Freshtel™

HOLDINGS

ANNUAL REPORT 2010

Freshtel™ HOLDINGS

Chairman's Statement

This has been another difficult year for Freshtel. We have continued to restructure the sales and cost structure of the company including terminating the Tesco and PTCL relationships and as a consequence, exiting the UK market altogether.

Consequently costs have been significantly reduced from $450,000 per month at the start of the year to some $50,000 per month at the year end. Revenues have also reduced and at year end are some $30,000 per month derived from call termination services for the remaining Australian retail and wholesale customer base.

Staff numbers have been minimized and provisioning, billing and call centre services have now been outsourced under SLA agreements.

In April this year the board announced a 15% share placement accompanied by a renounceable rights issue in May at a price of 0.375c per share. This has resulted in an additional $1.25M of cash being raised, and an additional 335M shares being issued, which will enable the company to continue as a going concern for the 2011 financial year.

The company will therefore commence the 2011 year with:

- a minimum of staff and overhead expenses
- a small recurring revenue from Australian retail and wholesale customers
- a very clean balance sheet with small debt and no intangible assets
- a cash pool of some $700,000
- VoIP related tax losses of some $23M at 30 June 2009
- a set of service level agreements for outsourced operating services

It is anticipated that operational cash burn for the company (in this year) will be some $480,000 with budgeted EBITDA approximately $350,000 loss.

The attention of the board will now be directed towards the selection of an appropriate, strong company to integrate with the Freshtel business structure to provide both existing and new shareholders with an attractive, ongoing growth oriented business which will benefit from the Freshtel restructuring overseen by the board in the past 18 months.

Dr Allan Sullivan
Chairman

FRESHTEL HOLDINGS LTD
And Controlled Entities
ACN 111 460 121

FINANCIAL REPORT
FOR THE YEAR ENDED 30 JUNE 2010

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CORPORATE GOVERNANCE

This statement outlines the main corporate governance principles and practices of Freshtel Holdings Limited that were in place during the year ended 30 June 2010. Unless otherwise stated, these comply with the ASX corporate governance principles and recommendations ('ASX recommendations') that took effect from 1 January 2008.

1. LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

The board's main role is to protect and maintain long-term shareholder value by providing strategic guidance and effective oversight of management for Freshtel Holdings Limited.

To facilitate accountability to Freshtel's shareholders the board has clearly defined roles and responsibilities for the board and management team and has ensured that there is a balance of power and appropriate authorisations to avoid any individual having sole authority.

Functions reserved for the board

The functions reserved for the board can be summarised as follows:

- Input into and final approval of the Company's strategic plan;
- Oversight of the strategic plan and accountability systems for delivery within the strategic plan;
- Review and ratification of risk management systems;
- Establishment of appointment criteria and review of board membership to identify and nominate directors for shareholder consideration;
- Appoint and removal of the CEO and management team;
- Ensuring appropriate resources are available to CEO and management team;
- Appoint and determine remuneration packages and performance criteria for the CEO and management team;
- Development and approval of delegations for the CEO and management team;
- Approval and monitoring financial and other reporting including assurance that the scope of the external audit is adequate;
- Approval and monitoring the progress of major capital expenditure, capital management and acquisitions.

Responsibility of management

The board has delegated responsibility for management to the acting CEO and the management team.

The directors have adopted a charter for the board, which sets out the responsibilities of the board and those matters reserved for the Board and those delegated to management. It is available from the corporate governance section of the Freshtel Holdings Limited website at www.freshtelholdings.com.

The Company had a few executive resignations that were not replaced. These positions are now the responsibility of the acting CEO. The acting CEO and management team receive management direction from the board.

The board's accountability

The board receives regular financial reporting and assesses financial performance against budgets and forecasts. The Company has filed cash flow statements with the ASX on a quarterly basis throughout the year. The Company places emphasis on having a strong accounting team in place, as monitoring and control of Freshtel's financial performance is paramount to its growth strategy.

The board receives reports from external auditors and takes all necessary follow-up action. In taking any required action, the board does not consider the composition of the Board or Management.

The board has developed a communication policy within its suite of policies. The Company utilises the Company website to ensure its policies are available for public scrutiny in addition to more formal notices as required by the Corporations Act or the ASX listing rules.

2. BOARD STRUCTURE

As at the date of this report, the board comprises one executive chairman (and acting CEO) and two non-executive directors. Freshtel's constitution provides for a minimum of three directors and not more than nine directors.

The board consists of an executive chairman (and acting CEO), Dr Allan Sullivan, who has a close association with the company's major shareholder. One of the independent non-executive directors is Mr Andy Dewhurst who is not a major shareholder and does not have any current association with a party holding over 5% of the paid up capital. The remaining director, Dr Kenneth Carr, is also an independent non-executive director with no current association with a party holding over 5% of the paid up capital.

This arrangement does not comply with ASX recommendation 2.1 that the majority of the board are not independent directors; however the board is confident that it brings independent judgement to bear on board decisions. The board continues to monitor its structure as the Group's operations develop.

The board has agreed a procedure to take independent legal advice at the expense of the company, whereby a board member advises the chairman of his intention to take such advice and the broad nature of the advice and shares the advice with the board on receiving it.

Remuneration and nomination committee

Remuneration and nomination committee

The committee is responsible for identifying the necessary and desirable competencies of directors, reviewing board succession plans, board evaluation, making director and management remuneration recommendations and evaluating and recommending option and bonus plans.

A policy for the selection and appointment of directors and a committee charter has been developed and published to the Company's website. The board undertakes performance evaluation in accordance with its policy for board performance evaluation and ensures that ongoing evaluation of the skills, experience and expertise of board members is made.

Remuneration

Remuneration of directors and management is in the mean range of market remuneration.

Board performance evaluation

The board undertook an informal peer evaluation during the year and the chairman met with each board member to discuss the evaluation.

3. ETHICAL AND RESPONSIBLE DECISION MAKING

Ethical business behaviour

Freshtel Holdings Limited is committed to maintaining high ethical standards in its internal operations and its interaction with shareholders, investors, clients, stakeholders and regulatory bodies. The board has prepared a statement of professional practice that is available from the corporate governance section of the Freshtel Holdings Limited website at www.freshtelholdings.com. This policy is in the nature of a code of conduct in accordance with ASX recommendations. Recommendation 3.1, and was developed to ensure a high standard of business behaviour and to ensure all directors, managements, contractors and employees understand and carry out their obligation to treat others with fairness, honesty and respect.

The board meets on a regular basis and follows meeting guidelines set down to ensure all directors are made aware of and have all necessary information to participate in informed discussion on all agenda items.

The board of directors identifies risks and opportunities and seeks assistance from the Company executives and, where applicable, from other professional advisors to the Company.

Dealing in company securities

The Company has in place an insider trading policy that sets out a procedure for Directors, officers and staff members dealing in the company's securities. The policy is on the company's website at www.freshtelholdings.com. The Company's constitution permits directors, officers and staff members to acquire shares in the Company.

The insider trading policy allows directors, officers and staff members to deal in Company shares only when the public is fairly well informed about the Company. Freshtel considers it is reasonable for directors, officers and staff members to buy, sell or otherwise deal in the securities of Freshtel during the so-called 'windows' which are:

- during the currency of a prospectus and any supplementary prospectus;
- for a new issue, while rights are being traded;
- between 3 and 30 days after the release of the half yearly results, preliminary final results and any dividend announcements;
- during the period from 3 days after the release of the annual report to 30 days after the annual general meeting;
- at other times with the approval of the chair providing the director, officer or staff member is not in possession of any price sensitive information.

The board can order the suspension of trading activities at any time during the trading windows if they believe that the directors, officers or staff members are in possession of price sensitive information not yet announced to the market. A copy of the insider trading policy is available from the corporate governance section of the Freshtel Holdings Limited website at www.freshtelholdings.com.

4. SAFEGUARDING INTEGRITY IN FINANCIAL REPORTING

Audit, risk and compliance committee

All board members make up the audit, risk and compliance committee.

The composition of the audit, risk and compliance committee initially complied with recommendation 4.2 of the ASX recommendations where all directors are independent but as at 30 June 2010, not all directors are independent. The board is confident that it brings independent judgement to bear on board decisions and continues to monitor its structure as the Group's operations develop.

The audit, risk and compliance issues are dealt with as part of the regular board meeting sequence and minuted accordingly. The CFO attends all board meetings and the company's external auditor attends meetings on request.

The audit, risk and compliance committee is responsible for;

- internal control including financial statements, due diligence, financial systems integrity and risk management;
- establishing and maintaining processes to ensure that there is adequate systems of internal control, risk management and safeguard of assets; and
- overseeing the relationship, appointment and work of external auditors.

The audit, risk and compliance committee is governed by an audit committee charter and operates under terms of reference. Both the charter and terms of reference have been published to the Company's website at www.freshtelholdings.com.

The audit, risk and compliance committee is responsible for establishing and maintaining an appropriate framework of internal control. The functions of the committee include:

- reviewing reports prepared by the external auditors, liaising with the external auditors and ensuring that the annual audit and half-yearly review are conducted in an effective manner;
- reviewing internal controls and recommending enhancements;
- monitoring compliance with the Corporations Act, Australian Stock Exchange listing rules and any matters outstanding with taxation and other regulatory authorities;
- monitoring the accounting function;
- nomination of external auditors; and
- overseeing the financial reporting process.

Representations by the acting CEO and the CFO

The acting CEO and the CFO have provided a management representation letter to the board for the financial statements where they certify that the Company's financial reports present a true and fair view of the results and the financial position of the Company and are in accordance with relevant accounting standards.

5. MAKE TIMELY AND BALANCED DISCLOSURE

The board recognises the significance of relevant and timely disclosure and has developed a continuous disclosure policy that is available from the corporate governance section of the Freshtel Holdings Limited website at www.freshtelholdings.com.

This policy and ongoing formal and informal meetings of the directors and executives, ensures provision of relevant, factual, fulsome and timely information to all market participants and stakeholders.

The Company complies with the Australian Stock Exchange listing rules on continuous disclosure and consults with the ASX whenever there is any question relating to continuous disclosure.

6. RESPECT THE RIGHTS OF SHAREHOLDERS

The directors recognise that for shareholders of Freshtel Holdings Limited to be able to make informed decisions regarding their investment and to properly participate in Company meetings, they need relevant, balanced and timely information. The board adheres to its shareholder communication policy available from the corporate governance section of the Freshtel Holdings Limited website at www.freshtelholdings.com.

The Company regularly updates its website with ASX releases and during the year has made several presentations to market representatives and financial analysts that are also released to market and placed on the website.

7. REMUNERATE FAIRLY AND RESPONSIBLY

Remuneration and nomination committee

All board members make up the remuneration and nomination committee.

In its remuneration role, the remuneration and nomination committee reviewed and implemented the remuneration of the CFO.

The board's remuneration and nomination committee considers the remuneration of the directors and senior management annually on an individual basis after considering performance and market information. The total allowable remuneration of non-executive directors is fixed by shareholders in general meetings.

Remuneration is designed to be market competitive and to incorporate incentives that align executive focus with shareholder interests. The remuneration and nomination committee reviews executive packages annually by reference to company performance, executive performance, market parity and appropriate independent advice.

The amount of remuneration for all directors and the highest paid continuing executives, including all monetary and non-monetary components, is detailed in the directors' report.

No remuneration was made to directors during the 2010 year other than by way of fees.

DIRECTORS REPORT

The directors of Freshtel Holdings Limited submit herewith the annual financial report on the consolidated entity (Group) consisting of Freshtel Holdings Limited and the entities it controls during, and at the end of the financial year ended 30 June 2010. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

Information about the directors and senior management

The names and particulars of the directors of the company during or since the end of the financial year are:

Dr Allan Sullivan PhD Elec.Eng., BElec.Eng, BSc
Executive Chairman and acting Chief Executive Officer

Dr Sullivan is closely associated with Custodial Capital Management Pty Ltd, Freshtel's largest shareholder with a 24.76 per cent interest in the Company. He brings more than 30 years of international experience in technology and engineering companies and has held a number of executive roles in technology-based companies including his current position as a non-executive director of EBet (ASX.EBT) and as an advisor to Utilico / Ingot group of companies and director of Ellect Holdings. Dr Sullivan was previously the CEO and director of ERG Group, and a member of the executive board of Siemens Building Technologies Asia Pacific.

Mr Andy Dewhurst
Non-Executive Director

Mr Dewhurst joined the Freshtel board in January 2007. He was chief executive officer for the Telecoms business within Tesco, including Tesco mobile, branded handset and landline categories, Tesco home phone and Tesco internet phone and Tesco broadband. Mr Dewhurst first joined Tesco Stores Ltd in 1983 and was a divisional director for over 21 years. His experience spans Tesco marketing, commercial, supply chain, property, and Tesco personal finance. He has considerable experience in joint ventures and start-up companies. In June 2003, Andy was appointed CEO of another new joint venture - between O2 and Tesco - Tesco Mobile Ltd. The business launched in September of that year and has developed to around two million customers. Tesco secured its position as a key telecoms retail destination, under Mr Dewhurst's direction. Mr Dewhurst resigned from Tesco in July 2008 and in addition to his role in Freshtel is now an advisor to a number of companies in the UK, France and Ireland.

Mr Sean Wilkins BA, ACMA
Non-Executive Director

Mr Wilkins was appointed to the Freshtel board on 2 July 2008 and is an Oxford University graduate with a depth of global executive experience in the telecommunications and finance fields. He has formerly held senior positions with O2, British Telecoms and top tier accounting firm Coopers and Lybrand. He heads Tesco Telecoms financial and commercial division.

Dr Kenneth Carr PhD Bus.Adm., Masters Bus.Adm., BSc
Non-Executive Director

Dr Carr joined the Freshtel board in February 2009. He has formerly held CEO and Board positions on several listed entities in Australia and overseas, most recently as CEO of Keycorp Limited. Previously he has held senior executive positions at British Telecom, AT&T, and Lucent Technologies. He spent some time as a Partner at IBM GSA with a primary focus on Telco consulting to all local carriers and overseas entities such as China Mobiles, and Nextel Inc. His main experience is related to corporate restructuring and recovery transformation, which has included several JVs and mergers and acquisitions in many countries.

The above named directors held office during the whole of the financial year and since the end of the financial year except:

- Dr Kenneth Carr – appointed 19 February 2009
- Mr Sean Wilkins – resigned 21 February 2009

Directors' shareholdings

The following table sets out each director's relevant interest in shares, debentures, and rights or options in shares or debentures of the company or a related body corporate as at the date of this report.

	Freshtel Holdings Limited		
	Fully paid shares	Share Options	Convertible Notes
Directors	Number	Number	Number
Dr Allan Sullivan	2,000,000	-	-
Mr Andy Dewhurst	1,784,800	-	-
Dr Kenneth Carr	-	-	-

Remuneration of directors and senior management

Information about the remuneration of directors and senior management is set out in the remuneration report of this directors' report, on pages 9 to 11.

Share options granted to directors and senior management

During and since the end of the financial year no options were granted to directors as part of their remuneration.

Principle activities

The principal activity of the consolidated entity during the period was the development and commercialisation of Voice over Internet Protocol products and services. The regional scope of the consolidated entity has reduced to an "Australia only" activity in 2010.

Review of operations

The parent company was incorporated on 20 October 2004. The consolidated entity was established by the acquisition of Freshtel Australia Pty Ltd and its subsidiaries. Consolidated sales revenue for the period was $1,173,074 (2009: $2,373,087). Interest and other revenue for the period was $158,390 (2009: $850,158), resulting in total revenue of $1,331,464 (2009: $3,223,245).

The Company undertook a renounceable rights issue in May 2010 for $1,049,448 and has implemented processes to preserve cash reserves to the fullest extent possible.

Operating results

The net loss of the consolidated entity after providing for income tax amounted to $734,975 (2009: $10,181,473)

Financial position

The net assets of the consolidated entity were $477,731 at 30 June 2010 (2009: $2,702,556). Full details of the net assets are disclosed on page 17.

Business strategies, future developments and strategies

The consolidated entity has significantly reduced the scope and reach of its activity in 2010. The Company will continue its strategy of focusing on the support of the existing retail customer base in Australia while seeking appropriate partners to drive future strategy.

Significant changes in state of affairs

The company has undergone further significant restructuring in the past 12 months leading to:

- a termination of the agreements with Tesco and PTCL in the UK;
- exit from the UK market and sale of the UK subsidiary;
- reduction of staff to an absolute minimum with outsourced services being provided under SLA's;
- reduction of revenue to the call termination income of the Australian customer base

Subsequent events

No matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of the consolidated entity in future financial years.

Environmental regulations

The Company and the Group's operations are not subject to any particular or significant environmental regulation.

Dividends

No dividends were paid or recommended by the directors.

Shares under option or issued on exercise of options

At the date of this report, no unissued ordinary shares of Freshtel Holdings Limited were under option. During the year ended 30 June 2009 options over the ordinary shares of Freshtel Holdings Limited were issued to key executives but these either expired or were forfeited by the executives concerned during the financial year.

No amounts are unpaid on any of the shares. No person entitled to exercise an option had or has any right by virtue of an option to participate in any share issue of any other body corporate.

Indemnification of officers and auditors

During the financial year, the company paid a premium in respect of a contract insuring the directors of Freshtel Holdings Limited, and all executive officers of the company against a liability incurred as such a director, secretary or executive officer to the extent permitted by the Corporations Act 2001, other than for conduct involving:

- a wilful breach of duty; or
- a contravention of Sections 232(5) or (6) of the Corporations Act, as permitted by section 241A(3) of the Act.

The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

Proceedings on behalf of the company

No person has applied for leave of court to bring material proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of these proceedings.

Directors' meetings

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (while they were a director or committee member). During the financial year, 15 board meetings were held, nomination and remuneration committee meetings were not formally held and minuted, and 2 audit, risk and compliance committee meetings were held.

	Board of directors		Nomination & remuneration committee		Audit, risk & compliance committee	
	Held	**Attended**	**Held**	**Attended**	**Held**	**Attended**
Dr Allan Sullivan	15	15	-	-	2	2
Mr Andy Dewhurst	15	14	-	-	2	1
Mr Sean Wilkins	9	5	-	-	2	1
Dr Kenneth Carr	6	5	-	-	1	-

The current members of the audit, risk and compliance committee are all the board members.
The current members of the nomination and remuneration committee are all the board members.

Non-audit services

The board of directors, sitting as the audit, risk and compliance committee, is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- all non-audit services are reviewed and approved by the board prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- the nature of the services provided do not compromise the general principles relating to auditor independence as set out in the Institute of Chartered Accountants in Australia and CPA Australia's Professional Statement F1: Professional Independence.

The external auditor did not perform any non-audit services during the year ended 30 June 2010.

Likely developments and expected results of operations

Likely developments in the operations of the Group constituted by Freshtel Holdings Limited and the entities it controls from time to time that were not finalised at the date of this report include:

Freshtel has reduced its global presence to an "Australia only" profile in 2010 and is consolidating, not growing, its Australian customer base.

Auditor's independence declaration

The auditor's independence declaration is included on page 12 of the annual report.

REMUNERATION REPORT (AUDITED)

This remuneration report, which forms part of the directors' report, sets out information about the remuneration of Freshtel Holdings Limited directors and its senior management for the financial year ended 30 June 2010. The prescribed details for each person covered by this report are detailed below under the following headings:

- director and senior management details
- remuneration policy
- remuneration of directors and senior management
- key terms of employment contracts.

Key management personnel details

The following persons were directors of Freshtel Holdings Limited during or since the end of the financial year:

Dr Allan Sullivan (Chairman)

Mr Andy Dewhurst

Dr Kenneth Carr (appointed 19 February 2010)

Mr Sean Wilkins (resigned 21 February 2010)

The term 'key management personnel' is used in this remuneration report to refer to the following persons. Except as noted, the named persons held their current position for the whole of the financial year and since the end of the financial year:

Ms Rhonda O'Donnell (Chief Executive Officer – Freshtel Holdings Limited, resigned 31 August 2009)

Ms Jan Macpherson (Company Secretary & General Counsel – Freshtel Holdings Limited, resigned 17 November 2009)

Mr David Sims (Company Secretary & Chief Financial Officer – Freshtel Holdings Limited, appointed 17 November 2009)

Mr Dan Hazell (General Manager UK – Freshtel UK Limited, resigned 31 May 2010)

Remuneration Policy

The remuneration policy of Freshtel Holdings Limited has been designed to align director and executive objectives with shareholder value and business objectives by providing a fixed remuneration component and offering specific long-term incentives based on key performance areas affecting the consolidated entity's financial results. The board of Freshtel Holdings Limited believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best executives and directors to run and manage the consolidated entity, as well as create goal congruence between directors, executives and shareholders.

The remuneration policy, setting the terms and conditions for the executive directors and other senior executives, was developed by the nomination and remuneration committee and approved by the board.

The Australian directors and executives receive a superannuation guarantee contribution required by the government, which is currently 9% of their salary or the maximum payable by law, and do not receive any other retirement benefits.

All remuneration paid to directors and executives is valued at the cost to the company and expensed.

The board policy is to remunerate non-executive directors at market rates for comparable companies for time, commitment and responsibilities. The nomination and remuneration committee determines payments to the non-executive directors and reviews their remuneration annually, based on market practice, duties and accountability. Independent external advice is sought when required.

The maximum aggregate amount of fees that can be paid to non-executive directors is subject to approval by shareholders at the annual general meeting. Fees for non-executive directors are not linked to the performance of the consolidated entity. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the Company.

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

The company rewards executives with level and mix of compensation commensurate with their position and responsibilities within the company, ensuring the compensation is competitive by market standards and ties to achievement of the company's strategies and goals.

The Freshtel share price opened at $0.011 (1.1 cents) on 1 July 2009 and closed at $0.003 (0.3 cents) on 30 June 2010.

Remuneration of directors and senior management

2010	Short-term employee benefits: Salary & fees	Short-term employee benefits: Bonus	Short-term employee benefits: Non-monetary	Post-employment benefits: Super-annuation	Other long-term employee benefits	Share-based payments: Options & rights	Total
	$	$	$	$	$	$	$
Executive chairman							
Dr Allan Sullivan	-	-	-	-	-	-	-
Non-executive directors							
Mr Andy Dewhurst [1, 2]	46,959	-	-	-	-	-	46,959
Mr Sean Wilkins [6]	-	-	-	-	-	-	-
Dr Kenneth Carr	17,000	-	-	-	-	-	17,000
Other key management personnel							
Ms Rhonda O'Donnell [1, 2, 6]	99,785	-	-	3,436	-	-	103,221
Ms Jan Macpherson [1, 4, 6]	42,840	-	-	-	-	-	42,840
Mr Dan Hazell [1, 6]	123,265	-	-	17,186	-	-	140,451
Mr David Sims [1, 2, 5]	204,250	-	-	-	-	-	204,250
							554,721

2009	Short-term employee benefits: Salary & fees	Short-term employee benefits: Bonus	Short-term employee benefits: Non-monetary	Post-employment benefits: Super-annuation	Other long-term employee benefits	Share-based payments: Options & rights	Total
	$	$	$	$	$	$	$
Non-executive directors							
Dr Allan Sullivan	-	-	-	-	-	-	-
Mr Andy Dewhurst [1, 2]	108,350	-	-	-	-	-	108,350
Mr Sean Wilkins [6]	-	-	-	-	-	-	-
Mr Leslie Taylor [6]	27,083	-	-	2,438	-	-	29,521
Mr David Elbourn [3, 6]	30,000	-	-	2,700	-	-	32,700
Mr Spiros Nikolakopoulos [6]	40,688	-	-	3,662	-	-	44,350
Mr K Loughnan AO [6]	48,000	-	-	4,320	-	-	52,320
Other key management personnel							
Ms Rhonda O'Donnell [1, 2, 6]	400,000	-	-	13,694	-	-	413,694
Mr John Coates [6]	39,077	-	-	2,240	-	-	41,317
Mr Ian Jackson [1, 2, 6]	274,793	-	-	24,083	-	-	298,876
Mr John McMullan [6]	24,329	-	-	1,953	-	-	26,282
Ms Jan Macpherson [2, 4, 6]	107,797	-	-	-	-	-	107,797
Mr Dan Hazell [1, 6]	151,690	-	-	4,550	-	-	156,240
Mr Michael Carew [1, 2, 6]	200,000	-	-	-	-	-	200,000
							1,511,447

[1] Denotes one of the five highest paid executives of the Group as required to be disclosed under the Corporations Act 2001

[2] Denotes one of the five highest paid executives of the Company as required to be disclosed under the Corporations Act 2001

[3] Paid to Dillon and Elbourn Chartered Accountants for the services of Mr David Elbourn

[4] Consulting fees paid to Blairgowrie Pty Limited, Ms Macpherson's employer

[5] Consulting fees paid to DS Consulting (Aust) Pty Ltd, Mr Sims's employer

[6] Resigned

	2010	2009	2008	2007	2006
Net comprehensive loss attributable to shareholders of the consolidated entity	$734,975	$10,181,473	$7,811,604	$7,614,000	$6,154,000
Dividends paid	$ nil	$ nil	$ nil	$ nil	$ nil
Share price	$0.003	$0.011	$0.200	$0.400	$0.620
Return of capital	0.00%	0.00%	0.00%	0.00%	0.00%

Key terms of employment contracts

The executive employment contracts stipulate a three month resignation period. The Company may terminate an employment contract without cause by providing three months written notice or making payment in lieu of notice, based on the individual's annual salary component together with any applicable redundancy payment. Termination payments are generally not payable on resignation or dismissal for serious misconduct. In the instance of serious misconduct the Company can terminate employment at any time.

END OF AUDITED REMUNERATION REPORT

This directors' report is signed in accordance with a resolution of directors made pursuant to s.298(2) of the Corporations Act 2001.

On behalf of the directors

Dr Allan Sullivan

Executive Chairman

Melbourne, 30 August 2010

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Australia

DECLARATION OF INDEPENDENCE BY JUSTIN OWEN TO THE DIRECTORS OF FRESHTEL HOLDINGS LIMITED

As lead auditor of Freshtel Holdings Limited for the year ended 30 June 2010, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

- the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
- any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Freshtel Holdings Limited and the entities it controlled during the period.

Justin Owen

JUSTIN OWEN

Director

BDO

BDO Audit (NSW-VIC) Pty Ltd

Melbourne, 30 August 2010

DECLARATION BY DIRECTORS

The directors of the company declare that:

1. The financial statements, comprising the statement of comprehensive income, statement of financial position, statement of cash flows, statement of changes in equity and accompanying notes, are in accordance with the Corporations Act 2001 and:

   (a) comply with Accounting Standards and the Corporations Regulations 2001; and

   (b) give a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the year ended on that date.

2. The company has included in the notes to the financial statements an explicit and unreserved statement of compliance with International Financial Reporting Standards.
3. In the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.
4. The remuneration disclosures included in page 10 of the directors' report (as part of audited Remuneration Report), for the year ended 30 June 2010, comply with section 300A of the Corporations Act 2001.
5. The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the directors by:

Director

Melbourne, 30 August 2010

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GPO Box 4736 Melbourne VIC 3001
Australia

INDEPENDENT AUDITOR'S REPORT

To the members of Freshtel Holdings Limited

We have audited the accompanying financial report of Freshtel Holdings Limited, which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the disclosing entity and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 3.1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements,* that the financial statements comply with *International Financial Reporting Standards*.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001* would be in the same terms if it had been given to the directors at the time that this auditor's report was made.

Auditor's Opinion

In our opinion:

(a) the financial report of Freshtel Holdings Limited is in accordance with the *Corporations Act 2001*, including:

   (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and its performance for the year ended on that date; and

   (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and

(b) the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 3.1.

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our conclusion, we draw attention to Note 3.2 in the financial statements, which indicates that the consolidated entity incurred a net loss of $734,975 during the year ended 30 June 2010 and, as of that date, the consolidated entity has a net asset position of $477,731. The consolidated entity has restructured its business model, which is subject to significant risk due to the inherent uncertainty surrounding the success of this model. Further to this, the adoption of the going concern basis is also dependent on a successful debt to equity conversion. These conditions, along with other matters as set forth in Note 3.2, indicate the existence of a material uncertainty, which may cast significant doubt about the consolidated entity's ability to continue as a going concern.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 9 to 11 of the directors' report for the year ended 30 June 2010. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion

In our opinion, the Remuneration Report of Freshtel Holdings Limited for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

BDO

BDO Audit (NSW-VIC) Pty Ltd

Justin Owen

JUSTIN OWEN

Director

Melbourne, 30 August 2010

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2010

	Notes	Consolidated Entity	
		2010	2009*
		$	$
Continuing operations			
Revenue	6	**453,742**	1,265,439
Other Income		**140,607**	17,909
Raw materials and consumables used		**(396,971)**	(628,910)
Employee benefits expense	7	**(1,493,861)**	(4,296,187)
Administrative expense		**(1,440,102)**	(1,814,740)
Marketing expenses		**-**	(53,520)
Depreciation and amortisation expenses	7	**(350,942)**	(1,582,212)
Impairment of intangible asset	7	**-**	(2,086,966)
Occupancy and facilities expenses		**(185,630)**	(698,498)
Finance costs	7	**(33,633)**	(4,036)
Loss before income tax		**(3,306,790)**	(9,881,721)
Income tax benefit	10	**134,327**	487,704
Loss for the year from continuing operations	7	**(3,172,463)**	(9,394,017)
Discontinued operations			
Profit / (Loss) for the year from discontinuing operations	8	**2,437,488**	(787,456)
LOSS FOR THE YEAR		**(734,975)**	(10,181,473)
Other comprehensive income			
Foreign currency translation reserve differences		**(107,422)**	(10,365)
Foreign currency translation reserve reclassified to profit		**(2,540,928)**	-
Other comprehensive loss for the year, net of tax		**(2,648,350)**	(10,365)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR		**(3,383,325)**	(10,191,838)
Loss attributable to Owners of Freshtel Holdings Limited		**(734,975)**	(10,181,473)
Total comprehensive loss attributable to Owners of Freshtel Holdings Limited		**(3,383,325)**	(10,191,838)
Earnings per share (cents per share)	9		
From continuing and discontinued operations			
Basic earnings / (loss) per share		**(0.18)**	(4.86)
Diluted earnings / (loss) per share		**(0.18)**	(4.86)
From continuing operations			
Basic earnings / (loss) per share		**(0.79)**	(4.49)
Diluted earnings / (loss) per share		**(0.79)**	(4.49)

* Restated 2009: See discontinued operation (refer to Note 8)

The accompanying notes from part of these financial statements.

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 30 JUNE 2010

	Notes	Consolidated Entity	
		2010	2009
		$	$
Current Assets			
Cash and cash equivalents	11	**768,671**	2,366,630
Trade and other receivables	12	**31,765**	947,176
Inventories	13	**5,000**	5,000
Other assets	14	**63,746**	131,180
Total Current Assets		**869,182**	3,449,986
Non-Current Assets			
Trade and other receivables	12	**-**	168,224
Plant and equipment	16	**324,933**	551,317
Total Non-Current Assets		**324,933**	719,541
Total Assets		**1,194,115**	4,169,527
Current Liabilities			
Trade and other payables	17	**361,999**	872,662
Provisions	18	**4,385**	275,786
Total Current Liabilities		**366,384**	1,148,448
Non-Current Liabilities			
Trade and other payables	17	**-**	154,940
Borrowings	20	**350,000**	-
Provisions	18	**-**	163,583
Total Non-Current Liabilities		**350,000**	318,523
Total Liabilities		**716,384**	1,466,971
Net Assets		**477,731**	2,702,556
Equity			
Issued Capital	22	**38,254,777**	37,096,277
Reserves	23	**-**	2,648,350
Accumulated losses	24	**(37,777,046)**	(37,042,071)
Total Equity		**477,731**	2,702,556

The accompanying notes from part of these financial statements.

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2010

	Issued Capital	Accumulated Losses	Foreign currency translation reserve	Share based payments reserve	Total equity
	$	$	$	$	$
Balance at 1 July 2008	34,976,979	(26,860,598)	2,658,715	406,566	11,181,662
Loss for the year	-	(10,181,473)	-	-	(10,181,473)
Foreign currency translation differences	-	-	(10,365)	-	(10,365)
Total comprehensive loss for the year	-	(10,181,473)	(10,365)	-	(10,191,838)
Transactions with owners in their capacity as owners					
Ordinary shares issued	2,029,791	-	-	-	2,029,791
Transaction costs arising on share issue	(90,185)	-	-	-	(90,185)
Employee options exercised	179,692	-	-	(179,692)	-
Employee options expensed	-	-	-	143,753	143,753
Employee options lapsed	-	-	-	(370,627)	(370,627)
	2,119,298	-	-	(406,566)	1,712,732
Balance at 30 June 2009	**37,096,277**	**(37,042,071)**	**2,648,350**	-	**2,702,556**
At 1 July 2009	37,096,277	(37,042,071)	2,648,350	-	2,702,556
Loss for the year	-	(734,975)	-	-	(734,975)
Foreign currency translation reserve differences	-	-	(107,422)	-	(107,422)
Foreign currency translation reserve reclassified to profit	-	-	(2,540,928)	-	(2,540,928)
Total comprehensive loss for the year	-	(734,975)	(2,648,350)	-	(3,383,325)
Transactions with owners in their capacity as owners					
Ordinary shares issued	1,256,342	-	-	-	1,256,342
Transaction costs arising on share issue	(97,842)	-	-	-	(97,842)
	1,158,500	-	-	-	1,158,500
Balance at 30 June 2010	**38,254,777**	**(37,777,046)**	-	-	**477,731**

The accompanying notes from part of these financial statements.

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 2010

	Notes	Consolidated Entity	
		2010	2009
		$	$
Cash Flows from Operating Activities			
Receipts from customers		**2,082,212**	3,126,958
Payments to suppliers and employees		**(4,950,373)**	(9,919,823)
Interest received		**25,889**	254,230
Finance costs		**(163,633)**	(4,595)
Income taxes paid		**339,731**	232,035
Net cash used in operating activities	11	**(2,666,174)**	(6,311,195)
Cash Flows from Investing Activities			
Purchase of plant and equipment		**(327,930)**	(64,617)
Capitalised development costs		**-**	(1,100,624)
Net cash inflow from sale of subsidiary	30	**150,000**	-
Net cash used in investing activities		**(177,930)**	(1,165,241)
Cash Flows from Financing Activities			
Proceeds from issue of ordinary shares		**1,158,500**	1,712,733
Proceeds from borrowings		**850,000**	-
Repayment of borrowings		**(500,000)**	(18,322)
Net cash provided by financing activities		**1,508,500**	1,694,411
Net decrease in cash held		**(1,335,604)**	(5,782,025)
Cash and cash equivalents at the beginning of the year		**2,366,630**	8,159,115
Effects of exchange rate changes on the balance of cash held in foreign currencies		**(262,355)**	(10,460)
Cash and cash equivalents at the end of the year	11	**768,671**	2,366,630

The accompanying notes from part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

Note 1: General Information

Freshtel Holdings Limited is a company limited by shares, incorporated and domiciled in Australia whose shares are publically traded on the Australian Stock Exchange.

Note 2: Adoption of new and revised Accounting Standards

2.1 Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective.

AASB 9: Financial instruments - AASB 9 amends the requirements for classification and measurement of financial assets. The standard is applicable for annual reporting periods commencing on or after 1 January 2013. Due to the recent release of these amendments and that adoption is only mandatory for the 30 June 2014 year end, the entity has not yet made an assessment of the impact of these amendments.

AASB 107: Statement of cash flows - made by AASB 2009-5 "Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project" clarifies that only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as cash flows from investing activities. The standard is applicable for annual reporting periods commencing on or after 1 January 2010. Initial adoption of this amendment will have no impact as the group only recognises cash flows from investing activities for expenditures that result in a recognised asset in the statement of financial position.

Note 3: Significant accounting policies

3.1 Statement of compliance

The financial statements are general purpose financial statements which have been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The financial statements also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

3.2 Basis of preparation

The financial statements have been prepared on the basis of historical cost, except for certain financial instruments, which are measured at fair value. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise noted.

The financial statements have been prepared on the basis that the consolidated entity is a going concern, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business. The consolidated entity has a net asset position of $477,731 as at 30 June 2010 and has incurred a loss of $734,975 for the twelve months ended 30 June 2010.

The directors are of the view that the going concern basis is appropriate due to the following factors:

- cash reserves in place at the date of this report and the budgeted business plan to which the Board is fully committed, demonstrate that the consolidated entity will be able to pay its debts as and when they fall due.
- the Company has previously been able to access additional capital in order to support the ongoing operations. The directors have reasonable expectations that they can raise additional capital resources as required.
- the business plan includes a forecast cashflow model to September 2011. During this period the loan facility in Freshtel Holdings Ltd (the "Company") from Custodial Capital Management Pty Ltd ("CCM") is repayable in full. As at 30 June 2010, the Company has $350,000 owing. The forecast cashflow model provides for a repayment of $150,000 in relation to this loan. The Company is relying upon an understanding it has with CCM, subject to relevant shareholder approval, that $200,000 of this debt is converted to equity in the Company.
- the Company has restructured its business model and upgraded their VoIP platform to allow the business to interact with a comprehensive range of PBX solutions for businesses of all types as well as catering for the traditional residential products currently offered.
- the Company has taken significant steps to reduce overheads and simplify the business. Additional cost reduction steps were identified and implemented over the second half of the financial year.
- If the entity is unable to continue as a going concern, it may be required to realise its assets and extinguish its liabilities other than in the normal course of business and at amounts different to those in the financial report.
- No adjustments have been made to the financial report relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that may be necessary should the consolidated entity not continue as a going concern.

Note 3: Significant accounting policies (cont'd)

3.3 Basis of consolidation

When Freshtel Holdings Limited acquired (as the legal parent) the Freshtel Australia Pty Limited Group of companies, the shareholders of Freshtel Australia Pty Limited (the legal subsidiary) obtained 63.1% of the shares in Freshtel Holdings Limited and therefore control of the combined entity. This financial report discloses the consolidated financial statements of the Group, with the above transaction accounted for as a reverse acquisition.

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Freshtel Holdings Limited ('company' or 'parent entity') as at 30 June 2010 and the results of all subsidiaries for the year then ended as if the Group was headed by Freshtel Australia Pty Limited. Subsidiaries are all those entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group (refer to Note 3.4).

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in subsidiaries are accounted for at cost less any impairment losses in the parent entity financial statements of Freshtel Holdings Limited.

Separate financial statements for Freshtel Holdings Limited as an individual entity are no longer presented as a consequence of a change to the Corporations Act 2001, however, limited financial information for Freshtel Holdings Limited as an individual entity is included in Note 35.

3.4 Business combinations

The acquisition method of accounting is used to account for all business combinations. Consideration is measured at the fair value of the assets transferred, liabilities incurred and equity interests issued by the group on acquisition date. Consideration also includes the acquisition date fair values of any contingent consideration arrangements, any pre-existing equity interests in the acquiree and share-based payment awards of the acquiree that are required to be replaced in a business combination. The acquisition date is the date on which the group obtains control of the acquiree. Where equity instruments are issued as part of the consideration, the value of the equity instruments is their published market price at the acquisition date unless, in rare circumstances it can be demonstrated that the published price at acquisition date is not fair value and that other evidence and valuation methods provide a more reliable measure of fair value. Acquisition-related costs are expensed when incurred. Transaction costs arising on the issue of equity instruments are recognised directly in equity and transaction costs arising on the issue of debt as part of the consideration are accounted for in accordance with Note 3.7.

Identifiable assets acquired and liabilities and contingent liabilities assumed in business combinations are, with limited exceptions, initially measured at their fair values at acquisition date. Goodwill represents the excess of the consideration transferred and the amount of the non-controlling interest in the acquiree over fair value of the identifiable net assets acquired. If the consideration and non-controlling interest of the acquiree is less than the fair value of the net identifiable assets acquired, the difference is recognised in profit or loss as a bargain purchase price, but only after a reassessment of the identification and measurement of the net assets acquired.

Where settlement of any part of the cash consideration is deferred, the amounts payable in future are discounted to present value at the date of exchange using the entity's incremental borrowing rate as the discount rate.

3.5 Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, allowances, duties and taxes paid. Revenue is recognised as set out below:

- revenue from the sale of goods is recognised upon the delivery of goods to customers.
- interest revenue is recognised as it accrues using the effective interest method.
- dividend revenue is recognised when the right to receive a dividend has been established.
- revenue from the rendering of a service is recognised upon the delivery of the service to the customers.

Note 3: Significant accounting policies (cont'd)

3.6 Foreign currencies

For the purpose of the consolidated financial statements, the results and financial position of each group entity are expressed in Australian dollars ('$'), which is the functional currency of Freshtel Holdings Limited and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in profit or loss in the period in which they arise.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Australian dollars using exchange rates prevailing at the end of the reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity.

On the disposal of a foreign operation, all of the accumulated exchange differences in respect of that operation attributable to the Group are reclassified to profit or loss.

3.7 Borrowings

All loans and borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the loans and borrowings using the effective interest method.

All borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

3.8 Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

3.9 Employee benefits

Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating sick leave expected to be settled within 12 months of the reporting date are recognised in other payables and provision for employee benefits in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled, including appropriate on-costs. Liabilities for non-accumulating sick leave are recognised when the leave is taken and measured at the rates paid or payable.

Contributions to defined contribution retirement benefit plans are recognised as an expense when employees have rendered service entitling them to the contributions.

3.10 Plant and equipment

Plant and equipment is carried at historical cost less accumulated depreciation or amortisation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation/amortisation is recognised so as to write off the cost or valuation of assets less their residual values over their useful lives, using the straight-line method. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

Leasehold improvements	25 - 40%
Plant and equipment	10 - 34%
Purchased software	40%

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. (refer to Note 3.12).

The gain or loss arising on the disposal or retirement of an item of plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Note 3: Significant accounting policies (cont'd)

3.11 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where appropriate, a proportion of variable and fixed overheads. Costs are assigned to individual items of inventory on the basis of weighted average cost.

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

3.12 Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment or more frequently if events or changes in circumstances indicate that they might be impaired. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If an indication of impairment exists, an estimate of the asset's recoverable amount is calculated. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

Impairment losses recognised for goodwill are not subsequently reversed.

3.13 Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with financial institutions, and bank overdrafts. For purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts. Any bank overdrafts are shown within borrowings in current liabilities on the statement of financial position.

3.14 Trade and other payables

Trade and other payables represent liabilities for goods and services provided to the Group prior to the end of financial year, which had not been settled at reporting date. These are carried at amortised cost but due to their short term nature they are not discounted. The amounts are unsecured and are usually paid within 30 days of recognition.

3.15 Provisions

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

If there is evidence of impairment for any of the Group's financial assets carried at amortised cost, the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, excluding future credit losses that have not been incurred. The cash flows are discounted at the financial asset's original effective interest rate. The loss is recognised in the statement of comprehensive income.

3.16 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. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of the acquisition as part of the purchase consideration.

3.17 Dividends

Provision is made for the amount of any dividend declared on or before the end of the financial year but not distributed at reporting date.

3.18 Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year.

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

Note 3: Significant accounting policies (cont'd)

3.19 Financial assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates designation at each financial year end, taking into account the restrictions on reclassifying to other categories.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading which are acquired principally for the purpose of selling in the short term with the intention of making a profit.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of selling the receivable. They are included in current assets, except for those with maturities greater than 12 months after the reporting date, which are classified as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method less an allowance for impairment. Trade receivables are due for settlement no more than 30 days. Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. An impairment provision is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

Available-for-sale financial assets

Available-for-sale financial assets, comprising principally marketable equity securities, are non-derivative financial assets that are either designated in this category or are not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the reporting date. Fair value gains or losses on available-for-sale financial assets are recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss reported in equity is recognised in profit or loss.

Recognition and de-recognition

Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss is initially recognised at fair value and transaction costs are expensed in the statement of comprehensive income. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership. For held-to-maturity investments, gains and losses are recognised in profit or loss when the investments are derecognised or impaired, as well as through the amortisation process.

Subsequent measurement

Available-for-sale financial assets and financial assets at fair value through profit and loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category, including interest and dividend income, are presented in the statement of comprehensive income within other income or other expenses in the period in which they arise.

Impairment

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of a security below its cost is considered in determining whether the security is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit and loss – is removed from equity and recognised in profit or loss.

3.20 Fair value

Fair values for financial instruments traded in active markets are based on quoted market prices at reporting date. The quoted market price for financial assets is the current bid price and the quoted market price. The fair value of financial instruments that are not traded in an active market are determined using valuation techniques. Assumptions used are based on observable market prices and rates at reporting date. The fair value of long-term debt instruments is determined using quoted market prices for similar instruments. Estimated discounted cash flows are used to determine fair value of the remaining financial instruments. The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the group for similar financial instruments.

Note 3: Significant accounting policies (cont'd)

3.20 Taxation

The income tax expense or gain for the period is the tax payable on the current period's taxable income based on the income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses. Deferred income tax is provided on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantially enacted. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or a liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses. Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Freshtel Holdings Limited and its wholly owned Australian subsidiaries formed a tax consolidated group with effect from 1 May 2005 and also entered into a tax sharing and funding agreement. Under the terms of this agreement, the wholly owned subsidiaries reimburse Freshtel Holdings Limited, as the head entity of the tax consolidated group, for any current income tax payable by Freshtel Holdings Limited arising in respect of their activities. There was no material impact arising from implementing tax consolidation.

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

The head entity Freshtel Holdings Limited and the controlled entities in the tax consolidated group account for their own current and deferred tax amounts.

In addition to its own current and deferred tax amounts Freshtel Holdings Limited also recognises the current tax liabilities (or assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from controlled entities in the tax consolidated group.

Assets or liabilities arising under tax funding agreements with tax consolidated entities are recognised as amounts receivable from or payable to other entities in the Group.

Any differences between amounts assumed and amounts receivable or payable under the tax funding agreement are recognised as a contribution to (or distribution from) wholly owned tax consolidated entities.

3.21 Goods and services tax

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

Cash flows are included in the statement of cash flows on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from or payable to the Australian Taxation Office, 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.

3.22 Comparative amounts

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

Note 4: Critical accounting judgments and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in Note 3, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

4.1 Critical judgements in applying accounting policies

The following are the critical judgements that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Income tax

The Group is subject to income taxes in Australia and jurisdictions where it has foreign operations. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses. Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

In addition, the Group has recognised deferred tax assets relating to carried forward tax losses to the extent there are sufficient taxable temporary differences (deferred tax liabilities) relating to the same taxation authority and the same subsidiary against which the unused tax losses can be utilised. However, utilisation of the tax losses also depends on the ability of the entity to satisfy certain tests at the time the losses are recouped.

Note 5: Segment information

5.1 Adoption of AASB 8 Operating Segments

The Group has applied AASB 8 Operating Segments from 1 July 2009. AASB 8 requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. This has resulted in an increase in the number of reportable segments presented, as the previously reported single business segment has been disaggregated into four separate segments for products [Fixed VoIP and White Label]. These business segments are reported by geographic location being Australia and the United Kingdom.

Operating segments are reported in a manner that is consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker has been identified as the Board and management team that makes strategic decisions.

5.2 Description of segments

Management has determined the operating segments based on the reports reviewed by the Board and management team that are used to make strategic decisions. The Board and management team currently consists of all Board members and the CFO.

The Board and management team considers the business from both a product and a geographic perspective and has identified four reportable segments. Fixed VoIP consists of call termination revenue sold both in Australia and the United Kingdom. White label consists of licence fees, capacity contribution, service management, active subscribers, hardware royalties and change request fees sold predominately in the United Kingdom. The Board and management team monitors the performance of those business segments by geographical location. All other segments consist of the non-material remainder of the business.

No information is disclosed for segment assets as no measure of segment assets is regularly provided to the chief operating decision maker. This is permitted by an amendment to AASB 8 that is included in AASB 2009-5, which was early adopted from 1 July 2009.

Note 5: Segment information (Cont'd)

5.3 Segment revenues and results

	Fixed VoIP		White label		All other segments	Total
	Australia	UK	Australia	UK		
	$	$	$	$	$	$
2010						
Total segment revenue	414,356	291,986	1,009	453,158	12,565	1,173,074
Revenue from external customers	414,356	291,986	1,009	453,158	12,565	1,173,074
Adjusted gross profit	17,521	47,032	872	451,873	12,565	529,863
2009						
Total segment revenue	631,934	526,765	182,025	807,583	224,780	2,373,087
Revenue from external customers	631,934	526,765	182,025	807,583	224,780	2,373,087
Adjusted gross profit	294,086	36,457	182,025	807,583	(95,499)	1,224,652

The Board and management team assesses the performance of the operating segments based on a measure of adjusted gross profit. This measurement basis excludes the effects of non-recurring expenditure from the operating segments such as restructuring costs and legal expenses. Furthermore, the measure excludes the effects of equity-settled share-based payments and unrealised gains/losses on financial instruments. Interest income and expenditure are not allocated to segments, as this type of activity is driven by the central treasury function, which manages the cash position of the group. The central treasury function is not a reportable segment.

Adjusted gross profit reconciles to operating loss before income tax as follows:

	Consolidated Entity	
	2010	**2009**
	$	$
Adjusted gross profit	**529,863**	1,224,652
Depreciation and amortisation expense	**(350,942)**	(4,067,165)
Finance expenses	**(576,187)**	(566,131)
Interest revenue	**25,889**	254,230
Legal expenses	**(94,452)**	(49,930)
Management costs	**(542,441)**	(1,618,169)
Operational expenses	**(1,378,533)**	(2,697,784)
Research and development expenses	**(1,023,427)**	(3,148,880)
Foreign currency translation reserve reclassified to profit	**2,540,928**	-
Loss before income tax	**(869,302)**	(10,669,177)

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Note 6: Revenue		
6.1 Revenue from continuing operations		
Sales revenue		
Sale of goods	**-**	206,129
Provision of services	**427,929**	813,958
	427,929	1,020,087
Interest revenues		
Other corporations	**25,813**	245,352
Total revenue from continuing operations	**453,742**	1,265,439
6.2 Revenue from discontinued operations		
Sales revenue		
Sale of goods	**-**	18,652
Provision of services	**745,145**	1,334,348
	745,145	1,353,000
Interest revenues		
Other corporations	**76**	8,878
Total revenue from discontinued operations	**745,221**	1,361,878
Note 7: Loss for the year from continuing operations		
Loss for the year from continuing operations is attributable to:		
Owners of Freshtel Holdings Limited	**(3,172,463)**	(9,394,017)
Loss for the year from continuing operations includes the following expenses:		
7.1 Employee benefits expense		
Personnel and salaries	**1,413,093**	3,702,832
Defined contribution superannuation	**115,367**	441,937
Share based payments	**-**	(222,609)
Other employee benefits	**(34,599)**	374,027
Total employee benefits expense	**1,493,861**	4,296,187
7.2 Depreciation		
Plant and equipment	**350,942**	537,336
Total depreciation	**350,942**	537,336
7.3 Amortisation		
Development costs	**-**	1,104,321
Impairment	**-**	2,027,521
Total amortisation	**-**	3,131,842
Total depreciation, amortisation and impairment	**350,942**	3,669,178
7.4 Finance costs		
Interest paid and payable	**33,633**	4,036
7.5 Rental expense on operating leases		
Minimum lease payments	**144,394**	598,253

Note 8: Discontinued operations

8.1 Disposal of Freshtel UK Limited

On 30 April 2010, the board of directors entered into a sale agreement to dispose of Freshtel UK Limited, which carried out the Group's overseas VoIP operations. The directors viewed this as a positive move for the Company as its UK business has been operating at a significant loss, and would otherwise have been closed down. The disposal of the UK assets, along with its UK tax losses, reduced the Company's ongoing operating expenses. The disposal was completed on 30 April 2010, on which date control of the operations passed to the acquirer.

The UK operations, as no other offers were received, has been sold to a related party, and the board will seek formal shareholder approval at the next EGM/AGM, however as time was of the essence to preserve tax losses and achieve value, Freshtel obtained voting intentions of members entitled to vote that contributed to more than 50% of the vote (UBS Wealth Management Australia Nominees Pty Ltd and Tesco PLC). Maximum value has been obtained for these assets.

Details of the assets and liabilities disposed of, and the calculation of the profit on disposal, are disclosed in Note 30.

8.2 Analysis of loss for the year from discontinued operations

The results of the discontinued operations included in the statement of comprehensive income are set out below. The comparative profit and cash flows from discontinued operations have been re-presented to include those operations classified as discontinued in the current period.

	Consolidated Entity	
	2010	2009
	$	$
Profit / (loss) for the year from discontinued operations		
Revenue	**745,221**	1,361,878
Other income	**(8,106)**	578,019
	737,115	1,939,897
Expenses	**(965,031)**	(2,727,353)
Loss for the year	**(227,916)**	(787,456)
Net gain on disposal of subsidiary	**124,476**	-
Foreign currency translation reserve reclassified to profit	**2,540,928**	-
Profit for the year from discontinued operations	**2,437,488**	(787,456)
Profit / (loss) for the year from discontinued operations is attributable to:		
Owners of Freshtel Holdings Limited	**2,437,488**	(787,456)

Note 9: Earnings per share		
Basic earnings / (loss) per share (cents)		
From continuing operations	(0.79)	(4.49)
From discontinued operations	0.61	(0.37)
Total basic earnings / (loss) per share	(0.18)	(4.86)
Diluted earnings / (loss) per share (cents)		
From continuing operations	(0.79)	(4.49)
From discontinued operations	0.61	(0.37)
Total diluted earnings / (loss) per share	(0.18)	(4.86)
Reconciliation of earnings to profit and loss		
Loss used in calculation of basic loss per share from continuing operations	**(3,172,463)**	(9,394,017)
Loss for the year from discontinued operations used in calculation of basic loss per share from discontinued operations	**2,437,488**	(787,456)
Loss used in calculation of total basic loss per share	**(734,975)**	(10,181,473)
Weighted average number of shares used as a denominator:	**No.**	**No.**
In calculating basic earnings per share	402,235,392	209,302,032
Weighted average number of options outstanding	-	992,095
Weighted average number of converting performance shares on issue	-	17,089,619
In calculating diluted earnings per share	402,235,392	227,383,746

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Note 10: Income Tax		
10.1 Income tax recognised in profit or loss		
Current tax expense in respect of the current year	**(134,327)**	(232,035)
Deferred tax expense relating to origination & reversal of temporary differences	**-**	(255,669)
Total tax expense relating to continuing operations	**(134,327)**	(487,704)
The expense for the year can be reconciled to the accounting loss as follows:		
Loss from continuing operations	**(3,306,790)**	(9,881,721)
Income tax expense calculated at 30% (2009: 30%)	**(992,037)**	(2,964,516)
Tax effect of amounts which are not (deductible)/taxable in calculation		
Amortisation of development costs	-	(939,553)
Non allowable / deductible items	**(69,708)**	(94,090)
R&D tax concession	**(134,327)**	(232,035)
Movement on deferred tax asset not recognised	**1,061,745**	3,742,490
Income tax expense attributable to ordinary activities	**(134,327)**	(487,704)
10.2 Tax losses		
Unused tax losses for which no deferred tax asset has been recognised		
Potential tax benefit @ 30%	**8,877,253**	7,732,865

10.3 Tax consolidation

Freshtel Holdings Limited and its wholly owned Australian controlled entities have implemented the tax consolidation legislation as of 1 May 2005. The accounting policy in relation to this legislation is set out in Note 3.20. On adoption of the tax consolidation legislation, the entities in the tax consolidated Group entered into a tax sharing agreement, which, in the opinion of the Directors, limits the joint and several liability of the wholly-owned entities in the case of a default by the head entity, Freshtel Holdings Limited.

The entities have also entered into a tax funding agreement under which the wholly-owned entities fully compensate Freshtel Holdings Limited for any current tax payable assumed and are compensated by Freshtel Holdings Limited for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to Freshtel Holdings Limited under the tax consolidation legislation. The funding amounts are determined by reference to the amounts recognised in the wholly-owned entities' financial statements.

The amounts receivable/payable under the tax funding agreement is due upon receipt of the funding advice from the head entity, which is issued as soon as practicable after the end of each financial year.

The head entity may also require payment of interim funding amounts to assist with its obligations to pay tax instalments. The funding amounts are recognised as current inter-company receivables or payables.

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Note 11: Cash and cash equivalents		
Cash at bank	**716,785**	2,066,630
Term deposits	**51,886**	300,000
	768,671	2,366,630

The effective interest rate on term deposits was 4.5% (2009: 8.3%).
The Group's exposure to interest rate risk is discussed in Note 26.

NOTES TO THE FINANCIAL STATEMENTS

Note 11: Cash and cash equivalents (Cont'd)

11.1 Reconciliation of loss for the period to net cash flows from operating activities

	Consolidated Entity	
	2010	2009
	$	$
Loss for the year	**(734,975)**	(10,181,473)
Non-cash flows in loss for the year		
Depreciation and amortisation	**462,160**	1,980,199
Foreign currency translation reserve reclassified to profit	**(2,540,928)**	-
Impairment of intangible asset	**-**	2,086,966
Write-off of fixed assets	**92,155**	-
Movements in working capital		
Decrease in trade and other debtors	**765,411**	163,830
Decrease in inventories	**-**	182,687
Decrease / (Increase) in prepayments	**245,116**	183,417
Decrease / (Increase) in deferred tax	**-**	(255,669)
(Decrease) / Increase in payables	**(510,667)**	(342,594)
(Decrease) / Increase in provisions	**(444,446)**	(128,558)
	(2,666,174)	(6,311,195)

Note 12: Trade and other receivables

12.1 Current

Trade receivables	**31,765**	143,860
Other receivables	**-**	803,316
	31,765	947,176

12.2 Non-Current

Security deposits	**-**	168,224

Note 13: Inventories

Finished goods – at cost	**5,000**	5,000

Note 14: Other assets

Prepayments	**54,287**	131,180
Other	**9,459**	-
	63,746	131,180

Note 15: Subsidiaries

The ultimate parent entity of the Group is Freshtel Holdings Limited. The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries, in accordance with the accounting policy in Note 3.3. The proportion of ownership interest is equal to the proportion of voting power held.

	Country of Incorporation	Equity Holding	
		2010	2009
		%	%
Subsidiaries of Freshtel Holdings Limited			
Freshtel Australia Pty Limited	Australia	**100**	100
Freshtel UK Limited	United Kingdom	**-**	100
Subsidiaries of Freshtel Australia Pty Limited			
Freshtel Pty Limited	Australia	**100**	100
Freshtel R&D Pty Limited	Australia	**100**	100
Voicedot Networks Pty Limited	Australia	**100**	100
Virbiage Pty Limited	Australia	**100**	100

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Note 16: Plant and equipment		
Leasehold improvements		
Leasehold improvements at cost	**65,303**	25,712
Accumulated amortisation	**(10,208)**	(17,732)
Net carrying amount of leasehold improvements	**55,095**	7,980
Purchased software		
Purchased software at cost	**515,293**	714,692
Accumulated depreciation	**(314,530)**	(572,122)
Net carrying amount of purchased software	**200,763**	142,570
Plant and equipment		
Plant and equipment at cost	**975,708**	2,268,482
Accumulated depreciation	**(906,633)**	(1,867,715)
Net carrying amount of plant and equipment	**69,075**	400,767
Leased plant and equipment		
Leased plant and equipment at cost	**-**	98,724
Accumulated amortisation	**-**	(98,724)
Net carrying amount of leased plant and equipment	**-**	-
Total plant and equipment	**324,933**	551,317

16.1 Movements in carrying amounts

Movements in the carrying amounts for each class of plant and equipment between the beginning and the end of the current financial year are reconciled as follows:

	Leasehold Improvements $	Purchased Software $	Plant & Equipment $	Leased Plant & Equipment $	Total $
Consolidated entity: 2009					
Balance at the beginning of year	15,473	342,788	905,856	15,944	1,280,061
Assets purchased	-	12,429	52,188	-	64,617
Depreciation and amortisation expense	(7,493)	(212,647)	(557,277)	(15,944)	(793,361)
Carrying amount at the end of the year	7,980	142,570	400,767	-	551,317
Consolidated entity: 2010					
Balance at the beginning of year	7,980	142,570	400,767	-	551,317
Assets purchased	65,303	250,000	53,410	-	368,713
Assets disposed	(7,448)	(52,265)	(73,224)	-	(132,937)
Depreciation and amortisation expense	(10,740)	(139,542)	(311,878)	-	(462,160)
Carrying amount at the end of the year	55,095	200,763	69,075	-	324,933

NOTES TO THE FINANCIAL STATEMENTS

	Consolidated Entity	
	2010	2009
	$	$
Note 17: Trade and other payables		
17.1 Current		
Trade payables	**209,282**	581,140
Sundry payables and accrued expenses	**116,995**	220,571
Income in advance	**35,722**	70,951
	361,999	872,662
17.2 Non-Current		
Other loans	-	154,940
	-	154,940
Note 18: Provisions		
18.1 Current		
Provision for employee benefits	**4,385**	142,964
Provision for lease incentives	-	25,215
Provision for onerous contracts	-	100,000
Provision for fringe benefits tax	-	7,607
	4,385	275,786
18.2 Non-Current		
Provision for employee benefits	-	40,761
Provision for lease incentives	-	37,822
Provision for onerous contracts	-	85,000
	-	163,583
Note 19: Intangible assets		
Development costs	-	5,294,094
Accumulated amortisation and impairment	-	(5,294,094)
Net carrying value of development costs	-	-
Balance at the beginning of the year	-	2,173,181
Additions from internal developments	-	1,100,623
Amortisation expense	-	(1,186,838)
Impairment losses recognised in profit or loss	-	(2,086,966)
Balance at the end of the year	-	-

Intangible assets have finite useful lives. The current amortisation charges in respect of intangible assets are included under depreciation and amortisation expense per the statement of comprehensive income and Note 7.

NOTES TO THE FINANCIAL STATEMENTS

	Consolidated Entity	
	2010	2009
	$	$
Note 20: Borrowings		
20.1 Unsecured		
Other loans	**350,000**	-
Note 21: Provisions for employee benefits		
21.1 Current		
Provision for annual leave	**4,385**	142,964
21.2 Non-Current		
Provision for long service leave	**-**	40,761
21.3 Employee numbers		
Number of full-time equivalent employees	**3**	30

21.4 Superannuation plan

The Company contributes to accumulation type employee superannuation plans in accordance with statutory requirements in Australia. In the UK the Company contributes to National Insurance in accordance with statutory requirements.

Note 22: Issued Capital		
615,563,785 fully paid ordinary shares (2009: 280,540,318)	**38,254,777**	37,096,277

22.1 Fully paid ordinary shares

		Consolidated Entity	
Date	**Details**	**Number of shares**	**$**
1 July 2008	**Opening Balance**	92,622,301	34,976,979
5 August 2008	Employee options exercised	230,000	163,142
5 August 2008	In lieu of services	90,000	20,700
15 August 2008	In lieu of services	301,304	69,300
3 October 2008	Employee options exercised	23,333	16,550
3 October 2008	In lieu of services	266,668	40,000
13 January 2009	In lieu of services	650,646	32,532
5 May 2009	Rights issue – underwriting entitlement	3,653,671	36,537
8 May 2009	Rights issue	182,683,536	1,826,835
13 May 2009	In lieu of services	208,859	3,887
30 June 2009	Less: transaction costs arising on share issue	-	(90,185)
30 June 2009	**Balance**	**280,730,318**	**37,096,277**
27 April 2010	Private placement	55,172,752	206,894
2 June 2010	Rights issue	279,850,715	1,049,448
30 June 2010	Less: transaction costs arising on share issue	-	(97,842)
30 June 2010	**Balance**	**615,753,785**	**38,254,777**

The issued share capital of the consolidated entity comprises the value of the share capital of Freshtel Australia Pty Limited prior to the reverse acquisition of Freshtel Holdings Limited, the value of the share capital issued as a result of this reverse acquisition, and the share capital issued by the Group to outside shareholders by Freshtel Holdings Limited after the date of the acquisition, net of the costs associated with capital raisings.

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of and amounts paid on the shares held. On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Note 23: Reserves		
Foreign currency translation	**-**	2,648,350
23.1 Foreign currency translation reserve		
Balance at beginning of year	**2,648,350**	2,658,715
Foreign currency translation reserve differences	**(107,422)**	(10,365)
Foreign currency translation reserve reclassified to profit	**(2,540,928)**	-
Balance at end of year	**-**	2,648,350

The foreign currency translation reserve is used to record exchange differences on translation of foreign controlled subsidiaries. Amounts are reclassified to profit or loss when the investment is disposed of.

Note 24: Accumulated losses		
Balance at beginning of year	**(37,042,071)**	(26,860,598)
Net loss attributable to members of the Company	**(734,975)**	(10,181,473)
Balance at end of year	**(37,777,046)**	(37,042,071)

Note 25: Dividends

No dividends were paid or declared throughout the year (2009: $0).

Note 26: Financial instruments

26.1 Capital risk management

Management controls the capital of the Group in order to maintain statement of financial position strength, and provide the shareholders with adequate returns and ensure that the Group can fund its operations and continue as a going concern.

The Group has a loan facility for $1M in place with Custodial Capital Management Pty Ltd that it will draw down on an as needs basis. The terms and conditions are as follows:

- maximum $1M drawdown over two years; repayable by August 2011.
- 10% draw down fee on the draw down amount; 10% interest calculated monthly, payable quarterly.

By monitoring the cash position through ongoing cash forecasting, management ensures that there is sufficient cash on hand to meet the Group's working capital requirement for at least one year. If the cash reserves fall below this point, management will consider all alternatives to raise further funds.

26.2 Financial risk management objectives

The Group's activities expose it to a variety of financial risks: market risk (including foreign currency risk and interest rate risk), credit risk and liquidity risk. The Group's overall risk management program seeks to minimise potential adverse effects on the financial performance of the Group. The Group uses different methods to measure different types of risk to which it is exposed. These methods include treasury operations in the case of interest rate and foreign exchange risks, and active credit management for credit risk.

The Group hold the following financial instruments:

	Consolidated Entity 2010 $	Consolidated Entity 2009 $
Financial Assets		
Cash	**768,671**	2,366,630
Trade and other receivables	**31,765**	947,176
	800,436	3,313,806
Financial Liabilities		
Trade and other payables	**361,999**	872,662

Note 26: Financial instruments (cont'd)

26.3 Market risk

Foreign currency risk

As the Group disposed of the subsidiary during the year (Freshtel UK), the Group had no exposure to foreign currency risk at the reporting date.

Interest rate risk

The Groups main interest rate risk arises from cash and term deposits. During 2010 and 2009 the Group's term deposits were denominated in AU$ and GB£. At the reporting date, the Group held the following term deposits:

	2010		2009	
	Weighted average interest rate	**Balance $**	**Weighted average interest rate**	**Balance $**
Term deposits	**4.5%**	**51,886**	8.3%	300,000

Group sensitivity

At 30 June 2010, if interest rates had changed by +/- 10 basis points from the year end rates with all other variables held constant, the post tax profit for the year would have been $519 higher/lower (2009: change of +/- 10 basis points: $3,000 higher/lower).

26.4 Credit risk

Credit risk is managed on a group basis. Credit risk arises from cash and cash equivalents, deposits with banks and financial institutions, as well as credit exposures to wholesale customers, including outstanding receivables. All deposits with banks are placed with the Group's corporate bankers which have independent rating of at least 'A'. Each wholesale customer is engaged by way of a commercial agreement and independently credit checked. The credit quality of financial assets that are neither past nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates.

	Consolidated Entity	
	2010 $	2009 $
Trade receivables		
Counterparties with external rating A or above A	**30,326**	141,992
Counterparties without external rating A or above A		
Existing customers for more than six months with no prior defaults	**1,439**	1,868
Total trade receivables	**31,765**	143,860
Cash at bank and short term deposits		
External rating AAA	**91,508**	509,366
External rating AA	**677,163**	1,857,264
Total bank and short-term deposit balances	**768,671**	2,366,630

The maximum exposure to credit risk amounts to $800,436 (2009: $2,510,490) for the consolidated entity.

26.5 Liquidity risk

Prudent risk management implies maintaining sufficient cash to meet ongoing liabilities. The Group manages liquidity by continually monitoring forecast and actual cash flows. Surplus funds are only invested in highly liquid markets.

The contractual maturities of current financial liabilities of the group are all due within six months of year end.

The maximum exposure to liquidity risk amounts to $361,999 (2009: $872,662) for the consolidated entity.

Note 27: Key management personnel

27.1 Remuneration

The remuneration paid to the key management persons was paid through the controlled entities of Freshtel Holdings Limited, being Freshtel UK Limited and the parent entity Freshtel Holdings Limited.

	Consolidated Entity	
	2010	2009
	$	$
Short-term employee benefits	**534,099**	1,451,807
Post-employment benefits	**20,622**	59,640
Total compensation	**554,721**	1,511,447

27.2 Equity instrument disclosures relating to key management personnel

Options and rights holdings

The numbers of options over ordinary shares in the Company held during the financial year by key management personnel of the Group, including their personally related parties, are set out below.

During the year ended 30 June 2009 options over the ordinary shares of Freshtel Holdings Limited were issued to key executives but these either expired or were forfeited by the executives concerned during the previous financial year.

2009 Key Management Personnel	**Balance at start of year**	**Granted during period**	**Exercised during period**	**Other change**	**Quantity held at 30.6.2009**	**Vested at 30.6.2009**	**Vested & exercisable at 30.6.2009**
Mr L Taylor	100,000	-	(50,000)	(50,000)	-	-	-
Ms J Macpherson	33,334	300,000	(33,333)	(300,001)	-	-	-
Mr K Loughnan AO	250,000	-	-	(250,000)	-	-	-
Mr J McMullan	66,667	-	-	(66,667)	-	-	-
Mr D Hazell	86,667	8,500	-	(95,167)	-	-	-
Ms R O'Donnell	-	1,750,000	-	(1,750,000)	-	-	-
Mr I Jackson	-	750,000	-	(750,000)	-	-	-
Total	536,668	2,808,500	(83,333)	(3,261,835)	-	-	-

Shareholdings

The numbers of ordinary shares in the Company held during the financial year by key management personnel of the Group, including their personally related parties, are set out below.

Key Management Personnel	**Balance at 1.7.2009**	**Granted as remuneration**	**Received on exercise of options or rights**	**Other changes**	**Balance at 30.6.2010**
Ms Jan Macpherson	2,275,525	-	-	(1,275,525)	1,000,000
Ms Rhonda O'Donnell	1,695,440	-	-	-	1,695,440
Mr Dan Hazell	366,333	-	-	-	366,333
Total	4,337,298	-	-	(1,275,525)	3,061,773

27.3 Loans to key management personnel

There were no loans to Directors of the Company and other key management personnel.

27.4 Other transactions with key management personnel

There were no other transactions with key management personnel.

NOTES TO THE FINANCIAL STATEMENTS

Note 28: Related party transactions

28.1 Parent entity

The immediate parent and ultimate controlling party respectively of the Group is Freshtel Holdings Limited.

28.2 Subsidiaries

Interests in subsidiaries are set out in Note 15.

28.3 Key management personnel

Disclosures relating to key management personnel are set out in Note 27.

28.4 Trading transactions

Transactions between related parties are on normal commercial terms and conditions no more favourable than those available to other parties unless otherwise stated. The following transactions occurred with director related parties:

	Consolidated Entity	
	2010	2009
	$	$
Services rendered by related parties and their entities		
Network management, monitoring and fault rectification	**236,000**	-
Customer support and account management	**93,956**	-
Internet connection and SIP trunks	**70,217**	-
	400,173	-

28.5 Loans to other related parties

There were no loans to other related entities at 30 June 2010 (30 June 2009: $ nil)

28.6 Loans from other director related parties

The Group has a loan facility for $1M in place with Custodial Capital Management Pty Ltd that it will draw down on an as needs basis. The terms of this loan are set out in Note 26.

28.7 Outstanding balances arising from sales / purchases of goods and services

Outstanding balances arising from sales at 30 June 2010 were $23,036; outstanding balances arising from purchases of goods and services were $66,061 (30 June 2009: $ nil)

28.8 Other matters

Under income tax consolidation legislation, Freshtel Holdings Limited assumes responsibility for the income tax payable by the consolidated tax group comprising Freshtel Holdings Limited and its wholly-owned entities. A tax sharing and funding agreement (TSA) between Freshtel Holdings Limited and its wholly owned entities covers the funding, accounting and calculation of the tax liability for each individual entity, and also caters for entities joining and exiting the Group. Under the terms of the TSA, Freshtel Holdings Limited has appointed Freshtel Australia Pty Limited as its agent for the purpose of making tax payments and will reimburse that entity through the inter-company loan account for amounts paid except for the tax allocated to that entity.

The Group disposed of a subsidiary to a director related party during the year, as set out in Note 30.

The Group had access to rent free premises, supplied by a director related party during the year.

	Consolidated Entity	
	2010	2009
	$	$
Note 29: Operating lease arrangements		
29.1 Leasing arrangements		
Non-cancellable operating leases contracted for at the reporting date but not capitalised in the financial statements include the following:		
Payable – not later than 1 year	**-**	290,932
– later than 1 year and not later than 5 years	**-**	498,013
	-	788,945

Note 30: Disposal of subsidiary

On 30 April 2010, the board of directors entered into a sale agreement to dispose of Freshtel UK Limited, which carried out the Group's overseas VoIP operations.

	Year ended 30 June 2010 $	Year ended 30 June 2009 $
30.1 Consideration received		
Consideration received in cash and cash equivalents	**150,000**	-
30.2 Analysis of assets and liabilities over which control was lost		
Non-current assets		
Plant and equipment	**25,524**	-
Non-Current Liabilities		
Trade and other payables to Freshtel Holdings Limited	**(7,727,647)**	-
Net assets disposed of	**(7,702,123)**	-
30.3 Gain on disposal of subsidiary		
Consideration received	**150,000**	-
Net assets disposed of excluding trade and other payables	**(25,524)**	-
Gain on disposal	**124,476**	-

Note 31: Commitments for expenditure

There was no capital expenditure commitments contracted for at the reporting date.

	Consolidated Entity	
	2010 $	2009 $
Note 32: Contingent liabilities		
The consolidated entity had contingent liabilities at 30 June 2009 in respect of bank guarantees given to Optus Pty Ltd to the maximum of:	**-**	200,000

During the year the bank guarantee was reduced to $50,000 and subsequently returned on 22 June 2010.

	Consolidated Entity	
	2010 $	2009 $
Note 33: Remuneration of auditors		
33.1 Auditor of the parent entity		
Audit or review of the financial statements	**48,690**	67,074
33.2 Other auditors		
Audit or review of the financial statements: Freshtel UK Limited	**-**	33,950

Note 34: Events after the reporting period

No matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of the consolidated entity in future financial years.

Note 35: Parent entity information

The following details information related to the parent entity, Freshtel Holdings Limited, at 30 June 2010. The information presented here has been prepared using the consistent accounting policies as set out in Note 3.

	Consolidated Entity	
	2010	2009
	$	$
Current assets	**777,353**	2,401,522
Non-current assets	**3,424**	7,980
Total assets	**780,777**	2,409,502
Current liabilities	**(265,045)**	(492,192)
Non-current liabilities	**(350,000)**	(318,523)
Total liabilities	**(615,045)**	(810,715)
Net assets	**165,732**	1,598,787
Issued capital	**48,563,826**	47,405,329
Accumulated losses	**(48,398,094)**	(45,806,542)
Total equity	**165,732**	1,598,787
Loss for the year	**(2,591,551)**	(19,249,070)
Other comprehensive income / (loss) for the year	**-**	-
Total comprehensive loss for the year	**(2,591,551)**	(19,249,070)

Note 36: Approval of financial statements

The financial statements were approved by the board of directors and authorised for issue on 30 August 2010. The Company has the power to amend and reissue this report.

Additional stock exchange information.

Freshtel Holdings Limited

Ordinary share capital as at 20 September 2010

704,443,069 fully paid ordinary shares are held by 1,303 individual shareholders.

Distribution of holders of equity securities as at 31 August 2010

	Total Holders	Units	% Issued Capital
1 – 1,000	85	49,325	0.01
1,001 – 5000	258	809,047	0.11
5,001 – 10,000	212	1,790,447	0.25
10,001 – 100,000	474	19,165,746	2.72
100,001 and over	274	682,628,504	96.91
	1,303	**704,443,069**	**100.00**

Unmarketable parcels as at 20 September 2010

	Min parcel size	Holders	Units
Min $500.00 parcel @ 0.003 per unit	**166,667**	**1,096**	**30,673,876**

Substantial shareholders as at 20 September 2010

	Units	% Issued Capital
Custodial Capital Management Pty Ltd	174,392,082	24.76
UBS Wealth Management Australia Nominees Pty Ltd	118,618,879	16.84
Citystyle Holdings Pty Ltd	60,972,752	8.66
Boundary Nominees Pty Ltd	49,972,752	7.09
Dequetteville Nominees Pty Ltd	36,000,000	5.11

Twenty largest holders of quoted equity securities as at 20 September 2010

	Units	% Issued Capital
Custodial Capital Management Pty Ltd	174,392,082	24.76
UBS Wealth Management Australia Nominees Pty Ltd	118,618,879	16.84
Citystyle Holdings Pty Ltd	60,972,752	8.66
Boundary Nominees Pty Ltd	49,972,752	7.09
Dequetteville Nominees Pty Ltd	36,000,000	5.11
Tesco PLC	26,636,423	3.78
Mr William Paul Clark	22,000,000	3.12
Brucar Pty Ltd	10,000,000	1.42
Ellenborough Securities Pty Ltd	6,000,000	0.85
Rabeko Pty Ltd	5,900,000	0.84
Clem Jones Pty Ltd	5,500,000	0.78
Ashton Super Pty Ltd	5,300,000	0.75
Bridgesun Pty Ltd	5,300,000	0.75
Ms Jillian Rutledge	4,739,018	0.67
Mr Peter Oswald Buttery & Dr Tanya Karen Buttery	4,120,000	0.58
Mr David Koelmel & Mr Pamela Koelmel	3,966,248	0.56
Ms Xiao Ling Liu	3,000,000	0.43
Mr Bernard Pang & Mrs Shirley Pang	2,600,000	0.37
Higgins Clan Pty Ltd	2,582,394	0.37
Meldex Pty Ltd	2,470,000	0.35
	550,070,548	78.08

Voting rights

The voting rights attaching to each class of security are set out below.

Ordinary shares

On a show of hands, each member present in person and each other person present as a proxy of a member has one vote. On a poll each member present in person has one vote for each fully paid share owned by the member and each person present as a proxy of a member has one vote for each fully paid share held by the member that the proxy represents.

CORPORATE INFORMATION

Freshtel Holdings Limited	ACN 111 460 121
Directors	Dr Allan Sullivan Mr Andy Dewhurst Dr Kenneth Carr
Company Secretary	Mr Graham Henderson
Annual General Meeting	23rd November 2010
Registered Office	Level 1, 121 – 127 High Street, Prahran, Victoria 3181
Share Registry	Computershare Investor Services Pty Ltd
Stock Exchange Listing	Australian Securities Exchange (FRE)
Auditors	BDO Audit (NSW-VIC) Pty Ltd
Lawyers	Church & Grace
Bankers	Westpac Banking Corporation – Australia