceptance of securities issued pursuant to that prospectus.

SFC Directors and senior executives are prohibited from trading at all other times. For the purposes of clarity, any Unscheduled ASX LR 3.1 announcement made within 4 weeks prior to a Scheduled Announcement does not enable SFC Directors and senior executives to trade SFC securities. The senior executives group to which these restrictive trading periods apply includes all General Manager personnel at Howe & Company Pty Ltd, Gosh Leather Pty Ltd, UrbanStone Pty Ltd, Limestone Resources Australia Pty Ltd, Delta Corporation Limited and SFC's Chief Financial Officer/Company Secretary and Group Chief Accountant.

The policy also requires that Directors and senior executives do not buy or sell the Company's securities on a short-term basis.

These rules also apply to trading by a related party of any SFC Director or senior executive. This Policy does not restrict participation by SFC senior executives in SFC's Employee Share Options Plan (ESOP), but applies in respect of the trading of SFC's securities to which plan participants become entitled under the ESOP.

A copy of the Company's Securities Trading Policy can be accessed from the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

### COUNCIL PRINCIPLE 3: SAFEGUARD INTEGRITY IN FINANCIAL REPORTING

#### Written Declaration by Management

SFC's Managing Director and CFO report in writing to the Audit Committee that the consolidated financial statements of SFC and its controlled entities for each half and full financial year present a true and fair view in all material respects, of the Group's financial condition and operational results are in accordance with accounting standards. This statement is in turn supported by written statements provided by the senior management of Australian Leather Holdings Limited, UrbanStone Pty Ltd and Delta Corporation Limited.

#### Audit Committee

The SFC Audit Committee was established by the Board in 1996. The Audit Committee has adopted a formal Charter, a copy of which can be accessed from the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

The Audit Committee's purpose is to provide assistance to the Board in fulfilling its corporate governance and oversight responsibilities in relation to the company's financial reporting, risk management systems and the external audit functions. In doing so, it is the responsibility of the Audit Committee to maintain free and open communication between the Committee, external auditors and management of the Company.

In discharging its oversight role, the Audit Committee is empowered to investigate any matter brought to its attention with full access to all books, records, facilities, and personnel of the Company and the authority to engage independent counsel and other advisers as it determines necessary to carry out its duties.

Council guidelines require the Audit Committee to consist of at least three directors and have an independent Chairperson who is not Chairperson of the Board.

The members of the SFC's Audit Committee are Mr Schwartz (Independent Chairman), Mrs Blain (Non-executive Director) and Mr Perrott (Independent Director). Accordingly SFC's Audit Committee complies with the Council's Audit Committee structure guidelines.

Consistent with Council Principle 4, the Company's information relevant to Principle 4 is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

year ended 30 June 2006

### COUNCIL PRINCIPLE 4: MAKE TIMELY AND BALANCED DISCLOSURE

#### Continuous Disclosure Policy

The Board is committed to ensuring that information that is expected to have a material effect on the price or value of SFC's shares is immediately notified to the ASX for dissemination to the market in accordance with the ASX Listing Rules. The Company's Continuous Disclosure Policy sets out the key obligations of the Board and senior management to ensure that SFC complies with its disclosure obligations pursuant to the ASX Listing Rules and the Corporations Act. In fulfilling its obligations of continuous disclosure SFC has adopted and adheres to the following practices.

- SFC's Managing Director and Chief Financial Officer/Company Secretary constitute the executive team charged with management of all elements of the Company's activities. This team is responsible for assessing the materiality of information and drafting all disclosures. For administrative convenience, SFC's Company Secretary is the nominated officer of the Company responsible for communications with the ASX;
- Information is released firstly via electronic means via the ASX. Further dissemination to analysts and investors does not occur until after ASX confirms the information has been released to the market;
- The information is posted to SFC's website at [www.schaffer.com.au](http://www.schaffer.com.au) in order to make the information accessible to the widest audience. Investor information is posted to an area on SFC's website separate from any promotional material about the Company or its products;
- SFC's Managing Director and Chief Financial Officer, and ALH's Managing Director are the officers authorised to speak on SFC's behalf at investor briefings and to the media. These officers understand that when speaking on behalf of the Company it is in respect of explanation and clarification of information previously released via the ASX. As these officers have knowledge of all information previously released to the ASX (they form part of the executive team responsible for the information disclosures), the risk of inadvertent disclosure of price sensitive information when speaking to investor briefings and the media is minimised. Presentations used in briefings which may have content which would trigger a continuous disclosure obligation are lodged with ASX prior to the briefing. All presentations are posted to SFC's website;
- Comments on analysts financial projections are confined to errors in factual information and underlying assumptions. The Company will not provide price sensitive information or earnings forecast guidelines to analysts unless it has already done so to the market via the ASX;
- Unless the executive team responsible for information disclosures believes it has an obligation to make a statement on a particular matter, SFC's policy is not to respond to market rumours or speculation.

Consistent with Council Principle 5, the Company's Continuous Disclosure Policy is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

### COUNCIL PRINCIPLE 5: RESPECT THE RIGHTS OF SHAREHOLDERS

#### Shareholder Communications Strategy

SFC aims to ensure that investors and the market are kept informed of all major developments affecting the Company.

Information is communicated to investors and the market in accordance with SFC's periodic and continuous disclosure obligations pursuant to the ASX Listing Rules and the Corporations Act. SFC's disclosure practices are aimed at ensuring timely access for all investors to Company information.

To achieve these objectives and to satisfy regulatory requirements, SFC provides information to investors and the market in a number of ways:

- SFC's principal communication with investors is by provision of the Annual Report and financial statements, the Interim Report and the Annual General Meeting
- Periodic and continuous disclosure announcements are released directly to the market via the ASX using ASX's electronic lodgement service. These announcements are immediately placed on the Company's website, at [www.schaffer.com.au](http://www.schaffer.com.au) and typically mailed to shareholders.
- The release of Interim and Final results are typically followed by investor briefings and road shows. The purpose of the investor briefings/road shows is for explanation and clarification of previously released information and non-material company or industry specific information. Site visits are also arranged to give those who advise investors a better understanding of the Groups operating facilities
- SFC's website contains further information about the Group and its activities, including copies of recent Annual and Interim Reports, the full text of notices of meetings and explanatory notes and copies of roadshow presentations and presentations to brokers/analysts
- The Annual General Meeting provides an opportunity for the Board to communicate with shareholders and investors through the presentation of the Chairman's Address and shareholders, through the Chairman, are given the opportunity to ask general questions of directors. SFC's external auditor attends each AGM and is available to answer any question shareholders may have that are relevant to the conduct of the audit.

SFC's senior management meets regularly to consider its continuous disclosure obligations and assess the appropriateness of its policy in the context of any legislative amendments to the disclosure regime. Unless SFC has an obligation to make a statement on a particular matter, the Company's policy is not to respond to market rumours and media speculation. Consistent with Council Principle 6, the Company's Shareholder Communication Policy is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

year ended 30 June 2006

### COUNCIL PRINCIPLE 6: RECOGNISE AND MANAGE RISK

#### Risk Management

The Board has formal written policies on risk oversight and management. SFC's risk management policy provides the framework to manage the risks associated with SFC's business activities.

The purpose of the policy is to identify, assess, monitor and manage risk with the objective of minimising losses and maximising shareholder value.

SFC prepares risk profiles including a description of material risks, both financial and non-financial. SFC reviews and updates its risk profile as required.

SFC implements a systematic process to assist in the identification, assessment, treatment and monitoring of risks.

SFC provides the necessary tools and resources to management and staff to support the effective management of risks.

SFC ensures that the Board is adequately informed of significant risk management issues and the actions undertaken to manage risks in a timely manner.

The SFC Board is responsible for SFC reviewing and analysing the implementation and effectiveness of SFC's risk management systems. The SFC Board reviews these control systems annually.

The Board has considered the need for an internal audit function and concluded that the size and nature of the Group's operations do not warrant such a function as present. Responsibility for implementation and effective conduct of SFC's risk management system rests with the Board, Chief Executive Officer, Chief Financial Officer, General Managers and all employees. The Managing Director and the Chief Financial Officer are required to state in writing to the Board in respect of the financial periods ending 31 December and 30 June that:

- The statement given in accordance with the ASX Corporate Governance Council's Best Practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and
- SFC's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Consistent with Council Principle 7, the Company's Risk Management Policy is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

### COUNCIL PRINCIPLE 7: ENCOURAGE ENHANCED PERFORMANCE

#### Performance Evaluation

SFC's Nominations and Remuneration Committee operates to support and advise the Board in fulfilling its responsibility to shareholders to ensure the Board comprises individuals best able to discharge the responsibilities of directors having regard to the law and corporate governance standards. With five members, the SFC Board is small but cohesive and effective. Given the relative size of the SFC Board, active participation and genuine performance by each director are qualities that are readily apparent.

The Board considers that adoption of a formal procedure for Board and director evaluation under these circumstances is not warranted and would serve little purpose.

Key executives across the Group participate in a formal annual review of performance. These annual performance reviews are conducted by SFC's Managing Director in the case of the Building Material division and Corporate executives and by the Managing Director of ALH in the case of Leather division executives. The performance review is a structured process which addresses the individual's core responsibilities, objective achievements, personal development activities, goals and objectives for the year ahead as well as longer term aspirations.

The executive performance review provides a valuable forum for encouraging enhanced performance and developing the Group's executive succession plan.

### COUNCIL PRINCIPLE 8: REMUNERATE FAIRLY AND RESPONSIBLY

#### Executive Remuneration

SFC's Nominations and Remuneration Committee operates to support and advise the board in fulfilling its responsibility to shareholders to ensure that the company has remuneration policies and practices which enable it to attract and retain directors and executives who will best contribute towards achieving positive outcomes for shareholders. The committee determines the remuneration and other conditions of service of the chief executive officer and executive directors, if any. The committee makes recommendations to the board on the remuneration of non-executive directors within the aggregate approved by shareholders in general meeting from time to time. The committee considers individual performance, company performance, internal relativity and fairness in setting levels of remuneration and may seek appropriate independent external advice to assist in its decision making.

SFC's remuneration policy is directed at attracting, motivating and retaining quality people.

The remuneration of SFC's senior executive consists of fixed remuneration and annual and long term incentives.

Fixed Remuneration – This includes base salary and the statutory Superannuation Guarantee Contribution ("SGC") which comprises the cash component;

and other non-cash benefits such as a motor vehicle.

The Schaffer Corporation Limited Superannuation Fund is available to executives for superannuation contributions and life insurance. Premiums for life insurance are deducted from member accounts. Executives can elect to have the company contribute superannuation beyond the statutory SGC level by way of a salary sacrifice in lieu of cash salary.

Annual Incentive – The Company has performance-based incentive plans in place at each of its operations in which management and the labour force participate. The level of remuneration payable to participating executives is linked to the financial performance of their business. Executives are provided with cash incentives provided profitability thresholds are met. The Group Managing Director and Chief Financial Officer/Company Secretary do not participate in any annual incentive program.

Long Term Incentive – SFC's senior executives (other than Mr Schaffer and Mr Mayer) participate in SFC's Employee Share Option Plan ("ESOP"). ALH operates the Employee Performance Unit ("EPU") Plan for its executives. The SFC ESOP and ALH EPU plans have long-term vesting provisions and are designed to align the interests of the participating executives with those of all SFC shareholders.

## STATEMENT OF CORPORATE GOVERNANCE PRACTICES

*year ended 30 June 2006*

### Non- Executive Director Remuneration

SFC's non-executive directors receive fees for their services (including statutory superannuation) and the reimbursement of reasonable expenses. The amount payable to non-executive directors is set by the Board after having taken regard to the size of the Company and Board, the responsibilities, demands and accountabilities faced by those directors in discharging their duties and after seeking independent advice to ensure the fees are in line with market standards. It is current SFC policy that non-executive directors do not receive shares, options or other securities and are not eligible to participate in SFC's Employee Share Option Plan.

The only exception to this policy is that Mrs Blain receives remuneration from the ALH EPU Plan, an entitlement originating from her time as an executive of the ALH business. Payment of fees (including statutory superannuation) and the reimbursement of reasonable expenses are the only remuneration payable to Mr Schwartz and any future non-executive director.

A directors' pool limit of \$250,000 per annum was approved by shareholders at SFC's 2003 Annual General Meeting. This limit is not currently fully utilised. The fee pool is payable only to non-executive directors. Non-executive directors were paid annual fees of for the 2005/06 financial year of \$60,000 from the fee pool (inclusive of superannuation). Non-executive directors appointed prior to July 2003 are entitled to a retirement benefit equivalent to one year's annual director's fees. The retirement benefit was reduced from three year's to one year's annual director's fees in July 2003 (a three year retirement benefit was in place at the time each director accepted their appointment to the Board). SFC considers the reduced benefit modest and appropriate given the benefit which historically existed. It is SFC's policy that no retirement benefit apply to new directors appointed after July 2003.

### COUNCIL PRINCIPLE 9: RECOGNISE THE LEGITIMATE INTERESTS OF STAKEHOLDERS

#### Code of Conduct

SFC has adopted a Code of Conduct which describes how SFC relates to its employees, customers, suppliers, shareholders and the community. SFC is committed to promoting integrity and maintaining the highest standard of ethical conduct in all of its activities. Our business success is dependent on the development and maintenance of trusting relationships, underpinned by the continuous demonstration of corporate integrity.

The purpose of the Code of Conduct is to provide a common behavioural framework for all SFC personnel which recognises social responsibility, complies with applicable laws and standards, and is in keeping with the spirit and rules of the Australian and international markets in which SFC operates. This Code of Conduct applies to SFC and its controlled affiliates.

SFC's directors and management team lead by example, demonstrating their commitment to this Code of Conduct at all times through their personal behaviour and through guidance provided to our personnel.

SFC's Code of Conduct is set out below:

**Mutual Respect:** SFC recognises that respect in all working relationships is fundamental in building team spirit and function. Harassing, discriminating, demeaning and offensive behaviour is not tolerated in the workplace. We practice the principle of equal opportunity employment without regard to age, gender, race, religion, political affiliation or physical disability. The privacy of our personnel is respected and is not disclosed without appropriate authority unless there is a legal obligation to do so. A culture of safety in the workplace is observed with all staff encouraged to take responsibility for ensuring a safe and secure working environment.

**Conflicts of interest:** The Board of Directors and all SFC personnel are required to conduct their business dealings in a manner that is in the best interests of the group and that avoids real, perceived or potential conflicts of interest which may interfere with the independent exercise of their judgement.

**Ethical business conduct:** SFC's marketing and advertising will be accurate and truthful. SFC competes in the context of the relevant legal framework of the jurisdictions in which it does business. SFC and its employees are required to act honestly and with integrity.

**Trading in Securities:** The release of information concerning SFC is done so within the context of the ASX's continuous disclosure regime. The overriding expectation on all SFC directors and personnel who become aware of material price sensitive information in the period pending its release to the ASX is that they will not use that information for personal profit and do not take advantage of the information by trading, or providing that information to others in order to trade in SFC securities.

**Financial Reporting:** SFC requires the honest and accurate reporting of any and all financial information in order to manage its business and facilitate responsible business decision making. The objective of SFC's statutory financial reports is to accurately reflect transactions and events, and conform to national accounting standards and the Corporations Act.

**Social responsibility:** We wish to be good corporate citizens and wish to build positive relationships with communities where we have a presence. SFC is committed to protecting the public interest by working to the requisite standards of environmental legislation. SFC believes behaving as a good corporate citizen is an important measure of our success.

Consistent with Council Principle 10, the Company's information relevant to Principle 10 is posted to the corporate governance section of the Company's website – [www.schaffer.com.au](http://www.schaffer.com.au)

## ASX ADDITIONAL INFORMATION

year ended 30 June 2006

Additional information required by the Australian Stock Exchange Ltd is as follows.

### TOTAL SHARE CAPITAL

Issued as at 12 September 2006 – 14,113,251 ordinary fully paid shares

### SHARE REGISTRY ADDRESS

|   |  |
|---|--|
| C/- Computershare Investor Services Pty Ltd<br>Level 2 Reserve Bank Building<br>45 St George's Tce<br>PERTH WA 6000 | Postal Address:<br>GPO Box D182<br>PERTH WA 6840 |
|---|--|

### STOCK EXCHANGE LISTING

The shares of the Company are listed on the Australian Stock Exchange Limited. The home exchange is Perth.

### VOTING RIGHTS

Subject to any restrictions from time to time being attached to any class or classes of shares at general meetings of Members or classes of Members.

- each Member entitled to vote may vote in person or by proxy, attorney or representative;
- on a show of hands, every person present who is a Member or a proxy, attorney or representative of a Member has one vote;
- on a poll, every person present who is a Member or a proxy, attorney or representative of a Member shall, in respect of each fully paid share held by him, or in respect of which he is appointed a proxy, attorney or representative, have one vote for the share, but in respect of partly paid shares, shall have a fraction of a vote for each partly paid share. The fraction must be equivalent to the proportion which the amount paid (not credited) is of the total amounts paid and payable (excluding amounts credited). Amounts paid in advance of a call are ignored when calculating the proportion.

### DISTRIBUTION OF HOLDINGS

As at 12 September 2006

| SHAREHOLDINGS      | SHAREHOLDERS |
|--------------------|--------------|
| 1 – 1,000          | 1,158        |
| 1,001 – 5,000      | 1,028        |
| 5,001 – 10,000     | 197          |
| 10,001 – 100,000   | 115          |
| 100,001 – and over | 14           |
|                    | <u>2,512</u> |

Number of shareholders holding less than a marketable parcel ie less than 83 shares: 56

### SUBSTANTIAL SHAREHOLDERS

As at 12 September 2006, the substantial shareholders of the company summarised below, were:

|  | NO. OF<br>SHARES | ECONOMIC<br>INTEREST AS A<br>PERCENTAGE OF<br>ISSUED ORDINARY<br>SHARES |
|--|------------------|---|
| Mr J M Schaffer & Associates                             | 1,967,240        | 13.94%  |
| 50% of interest held by<br>Swan Holdings Pty. Ltd.       | 652,687          | 4.62%   |
|  | <u>2,619,927</u> | <u>18.56%</u>   |
| Mrs D E Blain & Associates                               | 909,673          | 6.45%   |
| 50% of interest held by<br>Swan Holdings Pty. Ltd.       | 652,687          | 4.62%   |
|  | <u>1,562,360</u> | <u>11.07%</u>   |
| *Combined interest of<br>Mr J M Schaffer & Mrs D E Blain | 4,182,287        | 29.63%  |
| Jobling Investments Pty Ltd                              | 507,812          |   |
| Estate of Mr A E Jobling Deceased                        | 286,504          |   |
|  | <u>794,316</u>   | <u>5.63%</u>  |

\*Pursuant to the Corporation Act (2001), by virtue of the Swan Holdings Pty Ltd Voting Deed conferring on J M Schaffer the power to vote all Swan Holdings Pty Ltd's interest in Schaffer Corporation Limited's shares, J M Schaffer is also deemed to have an interest in all the Schaffer Corporation Limited shares held by D E Blain and her associates, and vice versa. The consequence of this is that each of the Substantial Shareholder notices lodged with the Regulatory Authorities by J M Schaffer and D E Blain show J M Schaffer's and D E Blain's combined interest at 30%, not their individual economic interests of 19% and 11% respectively.

### TWENTY LARGEST SHAREHOLDERS

| AS AT 12 SEPTEMBER 2006                         | NO. OF<br>SHARES | PERCENTAGE<br>OF ISSUED<br>ORDINARY<br>SHARES |
|---|------------------|---|
| Swan Holdings Pty. Ltd.                         | 1,305,374        | 9.25  |
| Schaffer Nominees Pty. Ltd.                     | 980,482          | 6.95  |
| Mrs Danielle Eva Blain                          | 907,570          | 6.43  |
| Mr John Michael Schaffer                        | 799,554          | 5.67  |
| Jobling Investments Pty. Ltd.                   | 507,812          | 3.60  |
| Mrs Blanka Schaffer                             | 432,897          | 3.07  |
| ANZ Nominees Limited                            |                  |   |
| Cash Income A/c                                 | 375,101          | 2.66  |
| Mr David Schwartz                               | 359,654          | 2.55  |
| Keyton Enterprises Limited                      | 344,263          | 2.44  |
| Estate of Mr. Albert Edward Jobling<br>Deceased | 286,504          | 2.03  |
| The Sports Café (Australia) Pty. Ltd.           | 226,072          | 1.60  |
| Argo Investments Limited                        | 184,204          | 1.31  |
| Mrs Debra Ruth Schaffer                         | 108,207          | 0.77  |
| Fredrick Bruce Wareham                          | 105,010          | 0.74  |
| JP Morgan Nominees Australia Limited            | 70,714           | 0.50  |
| Edward James Lewis                              | 69,105           | 0.49  |
| Milton Corporation Limited                      | 68,999           | 0.49  |
| Winifred Francis Schulze                        | 66,918           | 0.47  |
| Cooglegong Farm Pty. Ltd.                       | 50,000           | 0.35  |
| Mrs. Guiseppina Perrella                        | 47,500           | 0.34  |
|   | <u>7,295,940</u> | <u>51.71</u>                                  |

### ANNUAL GENERAL MEETING

The Annual General Meeting of Schaffer Corporation Limited will be held at Perth on Wednesday, 15 November, 2006 at 11.30am. Further information regarding the meeting including the business to be dealt with is contained in the separate notice of meeting.