Sunshine Heart, Inc.

Annual Report 2007

Sunshine Heart is a global medical device company, committed to the commercialisation of the C-Pulse™ an implantable, non-blood contacting, heart assist device for the treatment of people with heart failure. These patients include a large and under-served potential market segment and provide a significant market opportunity for the Company.

Contents

Notice of Meeting

The Annual General Meeting of Sunshine Heart, Inc. will be held at the offices of Henry Davis York, 44 Martin Place, Sydney on Thursday 15 November 2007 at 12 noon.

Chairman's Letter

Dear Shareholders,

Annual General Meeting

The Directors invite shareholders to attend the 2007 Annual General Meeting to be held in Sydney on Thursday, 15 November 2007. A notice of meeting is enclosed together with the Company's 2007 Annual Report.

Milestones achieved

It has been another successful year of considerable progress for Sunshine Heart, both in the United States and at St Leonards (Sydney), in the development of the C-Pulse™ heart assist device. Highlights include:

- The **Australian and New Zealand pilot clinical trial** gathered valuable patient data on the performance of the C-Pulse device;
- An experienced US based **Clinical Director** and a new CFO were recruited;
- Another Federal Government funded **Commercial Ready Grant** (for $2.1 million) was received;
- Two very experienced **Co-principal Investigators** were appointed to lead the proposed US clinical trial;
- A **$19.8 million capital raising** was arranged; and
- An **Investigational Device Exemption (IDE)** application to commence a US clinical trial was lodged with the Food and Drug Administration (FDA).

IDE Application

The most significant operational milestone was the lodgement of the IDE application. The application included details of the Company's past preclinical and clinical studies in Australia and New Zealand. The Company is currently in discussions with the FDA on the detail of the application. Approval of the application by the FDA will be a major step towards commencing a clinical trial in the United States.

Current with the IDE preparation and lodgement, the Company has initiated a number of activities to ensure that following FDA approval, there will be minimal delay in starting the clinical trial.

Selection of Medical Institutions and Surgical Training

The Company has selected 6 university-affiliated hospitals together with a quality team of heart failure cardiologists and thoracic surgeons to undertake the initial clinical trial. These clinicians have also undertaken training in the implantation and operation of the C-Pulse device.

Appointment of Co-Principal Investigators

The Investigators will be responsible for ensuring the clinical trial is carried out in accordance with the agreed protocols, in compliance with FDA regulations and for the safety and welfare of participants. The Company is fortunate to have secured the services of Drs William Abraham and Patrick McCarthy, two leading international clinicians in heart failure management. Dr Abraham served as Co-Principal Investigator for Medtronic's heart failure pacemaker trials and Dr McCarthy is a leading cardiovascular surgeon and researcher.

Funding

The most significant financial milestone was the announcement in September 2006 of the $19.8 million equity raising, payable in two tranches. The first tranche of $13.8 million was completed in November 2006. The second tranche of $6 million is conditional on FDA approval. This funding has been applied to C-Pulse driver development, preparation of the FDA application and working capital. The balance of the funding will be applied to further working capital and to commence the US clinical trial, when approved. The Company expects to raise additional equity in 2008.

Chairman’s Letter continued

The equity raising was supported by long standing venture capital shareholders GBS Venture Partners and Three Arch Partners together with several existing shareholders, directors and new shareholders. I would like to welcome those new shareholders and in particular CM Capital Investments, the Brisbane based venture capital investment group that provided $8 million of the raising. We welcomed CM Capital partner John Brennan to the board in November 2006.

Appreciation

I would also like to express the board’s appreciation to the management team and staff for their work, insight and effort during the year. In particular, I would like to thank CEO Don Rohrbaugh for his continued leadership, Medical Director and co-founder Dr William Peters for his clinical support and COO Victor Windeyer for his management of the technology team at St Leonards.

Yours sincerely

Malcolm McComas
Chairman

23 August 2007

Chief Executive Officer's Review

Dear Shareholders,

2007 has been an important year of progress for Sunshine Heart. Thanks to the passion, focus and creativity of our people, the Company achieved significant milestones advancing the C-Pulse heart assist device forward in both our clinical priorities and operational priorities. These 2007 achievements lay the foundation for the Company's 2008 goals.

2007 Key Achievements

- Reported clinical results of the Australian and New Zealand (ANZ) clinical study
- Filed an IDE application with US FDA
- Achieved availability of the new wearable driver
- Identified and trained US university research hospitals as clinical sites
- Identified internationally renowned doctors as US study Co-Principal Investigators
- Completed and trained the US clinical team
- Arranged a $19.8 million equity raising

Clinical Priorities

US IDE Filing

In June 2007, we filed an IDE application with the FDA to initiate the C-Pulse US feasibility clinical trial. Comprising nearly 4,000 pages of detailed results of design verification and validation activities, pre-clinical studies, human clinical experiences, and system test results, the IDE filing ultimately will lead to the initiation of the US feasibility study.

US Clinical Study

We finalised plans for the C-Pulse US feasibility trial with the selection of 6 premier medical institutions that should facilitate rapid, high-quality patient enrolment. The 6 university-affiliated medical hospitals that will serve as clinical sites are:

- Ohio State University Medical Centre, Columbus, Ohio
- Northwestern University Feinberg School of Medicine, Chicago, Illinois
- Pennsylvania State University Milton Hershey School of Medicine, Hershey, Pennsylvania
- University of Florida College of Medicine, Gainesville, Florida
- University of Louisville-Jewish Hospital, Louisville, Kentucky
- University of Alabama, Birmingham, Alabama

All of these centres have extensive experience in heart failure research studies encompassing drug therapies, heart assist technologies, CRT pacemakers, and other advances in the treatment of heart failure. In May, we conducted clinical training for all investigators to enable all clinical trial participants to meet or exceed all FDA requirements to ensure C-Pulse's safety and efficacy. Held during the annual meeting of the International Society for Heart and Lung Transplantation, the training was attended by more than 40 US healthcare professionals who will be involved in achieving our US clinical feasibility trial goals. This impressive, experienced clinical team adds yet another level of excellent capability for Sunshine Heart.

Co-Principal Investigator Selection

We also secured two prominent clinicians, Drs. William Abraham of Ohio State University, Columbus, Ohio, and Patrick McCarthy of Northwestern University, Chicago, Illinois, as Co-Principal Investigators for the US feasibility trial. Dr Abraham has participated in more than 100 drug and device clinical trials, and served as international principal or co-principal investigator for several of Medtronic's heart failure pacemaker trials. Dr McCarthy, who has been recognised as an innovative and leading cardiovascular surgeon and researcher, has been a clinical investigator in several heart assist device trials and is Chairman of the Society of Thoracic Surgeons/American Association for Thoracic Surgery Joint Working Group on New Technology. These two clinicians' expertise and combined experience in heart failure management lends great credibility to the C-Pulse trial within the international medical community.

US Clinical Team

The US clinical team was formulated under the leadership of our new US Clinical Director, Mary Beth Kepler, who has extensive experience in regulatory, bioengineering and clinical affairs activities related to artificial heart, left ventricular assist devices (LVAD) and cardiac resynchronisation technologies. We also established several key strategic clinical partners. Alquest Inc., a successful Minneapolis contract research organisation with proven results in clinical management, regulatory affairs and compliance/quality systems in the heart failure category, was selected as the clinical research organisation for the study. Vital Engineering, a University of Pittsburgh based group of experienced heart and lung transplant cardio-vascular surgeons and bio-medical engineers, was selected and trained to provide device management, in-hospital patient care and out-of-hospital care-giver support for US feasibility cases. Quorum Consulting, a San Francisco based medical reimbursement team, was selected for developing the C-Pulse US reimbursement strategy. To manage the US regulatory and clinical activities, the Company expanded its California offices in Tustin, California.

Management Team Growth

The Company strengthened our experienced management team and infrastructure in preparation for initiating the US clinical feasibility trial. Victor Windeyer, SHC's Chief Operating Officer, is leading the growing Sunshine Heart team in Australia with new responsibilities as General Manager of Sunshine Heart Company Pty Ltd, a wholly owned subsidiary.

Brian Bolton, who has nearly three decades of international financial management experience, joined Sunshine Heart as our Chief Financial Officer and Company Secretary, with responsibility for the Company's financial management and investor relations activities.

ANZ Clinical Data Reported

We were pleased that the Cardiac Society of Australia and New Zealand accepted an abstract on the C-Pulse ANZ pilot clinical trial. The abstract features data from the C-Pulse pilot clinical cases conducted in several institutions in Australia and New Zealand (St. Vincent's-Sydney, Royal Perth Hospital-Perth, Monash Medical Centre-Melbourne and Auckland City Hospital-Auckland). This data also served as the foundation for C-Pulse safety and performance information presented to the US FDA as part of our feasibility trial application. The study concluded that C-Pulse was safely implanted, provided significant relief of heart failure symptoms and improved cardiac performance.

Operational Priorities

Clinical C-Pulse System Available

Following a successful development activity with our US partners, Plexus Corporation, Chicago, Illinois and Polymer Technology Group, Berkeley, California, we were pleased to announce the availability of our next-generation C-Pulse System for the US clinical study. Clinical quality implantable cuffs have exceeded their durability and reliability goals. Most importantly, the availability of a new, proprietary wearable C-Pulse Driver (illustrated below) represents a significant enhancement over the prior technology. The new smaller, more portable C-Pulse system is expected to enable greater patient mobility and improved quality of life benefits. Pre-clinical studies have validated all design and functional elements in anticipation of the system's use in the upcoming US trials.

New Wearable Driver: Clinically Available

- Preclinical studies complete
  - Driver Performance
  - System Performance
  - Data to FDA
- Smaller, portable
- Ergonomic design
- Infrared programming

Business Priorities

Financial Activities

In September 2006, the Company announced a $19.8 million financing. This financing was led by CM Capital Investments, the Brisbane based venture capital investment group, with an $8 million commitment. Existing investor, GBS Venture Partners, also committed $7 million, along with support from the other existing investors.

Financial Management

As described in the financial sections of this Annual Report, the Company completed the year with a cash position of $7.7 million plus an expected second tranche of $6 million from the recent round of financing.

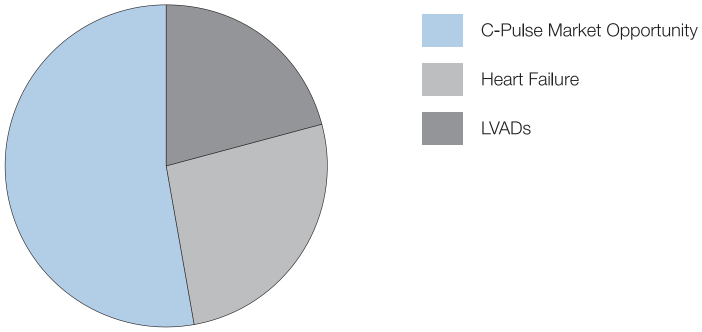
Market / Business Vision

The positive response from the US medical community to the C-Pulse US clinical trial has reinforced the market vision of the Company. The medical community clearly recognizes the unmet clinical treatment need for moderate heart failure patients and envisages that the C-Pulse could fulfil part of that clinical need.

From a market standpoint, device therapies are appropriate to Class III and IV heart failure patients. As shown below, the heart failure pacemakers provide a device therapy for approximately 30% (or 420,000 people) of the 1.4 million Class III heart failure patients in the US (about 100,000 in Australia). Pacemakers are appropriate for patients with an electrical de-synchronisation. C-Pulse provides assistance to Class III patients who are not assisted by pacemakers. As such, C-Pulse device therapy is targeting the remaining portion of those patients Class III patients (or 980,000 people). C-Pulse is not targeting Class IV patients (400,000 people) and as such does not compete against LVADs.

Class III and IV Heart Failure Opportunity (in 000's)

Device Therapies targeted for Class III (CRT Pacemakers and C-Pulse) & Class IV (LVADs) heart failure



Importantly from a market acceptance standpoint, the C-Pulse has similar cost parameters (device plus hospitalisation) as pacemakers and is simple to implant. Both therapies provide relief of symptoms for their particular clinical condition, however, the C-Pulse has two distinct advantages over LVADs:

- C-Pulse is non-blood contacting
- C-Pulse provides a significant increase in blood flow to the heart's muscle.

These advantages and the unmet clinical need are motivation for the US clinical research university hospitals to engage in the US feasibility trial.

"Despite available therapies, many moderate heart failure patients remain moderately or severely disabled. There is a need for additional therapies. The C-Pulse approach promises to improve poor cardiac output."

Professor William Abraham, MD
Ohio State University

"I'm looking forward to offering patients a heart support device, without the risks inherent in VAD technology, to much earlier heart failure patients. C-Pulse is a major step in the right direction."

Professor Patrick McCarthy, MD
Northwestern University

Looking Ahead: Company Goals For 2008

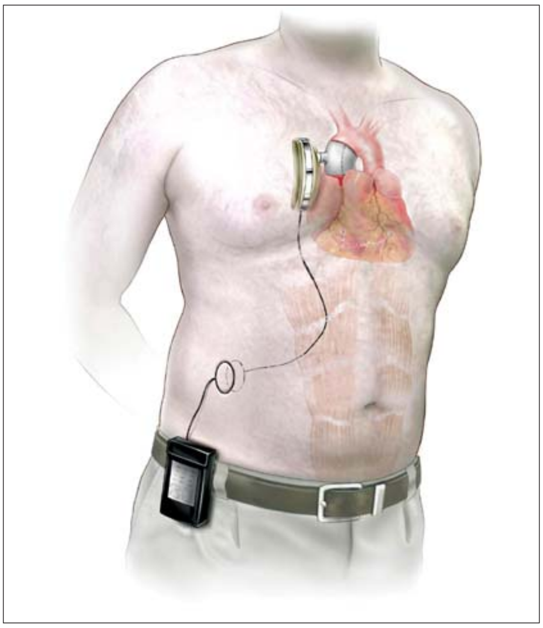
The Company's focus for fiscal year 2008 is:

- to obtain FDA approval for the US IDE C-Pulse clinical trial and then subsequent enrolment of patients into that trial; and
- to advance the development of a fully implantable C-Pulse.

At the time of this letter, the Company is pleased with its discussions on various aspects of the IDE submission with the FDA. The management team is confident that the Company is proceeding towards an effective US clinical study. This US approval will enable Sunshine Heart to enrol patients at premier US research locations and collect the clinical data that the global medical community demands to validate all new products and therapies. A successful FDA sanctioned clinical trial is the pathway to the large heart failure market.

Already, C-Pulse is the 'first non-blood contacting heart assist device to enter clinical trials,' which is an outstanding achievement.

The second 2008 Goal is to accelerate development of the next generation and fully-implanted C-Pulse. Sunshine Heart initially developed a fully implanted system. However, at the recommendation of the Company's Medical Advisors, the Company focused efforts to first validate the implantable aortic cuff using an external driver.



The Next Generation C-Pulse

- Implanted Driver
- No Percutaneous Lead
- Clinically proven Cuff
- Enhanced implanted Driver
- Skin energy transfer system
- No implanted battery
- Wearable battery system

With major benefits:

- Non-blood contacting
- Elective disconnection

The next generation C-Pulse is graphically shown above. Key to this design is the incorporation of the aortic cuff configuration that has been successfully used clinically in the ANZ study and incorporated into US IDE studies. However, rather than the cuff being inflated by an external driver, a small implanted driver will be developed, building on Sunshine Heart's first prototype design. This driver will be powered by a transcutaneous energy transfer system from an external power supply, similar to other implanted system. However, it should be noted that since this design is non-blood contacting and does not have to operate at all times, the criticality of the energy transfer is greatly diminished… thus there is no need for an implantable power backup system (internal battery) required by other heart assist systems.

An overall goal of Sunshine Heart and the C-Pulse heart assist system is to allow moderate heart failure patients a lifestyle that enables them to experience greater comfort and enjoyment by relieving their debilitating symptoms. Sunshine Heart believes that a fully implantable system will provide greater patient flexibility and convenience.

Summary

The state of the Company in 2007 has significantly advanced with several significant achievements. These include:

- the reporting of the ANZ clinical results
- the filing of the IDE requesting the FDA to initiate a US feasibility study
- completing the development of the new wearable driver concluding several years of development activities
- establishing a premier group of doctors and university-based clinical research hospitals for the study
- establishing a US based clinical support team to supplement the St. Leonards engineering team.

Building on the clinical results experienced in the Australian / New Zealand pilot study, the Company is prepared to initiate an FDA sanctioned US clinical trial in 2008. This US trial is the globally recognized pathway to the market. The Company confidently anticipates FDA approval and rapid patient enrolment thereafter.

In 2008, the Company plans to initiate further development of the 'next generation C-Pulse'. The creativity and ingenuity demonstrated in developing the C-Pulse will be applied to the next generation product.

The Company is extremely proud of the demonstrated patient performance of C-Pulse in heart failure patients:

- increases coronary flow
- unloads the heart
- increases cardiac output
- non-blood contacting
- elective disconnection

This performance uniquely positions C-Pulse for the large under-served market of moderate heart failure. We are committed to our innovative approach to heart failure, and believe C-Pulse fulfills a critical unmet clinical need for moderate heart failure patients, who represent a growing epidemic with limited therapeutic options.

I wish to thank the employees and management of the Company for their tireless dedication to the pursuit of this medical innovation. I am also thankful for the guidance provided by the Board of Directors, the Medical Advisory Board and the teams of medical research personnel committing to the C-Pulse clinical trials.

We also wish to thank you, the investors in Sunshine Heart, for your continuing support and confidence that the C-Pulse (which already has been shown to improve coronary blood flow, reduce the heart's workload and relieve patient symptoms) will halt the progression of moderate heart failure and ultimately serve as a cost-effective, long lasting therapy for patients worldwide.

Yours Sincerely,

D. G. Rohrbaugh

Donald Rohrbaugh
Chief Executive Officer

23 August 2007

Directors

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

Names, qualifications, experience and special responsibilities

Mr Malcolm McComas BEc LLB
Non-executive Chairman

Mr McComas became a director and the chairman of Sunshine Heart on 20 July 2004. He is a member of the Audit, Compliance and Corporate Governance Committee.

Mr McComas has 20 years investment banking experience and 5 years legal experience. He has experience in equity and debt finance, acquisitions and divestments, and the structuring and implementation of major equity issues and privatisations.

Since 1999, he has been a director and is now a consultant to Grant Samuel, the corporate advisory, property services and funds management group. In the previous 10 years, he established and developed County NatWest's corporate finance business which in 1998 became, through merger, the investment banking division of Salomon Smith Barney in Australia (a subsidiary of Citigroup, Inc). Mr McComas was a managing director and co head of investment banking at Salomon Smith Barney and managing director of investment banking at County NatWest.

Mr McComas has a Bachelor of Economics and a Bachelor of Laws from Monash University. He is a Senior Fellow and a National Council Member of the Financial Services Institute of Australia. During the past 3 years Mr McComas has served as a director of the following other listed companies:

- Pharmaxis Limited *
- Ion Limited – resigned February 2005.

Dr Geoffrey Brooke MBBS MBA

Dr Brooke became a director of Sunshine Heart on 25 September 2003. He is the Chairman of the Remuneration and Nomination Committee.

Dr Brooke is managing director of GBS Venture Partners Ltd, the manager of $300 million in early staged venture funds. With more than 15 years of venture capital experience, Dr Brooke has been a founder, lead investor and director of many healthcare and bioscience based companies in the US and Australia, a number of which have been sold or undertaken IPO's on either NASDAQ or ASX. A medical graduate of the University of Melbourne with five years of clinical experience, Dr Brooke holds an MBA from IMEDE (now IMD) in Switzerland. During the past 3 years Dr Brooke has served as a director of the following other listed companies:

- Cogstate Limited *
- ChemGenex Pharmaceuticals Ltd *

Dr Richard Lin MD

Dr Lin became a director of Sunshine Heart in December 2002. He is a member of the Remuneration and Nomination Committee.

Dr Lin is a Partner at Three Arch Partners, a Silicon Valley-based venture capital firm specialising in funding the development of medical technologies, healthcare services, biotechnology, and information technology. Prior to joining Three Arch Partners, he received his general surgical training at the University of California, San Francisco. He also spent time as a research scientist at the University of California, San Francisco, School of Medicine and Harvard Medical School.

* denotes current directorship

Mr Crispin Marsh BSc FAICD

Mr Marsh became a non-executive director of Sunshine Heart on 1 July 2006. He was the executive director of Corporate Affairs of Sunshine Heart, until 30 June 2006. He has been associated with Sunshine Heart since its inception in 1999, having been the inaugural Chairman of the company. Mr Marsh has been responsible within Sunshine Heart for administration, legal issues, intellectual property protection, obtaining research grants, contract negotiation and management of corporate relationships.

Mr Marsh is also managing director of SCP Technology and Growth Pty Ltd, an independent innovation commercialisation consultancy. He has been directly involved in the successful commercialisation of a number of technologies in a variety of technical fields including the medical area. It was in this role that he co-founded Sunshine Heart with Dr Peters.

An Australian patent attorney since 1969, Mr Marsh was a partner of an Australian firm of patent attorneys for nearly 30 years before establishing SCP. He has a BSc degree from the University of Sydney, is a registered mediator and a Fellow of the Australian Institute of Company Directors. Mr Marsh is also Chairman of Colocare Holdings Pty Ltd and a director of Australian Biotechnology and Healthcare Fund No. 3 Ltd.

Mr Donal O'Dwyer

Mr O'Dwyer became a non-executive director of Sunshine Heart in July 2004. He is the Chairman of the Audit, Compliance and Corporate Governance Committee.

Mr O'Dwyer relocated to Australia in 2004, having retired as worldwide president of Cordis Cardiology, the cardiology division of a Johnson & Johnson subsidiary, Cordis Corporation. In this role Mr O'Dwyer saw Cordis Cardiology move from number four to number one in market share of coronary stents worldwide. Prior to joining Cordis he worked 12 years for Baxter Healthcare, rising from plant manager in Ireland to president of the Cardiovascular Group, Europe. He brings a wealth of medical device experience to Sunshine Heart. During the past three years Mr O'Dwyer has also served as a director of the following other listed companies:

- Cochlear Limited *
- Mesoblast Limited *
- AtCor Medical Holdings Limited *

Dr William Peters MD

Medical Director and Chief Technical Officer

Dr Peters is responsible for implementing the clinical trials and defining the device development appropriate for the clinical need. Dr Peters is the inventor of the C-Pulse and was co founder and start up CEO of Sunshine Heart. He has served as a member of the Board since inception.

Dr Peters has a track record of successful invention and commercialisation in the field of cardiac technologies. He previously invented a system for endovascular cardiopulmonary bypass to allow minimally invasive cardiac surgery. This technology was assigned to Heartport, Inc, which listed on NASDAQ in 1996 and was bought by Johnson & Johnson in 1999. Dr Peters spent 2 years as a research fellow in minimally invasive cardiac surgery (1994 – 1995) at Stanford University, California. He was also employed during this time as manager of medical affairs at Heartport, Inc.

Dr Peters completed a medical degree (MB ChB) at Otago University 1989 and a Doctorate of Medicine (MD) at Monash University in 2002. Dr Peters has a strong interest in devices to support the failing heart, and has clinical experience in thoracic transplantation and use of various LVADs (including Biomedicus, Abiomed, Thoratec, Novacor and IAB systems). Dr Peters has authored or co-authored over 20 published articles and 4 book chapters regarding cardiac surgery.

Dr Peters' continued association with heart surgery, as a research fellow in cardiothoracic surgery at Auckland City Hospital, affords Sunshine Heart a direct view of developments in the heart surgery field generally, and in the field of congestive heart failure in particular.

* denotes current directorship

Mr Donald Rohrbaugh MSME

Director and Chief Executive Officer

Mr Rohrbaugh joined Sunshine Heart in September 2002 as a consultant.

Mr Rohrbaugh became the CEO in January 2003 and is responsible for implementing the Company's strategies and tactics approved by the Board of Directors.

Previously, Mr Rohrbaugh was the founding CEO and director of Acorn Cardiovascular, Inc., a company engaged in developing a non-active device treatment for heart failure. He currently serves on Acorn's Board of Directors. During Mr Rohrbaugh's role as President and Chief Executive Officer, from December 1997 to December 2001, Acorn completed 4 rounds of financing totalling $US47.6 million to advance the innovative Cardiac Support Device, CorCap, from concept to Phase II randomised clinical trials in the USA and Europe.

Mr Rohrbaugh has also served as a consultant to various venture capital firms from 2001 to 2006. At times he served as CEO for start-up companies such as Embolix, which was acquired by Edwards Lifesciences, and AMED Systems. In those roles he also served on the Board of Directors.

Prior to joining Acorn, Mr Rohrbaugh was president of eMed Corporation and acting COO of AeroGen, both venture funded device drug delivery companies. From 1977 to 1996, Mr Rohrbaugh held a variety of executive management positions with Baxter Healthcare International, including Vice President of Research and Development for the Edwards Critical Care Division and Vice President/General Manager of the Edwards MDS and the Novacor Division (an LVAD manufacturer).

Mr Rohrbaugh has over 28 years of business and product development experience in both the domestic and international medical device markets, including nearly 15 years with heart failure devices. He also has 10 years experience in the scientific instrumentation business and 4 years in the aerospace field.

Mr Rohrbaugh's formal education includes a Bachelor of Science in Mechanical Engineering from Pennsylvania University and a Master of Science in Mechanical Engineering from University of Southern California.

Mr John Brennan LLB

(appointed 1 November 2006)

Mr Brennan is a Partner of CM Capital Investments, an Australian venture capital fund manager. CM Capital Investments manages $260 million in early stage venture capital funds focused on the life sciences and telecommunications sectors. Mr Brennan has more than 15 years of venture capital, corporate finance, commercial and legal experience. Prior to joining CM Capital in 2004, Mr Brennan had experience in mergers and acquisitions, divestments, capital raisings, venture capital and private equity gained from corporate and advisory roles both internationally and in Australia. Mr Brennan started his career as a corporate and commercial lawyer in Brisbane. He subsequently gained international experience in the UK where he worked for GE Capital and Ernst & Young Corporate Finance in M&A and corporate finance roles. At GE Capital Mr Brennan had a pan European M&A role focused on acquisitions, strategic equity investments and divestments for one of its main operating businesses. Mr Brennan holds a Bachelor of Laws degree from Queensland University of Technology.

Company Secretary

Mr Brian Bolton BCom MBA FCPA

(appointed 16 April 2007)

Mr Bolton is the Chief Financial Officer and Company Secretary of Sunshine Heart since he joined the Company in April 2007. Mr Bolton is responsible for all financial, taxation, compliance (non-clinical), risk and company secretarial functions.

Mr Bolton has held various financial and treasury executive positions with Esso Australia Ltd during his 16 year tenure in both Australia and the USA. In addition he has 12 years of experience as Chief Financial Officer with ASX listed Plutonic Resources Ltd and Atlantic Gold NL.

Mr Andrew Blunden B.Com CA FEI MAICO

(resigned 31 January 2007)

Mr Blunden was the Chief Financial Officer and Company Secretary of Sunshine Heart from May 2004 to January 2007. Mr Blunden was responsible for all financial aspects related to the business of Sunshine Heart until his resignation.

Mr Blunden is a Chartered Accountant and registered tax agent who was Finance Director and CFO of LAN Systems Pty Limited, a member of the New York based Westcon Group. Prior to serving with LAN Systems, he was Group Finance Manager of Sonic Healthcare Ltd and was Company Secretary and CFO of Computershare Ltd. Mr Blunden consults to a number of public and private companies and he has a wealth of experience in managing the financial affairs of rapidly growing companies.

Director's Interests

The direct and indirect interests of the directors in the shares of the Company (including interest in options) are set out in note 22.

Earnings per Share

Basic Earnings per Share	(8.3) cents
Diluted Earnings per Share	(8.3) cents

Dividends

No dividends were paid or recommended to be paid during the year (2006: Nil).

Corporate Information

Corporate structure

Sunshine Heart, Inc. is a company limited by shares that is incorporated in Delaware, USA. It has prepared a consolidated financial report incorporating the entity that it controlled during the financial year, Sunshine Heart Company Pty Limited.

Nature of operations and principal activities

The principal activity during the year of entities within the consolidated entity was the design and development of heart assist devices.

There have been no significant changes in the nature of those activities during the year.

Employees and Consultants

The consolidated entity employed 12 employees and 4 consultants as at 30 June 2007 (2006: 8 employees and 4 consultants).

Operational and Financial Review

Group Overview

The Company has continued the development of the C-Pulse heart assist device during the year by continuing the ANZ long term human trial and continuing activities to support an IDE trial in the United States.

Operating Results for the Year

The Group incurred a net loss for the year of $11,539,413 (2006 loss – $7,035,448). The Company increased the level of its expenditure during the year, particularly the development of the C-Pulse heart assist device, in pursuit of its business objectives.

Likely Developments and Expected Results

Over the coming year, Sunshine Heart's efforts shall focus on the following key areas:

- Seeking US FDA approval to commence a US clinical trial; and
- Completing design specification on the next generation fully implantable C-Pulse device.

The Company expects to make an operating loss for the 2008 financial year. The Company's business plan necessitates continued spending in pursuit of the business objectives. The Company's ongoing success will depend on its continued ability to raise additional capital in the future.

Significant Changes in the State of Affairs

In June 2007 the Company announced that it had filed an IDE application with the FDA. This comprehensive application will initiate interaction with the FDA which is expected to ultimately lead to approval for a clinical trial being undertaken at six prestigious US university teaching hospitals commencing in the second half of 2007 or early 2008.

In November 2006 the Company announced that it had completed a $19.8 million institutional capital raising. The raising consisted of 2 tranches. Funds from the first tranche amounting to $13.8 million have been received and funds from the second tranche amounting to $6 million are expected to be received immediately following and conditional upon FDA approval of the Company's IDE application by 15 November 2007. The raising in total will result in the Company issuing 132 million new shares at $0.15 cents per share. Additionally the Company will issue 3 options for every 10 shares subscribed. The options will have an exercise price of $0.20 and a three year term.

Cash Used in Operations

Net cash flows used in operating activities was $9,997,492 (2006: $6,332,182).

Liquidity and Funding

The Company has sufficient funds to finance its operations over the next year if the second tranche funding is received. However the Company's business plan dictates that future funding will be required in order to commercialise the C-Pulse.

Risk Management

The Group takes a proactive approach to risk management. The Board is responsible for ensuring that risks, and also opportunities, are identified on a timely basis and that the Group's objectives and activities are aligned with the risks and opportunities identified by the Board.

The Group believes that it is important for all Board members to be a part of this process, and as such the Board has not established a separate risk management committee. Instead, sub-committees are convened as appropriate in response to issues and risks identified by the Board as a whole and the sub-committee further examines the issue and reports back to the Board.

The Board has a number of mechanisms in place to ensure that management's objectives and activities are aligned with the risks identified by the Board. These include the following:

- Board approval of a strategic plan, which encompasses the Group's vision, mission and strategy statements, designed to meet stakeholders needs and manage business risk; and
- Implementation of Board approved operating plans and budgets and Board monitoring of progress against these budgets.

Significant Events after the Balance Date

There were no material events occurring after balance date which may affect either the Group's operations or results of those operations or the Group's state of affairs.

Share Options

Unissued shares

As at the date of this report, there were 54,414,281 unissued ordinary shares under options in Sunshine Heart, Inc.

Employee Options

During the year ended 30 June 2007, a total of 15,398,784 unissued ordinary shares under option were issued as remuneration to directors, consultants and employees of the Company. Approximately 45% of options are performance based and consequently at risk of forfeiture if performance criteria is not achieved.

Placement Options

During the year ended 30 June 2007, a total of 27,604,079 unissued ordinary shares under option were issued as part of tranche 1 of the capital raising.

Refer to note 14(c) of the financial statements for further details of the options outstanding.

Option holders do not have any right, by virtue of the option, to participate in any share issue of the Company or any related body corporate or in the interest issue of any other registered scheme.

Environmental Regulation and Performance

There have been no known breaches by the consolidated entity of any environmental regulations or obligations.

Directors Indemnity

During the financial year, Sunshine Heart, Inc. paid a premium of $90,225 in respect of a contract insuring all the Directors and Officers against liability, except willful breach of duty, of a nature that is required to be disclosed under section 300 (8) of the Corporations Act 2001.

The liabilities insured include costs and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of the Company or a related body corporate.

Remuneration Report – Audited

This Remuneration Report outlines the director and executive remuneration arrangements of the Company and the Group in accordance with the requirements of the Corporations Act 2001 and its Regulations. It also provides the remuneration disclosures required by paragraphs Aus 25.4 to Aus 25.7.2 of AASB 124 Related Party Disclosures, which have been transferred to the Remuneration Report in accordance with Corporations Regulation 2M.6.04. For the purposes of this report, Key Management Personnel of the Group are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the Company and the Group, directly or indirectly, including any director (whether executive or otherwise) of the parent Company and includes the five executives in the parent and the Group receiving the highest remuneration.

For the purposes of this report, the term 'executive' encompasses the Chief Executive, senior executives, general managers and secretaries of the parent and the Group.

Remuneration philosophy

The performance of the Company depends upon the quality of its Directors and executives. To prosper, the Company must attract, motivate and retain highly skilled Key Management Personnel. To this end, the Company embodies the following principles in its remuneration framework:

- Provide competitive rewards to attract high calibre individuals; and
- Link rewards to shareholder value

Remuneration and nomination committee

The remuneration and nomination committee of the Board of Directors of the Company is responsible for determining and reviewing compensation arrangements for the Key Management Personnel. The committee assesses the appropriateness of the nature and amount of remuneration of the Key Management Personnel on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality team.

The remuneration and nomination committee has in place a process to review the performance of the board, sub committees and that of individual Key Management Personnel. To assist in this process an independent advisor may be used. The committee conducts a survey of directors to review the role of the board, assess the performance of the board since the previous survey and to examine ways of assisting the board in performing its duties more effectively. The issues examined include board interaction with management, the type of information provided to the board by management, and overall management performance in helping the board meet its objectives.

A similar review is performed of the board sub committees, to assist in assessing the performance of each committee and to identify areas where improvement can be made.

The committee is also responsible for reviewing the performance of Key Management Personnel. This evaluation is based on specific criteria, including the group's business performance, whether strategic objectives are being achieved and the development of management and personnel.

Further details on the remuneration of directors and executives are also provided in Note 22 to the financial statements.

Remuneration structure

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

Non-executive director remuneration

Objective

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

Structure

Remuneration consists of the following key elements:

- Fixed Remuneration; and
- Options – Long Term Incentive ('LTI') – refer below for details of the objective and structure of options granted as LTI.

The amount of fixed remuneration and share based compensation through options (potential long term incentives) is established for each non-executive director by the remuneration and nomination committee.

The ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. An amount not exceeding the amount determined is then divided between the directors as agreed. The latest determination was at the Annual General Meeting held on 30 November 2004 when shareholders approved an aggregate remuneration of $250,000 per year. The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned amongst directors is reviewed annually. No change to the aggregate remuneration previously approved by shareholders is proposed. The board may consider advice from external consultants as well as the fees paid to non-executive directors of comparable companies when undertaking the annual review process.

Each non-executive director receives a fee for being a director of the Company except for Dr. Geoff Brooke, Dr. Richard Lin and John Brennan. No additional fees are paid for each board committee on which a director sits. Non-executive directors are not required by the board to hold shares in the Company.

The remuneration of non-executive directors for the period ending 30 June 2007 is detailed in Table 1 on page 18 of this report.

Key Management Personnel and Executive Director remuneration

Objective

The Company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the Company and so as to:

- align the interests of executives with those of shareholders;
- link reward with the strategic goals and performance of the Company; and
- ensure total remuneration is competitive by market standards.

Structure

In determining the level and make-up of executive remuneration, the remuneration and nomination committee primarily relies upon internal surveying of prevailing market conditions. However it may seek external advice as required.

It is the remuneration and nomination committee’s policy that employment contracts are entered into with the Executive Director’s and other Key Management Personnel. Details of these contracts are provided on page 16.

Remuneration consists of the following key elements:

- Fixed Remuneration – Base Salaries;
- Cash Bonus – Short Term Incentive Plan (‘STIP’); and
- Options – Long Term Incentive Plan (‘LTIP’)

The amount of fixed remuneration and share based compensation through options (potential long term incentives) is established for each senior manager by the remuneration and nomination committee.

Fixed Remuneration

Objective

The level of fixed remuneration is set so as to provide a base level of remuneration, which is both appropriate to the position and is competitive in the market. Fixed remuneration is reviewed annually by the remuneration and nomination committee and the process consists of a review of company wide, business unit and individual performance, relevant comparative remuneration in the market and internal and, where appropriate, external advice on policies and practices. As noted above, the committee has access to external advice independent of management.

Structure

Key Management Personnel receive their fixed (primary) remuneration in cash. The fixed remuneration component of the Key Management Personnel remuneration is detailed in Tables 1 and 2. The Company has no other Key Management Personnel at the date of this Report.

Cash/Options Bonus — Short Term Incentive Plan (STIP)

Objective

The objective of the STIP is to reward staff including Key Management Personnel in a manner that focuses participants on achieving personal and business goals which contribute to the creation of sustained shareholder value. Bonus differential reflects performance against these goals.

Structure

The STIP facilitates bi-annual cash and/or options bonus opportunities that reflect performance outcomes against pre-determined personal and business goals (as determined by the Board) which are key drivers for short term success and delivering long term value. The amount of any bonus is at the discretion of the Board.

Details of the cash bonuses earned under the STIP is provided in Tables 1 and 2 for Key Management Personnel and Note 17 for all employees.

Options — Long Term Incentive Plan (LTIP)

Objective

The objective of the LTIP plan is to reward staff including Key Management Personnel in a manner that aligns this element of remuneration with the creation of shareholder value. As such LTIP grants are made to staff that are able to influence the generation of shareholder wealth and thus have an impact on the Company's performance.

Structure

LTIP grants to staff including Key Management Personnel are delivered in the form of options. The Company uses a premium to the market price of the shares under option as the performance hurdle for the long-term incentive plan. Option recipients are required to meet certain length-of-service obligations.

Details of options granted, including the value of options and vesting periods under the LTIP plan, is detailed in Note 17 for employees and Note 22(c) for directors.

Employment and Consultancy contracts

The Key Management Personnel salaries and fees are as set out below. All salaries and fees are for full time services unless otherwise noted. All contracts are terminable upon one months notice, except as described below:

Name	Title	Annual Base Fees
D. Rohrbaugh	Chief Executive Officer	$US275,600 (1)
W. Peters	Medical Director/Chief Technology Officer	$A220,000 (2)
V. Windeyer	Chief Operating Officer	A$190,000 (3)
G. Frugard	Vice President of Regulatory and Quality Affairs	$US60,000 (4)
B. Bolton	Chief Financial Officer/Company Secretary	$A220,000 (5)
A. Blunden	Chief Financial Officer/Company Secretary (resigned 31 January 2007)	$A82,080 (6)

(1) Mr Rohrbaugh's consulting contract commenced on 1 July 2005 and is ongoing. If Sunshine Heart terminates Mr Rohrbaugh's contract other than for cause, he is entitled to receive continued payment of his monthly fee until the earlier of: (i) the date he begins providing full time services to a third party or (ii) the six month anniversary of his termination date.

(2) Dr Peters' consulting contract commenced on 3 August 2004 and is ongoing. If Sunshine Heart terminates Dr Peters' contract other than for cause, he is entitled to receive one months notice of termination, or payment in lieu of actual notice.

(3) Mr Windeyer's employment contract commenced on 3 January 2006 and is ongoing. If Sunshine Heart terminates Mr Windeyer's employment other than for cause, he is entitled to receive three months notice of termination, or payment in lieu of actual notice. In addition, the Company also contributes superannuation on behalf of Mr Windeyer.

(4) Mr Frugard's consulting contract commenced on 1 June 2004 and is ongoing. The minimum fee of $US5,000 per month is based on service of two days per week, which may be increased at the Company's discretion by an additional $US3,000 per additional day of service, up to a maximum of $US16,667 per month for full time service ($US200,000 on an annualised basis).

(5) Mr Bolton's employment contract commenced on 16 April 2007 and is ongoing. If Sunshine Heart terminates Mr Bolton's employment other than for cause, he is entitled to receive six months notice of termination, or payment in lieu of actual notice. In addition, the Company also contributes superannuation on behalf of Mr Bolton.

(6) Mr Blunden's consulting contract commenced on 26 March 2006. The minimum retainer fee of $6,840 was based on four days per month of consulting services. Mr Blunden resigned as Chief Financial Officer/ Company Secretary on 31 January 2007. He continues to consult to the Group.

Remuneration of Key Management Personnel

Table 1: Remuneration for the year ended 30 June 2007

	Short term		Post employment	Share based payments	Total	% performance related (a)
	Salary & Fees	Cash STI	Superannuation	Options (b)		
Non-executive Directors						
M. McComas	87,500	–	–	287	87,787	–
G. Brooke	–	–	–	1,400	1,400	–
R. Lin	–	–	–	1,522	1,522	–
C. Marsh (c)	63,219	–	–	7,429	70,648	–
J. Brennan (d)	–	–	–	–	–	–
D. O'Dwyer	50,000	–	–	1,505	51,505	–
Sub-total Non-executive Directors	200,719	–	–	12,143	212,862	
Executive Directors						
D. Rohrbaugh	364,366	51,558	–	87,504	503,428	10.25
W. Peters	220,000	40,000	–	38,631	298,631	13.40
Other Key Management Personnel						
B. Bolton (e)	45,974	–	4,137	7,899	58,010	–
V. Windeyer	163,192	62,700	20,330	87,721	333,943	20.07
A. Blunden (f)	70,744	–	–	–	70,744	–
G. Frugard	231,364	–	–	22,368	253,732	–
Sub-total executive KMP	1,095,640	154,258	24,467	244,123	1,518,488	
Total	1,296,359	154,258	24,467	256,266	1,731,350	

Table 2: Remuneration for the year ended 30 June 2006

	Short term		Post employment	Share based payments	Total	% performance related (a)
	Salary & Fees	Cash STI	Superannuation	Options (b)		
Non-executive Directors						
M. McComas	50,000	–	–	11,958	61,958	–
G. Brooke	–	–	–	4,541	4,541	–
R. Lin	–	–	–	4,938	4,938	–
C. Marsh (c)	120,000	5,000	–	123	125,123	4.00
D. O'Dwyer	50,000	–	–	4,931	54,931	–
Sub-total Non-executive Directors	220,000	5,000	–	26,491	251,491	
Executive Directors						
D. Rohrbaugh	365,435	–	–	104,423	469,858	–
W. Peters	212,000	20,000	–	41,627	273,627	7.31
Other Key Management Personnel						
V. Windeyer (g)	75,688	22,700	6,813	25,403	130,604	17.38
A. Blunden	101,646	–	–	5,533	107,179	–
G. Frugard	169,660	–	–	26,044	195,704	–
Sub-total executive KMP	924,429	42,700	6,813	203,030	1,176,972	
Total	1,144,429	47,700	6,813	229,521	1,428,463	

(a) No future maximum or minimum total value of performance related remuneration has been determined as at the date of this report

(b) Options issued to Director's related parties and other Key Management Personnel as described in Note 22(c)

(c) Resigned as Director of Corporate Affairs (executive) on 30 June 2006. Appointed a non-executive director 1 July 2006

(d) Appointed as a non-executive director on 1 November 2006.

(e) Commenced 16 April 2007

(f) Resigned as Company Secretary on 31 January 2007

(g) Commenced 3 January 2006

Table 3: Options granted as part of remuneration for the year ended 30 June 2007

	Grant date	Exercise price $	Grant number	Value per option at grant date $	Value of options granted during the year $	% Remuneration consisting of options for the year
C. Marsh (c)	1 Nov 06	0.30	97,000	0.0582	5,645	
C. Marsh (b)	1 Nov 06	0.30	161,784	0.0582	9,415	
C. Marsh (b)	18 Apr 07	0.25	50,000	0.0516	2,580	
			308,784		17,640	10.5
D. Rohrbaugh (c)	1 Nov 06	0.18	640,000	0.0864	55,296	
D. Rohrbaugh (a)	18 Apr 07	0.30	2,000,000	0.0878	175,600	
D. Rohrbaugh (c)	18 Apr 07	0.30	3,000,000	0.0434	130,200	
			5,640,000		361,096	17.4
W. Peters (c)	1 Nov 06	0.18	440,000	0.0864	38,016	
W. Peters (a)	18 Apr 07	0.30	1,400,000	0.0878	122,920	
W. Peters (c)	18 Apr 07	0.30	600,000	0.0434	26,040	
			2,440,000		186,976	12.9
V. Windeyer (a)	31 Jan 07	0.25	1,000,000	0.1006	100,600	
V. Windeyer (b)	31 Jan 07	0.25	40,000	0.1006	3,512	
V. Windeyer (c)	31 Jan 07	0.30	1,000,000	0.0878	87,800	
			2,040,000		191,912	26.3
B. Bolton (a)	16 Apr 07	0.25	275,000	0.0613	16,857	
B. Bolton (c)	16 Apr 07	0.30	1,525,000	0.0521	79,453	
			1,800,000		96,310	13.6
G. Frugard (a)	31 Jan 07	0.25	355,000	0.1006	35,713	
G. Frugard (c)	31 Jan 07	0.30	280,000	0.0878	28,168	
			635,000		63,881	8.8

(a) Options are performance based and will be forfeited if performance criteria is not achieved.

(b) Options fully vested at grant date

(c) Vesting is 1/4th after 1 year and 1/48th every month thereafter.

For details on the valuation of the options, including models and assumptions used, refer to Note 17. There were no alterations to the terms and conditions of options granted as remuneration since their grant date.

No options held by Key Management Personnel were exercised or lapsed during the year. For details of options vested during the year refer note 22(c).

Table 4: Options granted as part of remuneration for the year ended 30 June 2006

	Grant date	Exercise price $	Grant number	Value per option at grant date $	Value of options granted during the year $	% Remuneration consisting of options for the year
V. Windeyer	9 Feb 06	0.34	800,000	0.164	131,200	19.45
A. Blunden	21 Apr 06	0.38	50,000	0.136	6,800	5.16
G. Frugard	21 Apr 06	0.19	25,000	0.152	3,800	13.30

Vesting is 1/4th after 1 year and 1/48th every month thereafter.

For details on the valuation of the options, including models and assumptions used, refer to Note 17. There were no alterations to the terms and conditions of options granted as remuneration since their grant date.

Directors' Meetings

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

	Directors' Meetings	Meetings of Committees Audit	Remuneration and Nomination
Number of meetings held:	**12**	**4**	**3**
Number of meetings attended:			
M. McComas	12	4	–
G. Brooke	9	2	3
R. Lin	9	–	3
C. Marsh	11	–	–
D. O'Dwyer	10	4	–
W. Peters	11	–	–
D. Rohrbaugh ^	11	–	–
J. Brennan	6	–	–

All directors were eligible to attend all meetings held, except for J Brennan who was eligible to attend 6 Directors' meetings.

Committee membership

The Company established an Audit, Compliance and Corporate Governance Committee and a Remuneration and Nomination Committee of the Board of Directors on 20 July 2004. Members acting on the committees of the board are:

Audit	Remuneration and Nomination
D. O'Dwyer (Chairman)	G. Brooke (Chairman)
G. Brooke (resigned 24 May)	R. Lin
M. McComas	

Note

^ D. Rohrbaugh is a non-voting participant at Remuneration and Nomination Committee meetings.

Corporate Governance

In recognising the need for the highest standards of corporate behaviour and accountability, the Directors of Sunshine Heart, Inc. support and have adhered to the principles of corporate governance. The Company's corporate governance statement is contained in the following section of this annual report.

Auditor Independence

We have obtained the independence declaration from our auditors, Ernst & Young, a copy of which is included on page 59 of this annual report.

Non-Audit Services

The Company's auditors, Ernst & Young, provided non-audit services during the year ended 30 June 2007. The Directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

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

Tax compliance services	2007: $23,372 (2006: $30,989)
Other advisory services	2007: $2,500 (2006: $nil)

Refer to Note 21 of the financial statements for details of the remuneration that Ernst & Young received or are due to receive for the provision of audit and other services.

Signed in accordance with a resolution of the Directors.

Donald Rohrbaugh
Director

Sydney, 23 August 2007

Corporate Governance Statement

The board of Directors is committed to the Company meeting stakeholders' expectations of sound corporate governance practices.

The Board of Directors of Sunshine Heart, Inc. is responsible for the corporate governance of the consolidated entity. The Board guides and monitors the business and affairs of Sunshine Heart, Inc. on behalf of the shareholders by whom they are elected and to whom they are accountable. The format of the Corporate Governance Statement has been drafted in accordance with the Australian Stock Exchange Corporate Governance Council's (the Council's) 'Principles of Good Corporate Governance and Best Practice Recommendations' (the Recommendations). In accordance with the Council's recommendations, the Corporate Governance Statement must now contain certain specific information and must disclose the extent to which the Company has followed the guidelines during the period. Where a recommendation has not been followed, that fact must be disclosed, together with the reasons for the departure.

Sunshine Heart, Inc's Corporate Governance Statement is now structured with reference to the Corporate Governance Council's principles and recommendations, which are as follows:

Principle 1. Lay solid foundations for management and oversight
Principle 2. Structure the board to add value
Principle 3. Promote ethical and responsible decision making
Principle 4. Safeguard integrity in financial reporting
Principle 5. Make timely and balanced disclosure
Principle 6. Respect the rights of shareholders
Principle 7. Recognise and manage risk
Principle 8. Encourage enhanced performance
Principle 9. Remunerate fairly and responsibly
Principle 10. Recognise the legitimate interests of stakeholders

This Statement outlines the Company's main corporate governance practices.

Structure of the Board

The skills, experience and expertise relevant to the position of Director held by each Director in office at the date of the Annual Report is included in the Directors' Report. Directors of Sunshine Heart, Inc. are considered to be independent if they have not been previous executives of the firm, are not nominees of a major shareholder, are not involved in the value chain of the Company, are not advisors to the Company for fees, and are free from any other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the exercise of their unfettered and independent judgment. In the context of Director independence, 'materiality' is considered from both the Company and individual Director perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal or less than 5% of the appropriate base amount. It is presumed to be material (unless there is qualitative evidence to the contrary) if it is equal to or greater than 10% of the appropriate base amount. Qualitative factors considered include whether a relationship is strategically important, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors which point to the actual ability of the Director in question to shape the direction of the Company's loyalty. In accordance with the definition of independence above, and the materiality thresholds set, the following Directors of Sunshine Heart, Inc. are considered to be independent:

Name	Position
M. McComas	Chairman, Non-Executive Director
D. O'Dwyer	Non-Executive Director

It is noted that, contrary to Recommendation 2.1, the Board does not have a majority of independent Directors, although it does have a majority of non-executive Directors. It is considered that the composition is appropriate as three of the non-executive Directors who are not independent are experienced venture capital managers who bring to the Board particular expertise in the management and development of early stage medical device companies and the fourth is a co-founder of the Company who offers substantial strategic foresight in commercialising the Company's technology.

The term in office held by each director in office at the date of this report is as follows:

Name	Term in Office
M. McComas	3 years
G. Brooke	3 years
R. Lin	4 years
C. Marsh	7 years
J. Brennan	8 months
D. O'Dwyer	3 years
D. Rohbraugh	4 years
W. Peters	7 years

The role of the Board

The Board consists of 2 Executive Directors (Dr Peters and Mr Rohrbaugh) and 6 Non Executive Directors (Drs Brooke and Lin and Messrs McComas, O'Dwyer, Marsh and Brennan).

The Board is responsible for directing and monitoring the business and affairs of the Company, including compliance with the Company's corporate governance policies and procedures. The functions of the Board include:

- Ensuring compliance with the statutory, regulatory and reporting requirements imposed upon the Company and its officers;
- Overseeing the financial standing, operating results and business risks of the Company;
- Approving goals, strategy and plans for the direction of the Company; and,
- Reviewing the performance of the CEO.

The responsibility for the operation and administration of Sunshine Heart, Inc is delegated by the Board to the CEO and the management team. The Board has established 2 specialist committees, the Remuneration and Nomination Committee and the Audit, Compliance and Corporate Governance Committee.

Remuneration and Nomination Committee

The Remuneration and Nomination Committee consists of two Non-Executive Directors, Drs Lin and Brooke.

The Remuneration and Nomination Committee is responsible for matters related to succession planning, recruitment and the appointment and remuneration of the directors and the CEO, and overseeing succession planning, selection and appointment practices and remuneration packages for management and employees of Sunshine Heart.

In making recommendations to the Board regarding the appointment of directors, the Remuneration and Nomination Committee periodically assesses the appropriate mix of skills, experience and expertise required on the Board and assesses the extent to which the required skills and experience are represented on the Board.

The Remuneration and Nomination Committee may obtain information from, and consult with, management and external advisors as it considers appropriate.

Audit, Compliance and Corporate Governance Committee

The Board has established an Audit, Compliance and Corporate Governance Committee consisting of 2 directors (Messrs McComas and O'Dwyer), each of whom is non-executive and possesses substantial experience as a company director of companies. The majority of this committee are also independent directors.

The Audit, Compliance and Corporate Governance Committee reviews Sunshine Heart's policies and procedures for compliance with reporting standards, reviews audit plans, accounting policies and financial reports and ensures the independence of the external auditors. It also monitors corporate risk management, internal control and compliance. Members of management and the external auditors attend meetings of the Audit, Compliance and Corporate Governance Committee by invitation. The committee may also have access to financial and legal advisors, in accordance with the Board's general policy.

Continuous disclosure

The CFO and the CEO carry responsibility to ensure Sunshine Heart complies with its disclosure obligations. Policies and procedures for compliance with ASX Listing Rule disclosure requirements are regularly reviewed. All relevant information provided to the ASX will be promptly posted on the Company's corporate website: www.sunshineheart.com.

Performance

The performance of the Board and key executives is formally reviewed on an annual basis, against both measurable and qualitative key performance indicators. During the reporting period, the Remuneration and Nomination committee conducted a performance evaluation which involved an assessment of each Board member's and key executive's performance against specific and measurable qualitative and quantitative performance criteria. The performance criteria against which directors and executives are assessed is aligned with the financial and non-financial objectives of Sunshine Heart, Inc. Directors whose performance is consistently unsatisfactory may be asked to retire.

Securities trading guidelines

The Bylaws of the Company permit directors to acquire shares. The Board of directors governs both director and employee trading in the Company's shares through the administration of a window-based share trading policy. Under this policy and consistent with the legal prohibitions on insider trading, all directors and employees are prohibited from trading in the Company's shares, options or other securities issued while in possession of unpublished price sensitive information.

The share trading policy requires the Chairman of the Board of directors to open and close share trading windows. Directors and employees are prevented from trading shares under the policy and as a result of their contractual terms with the Company, except during the course of an open window period.

Conflicts of interest and access to legal advice

Under Delaware law, a contract or transaction between a company and one of its directors or officers (or an entity affiliated with such Director or officer) is not void or voidable if:

(a) the material facts as to the director's or officer's relationship is disclosed to the Board and the contract or transaction is approved by a majority of the disinterested directors;

(b) the material facts as to the director's or officer's relationship is disclosed to the shareholders entitled to vote thereon and the contract or transaction is approved by the shareholders; or

(c) the contract or transaction is fair to the corporation.

Interested directors may be present at or participate in the meeting and may be counted in determining the presence of a quorum.

Any director who requires legal advice in relation to the performance of the director's duties as a director of the Company may inform the chairman of the issue that raises the concern that requires the legal advice. Such advice may then be obtained in consultation with, and after the approval of, the Chairman. Legal costs reasonably incurred are reimbursable by the Company. Any advice obtained is to be made available to all the other directors.

For further information on corporate governance policies adopted by Sunshine Heart, Inc., refer to our website: www.sunshineheart.com

Income Statement

FOR THE YEAR ENDED 30 JUNE 2007

		CONSOLIDATED		SUNSHINE HEART, INC.	
	Notes	2007 $	2006 $	2007 $	2006 $
Revenue and other income	3	**3,220,722**	1,688,732	**485,291**	241,247
Write-down of investments	3	**–**	–	**(11,243,813)**	(6,654,386)
Depreciation and amortisation expenses	3	**(64,269)**	(46,307)	**–**	–
Insurance		**(174,878)**	(257,990)	**(106,698)**	(196,323)
Listing fees		**(19,241)**	(40,457)	**(19,241)**	(40,457)
Office expenses	3	**(155,817)**	(113,912)	**(3,588)**	–
Professional fees		**(338,394)**	(165,796)	**(289,180)**	(114,454)
Salaries, consultants and employee benefits	3	**(2,371,082)**	(1,579,902)	**–**	(144,990)
Research and development	3	**(10,295,675)**	(5,929,034)	**–**	–
Travel		**(554,056)**	(295,282)	**(12,899)**	(2,343)
Patents		**(80,947)**	(161,846)	**–**	–
Other expenses		**(705,776)**	(423,476)	**(349,285)**	(123,742)
Loss before income tax		**(11,539,413)**	(7,325,270)	**(11,539,413)**	(7,035,448)
Income tax benefit	4	**–**	289,822	**–**	–
Loss after tax		**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Loss for the year attributable to members of Sunshine Heart, Inc.	14(e)	**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Basic loss per share (cents per share)	20	**(8.3)**	(9.6)		
Diluted loss per share (cents per share)	20	**(8.3)**	(9.6)		

Balance Sheet

AT 30 JUNE 2007

		CONSOLIDATED		SUNSHINE HEART, INC.	
	Notes	**2007 $**	2006 $	**2007 $**	2006 $
ASSETS					
Current Assets					
Cash and cash equivalents	15(b)	**7,718,498**	4,531,974	**5,248,426**	3,552,144
Other current assets	5	**120,725**	1,287,451	**22,654**	42,798
Other receivables	6	**183,385**	32,203	**26,536**	328,000
Total Current Assets		**8,022,608**	5,851,628	**5,297,616**	3,922,942
Non-Current Assets					
Property, plant and equipment	10	**358,899**	248,921	**–**	–
Other non-current assets	7	**–**	301,143	**–**	–
Other financial assets	8	**–**	–	**2,906,086**	2,080,152
Total Non-Current Assets		**358,899**	550,064	**2,906,086**	2,080,152
Total Assets		**8,381,507**	6,401,692	**8,203,702**	6,003,094
LIABILITIES					
Current Liabilities					
Trade and other payables	11	**189,242**	295,827	**79,954**	95,358
Provisions	12	**68,517**	40,608	**–**	–
Government grants	13	**–**	157,521	**–**	–
Total Current Liabilities		**257,759**	493,956	**79,954**	95,358
Total Liabilities		**257,759**	493,956	**79,954**	95,358
Net Assets		**8,123,748**	5,907,736	**8,123,748**	5,907,736
EQUITY					
Contributed equity	14(a)	**37,074,128**	23,638,463	**37,074,128**	23,638,463
Accumulated losses	14(e)	**(30,215,208)**	(18,675,795)	**(30,215,208)**	(18,675,795)
Reserves	14(f)	**1,264,828**	945,068	**1,264,828**	945,068
Total Equity		**8,123,748**	5,907,736	**8,123,748**	5,907,736

Statement of Recognised Income and Expense

FOR THE YEAR ENDED 30 JUNE 2007

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007	2006	**2007**	2006
	$	$	**$**	$
Net income recognised directly in equity	**–**	–	**–**	–
Loss for the year	**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Total recognised income and expense for the year	**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Attributable to: Equity holders of Sunshine Heart, Inc.	**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)

Cash Flow Statement

FOR THE YEAR ENDED 30 JUNE 2007

	Notes	CONSOLIDATED 2007 $	CONSOLIDATED 2006 $	SUNSHINE HEART, INC. 2007 $	SUNSHINE HEART, INC. 2006 $
Cash flows from operating activities					
Receipt of government grants		**2,633,024**	1,691,833	**–**	–
Payments to suppliers and employees		**(13,157,861)**	(8,672,806)	**(705,854)**	(940,029)
Income tax received		**–**	289,822	**–**	–
Interest received		**527,345**	358,969	**486,139**	276,623
Net cash flow used in operating activities	15(a)	**(9,997,492)**	(6,332,182)	**(219,715)**	(663,406)
Cash flows from investing activities					
Investment in subsidiary		**–**	–	**(11,750,000)**	(5,223,216)
Purchase of property, plant and equipment		**(174,246)**	(121,404)	**–**	–
Net cash flows used in investing activities		**(174,246)**	(121,404)	**(11,750,000)**	(5,223,216)
Cash flows from financing activities					
Proceeds from issue of ordinary shares		**13,802,396**	3,300,000	**13,802,396**	3,300,000
Proceeds from repayment of loan by subsidiary		**–**		**307,735**	–
Payment of share issue costs		**(366,726)**	(227,490)	**(366,726)**	(227,490)
Net cash flows from financing activities		**13,435,670**	3,072,510	**13,743,405**	3,072,510
Net increase/(decrease) in cash and cash equivalents		**3,263,932**	(3,381,076)	**1,773,690**	(2,814,112)
Net foreign exchange differences		**(77,408)**	35,956	**(77,408)**	35,956
Cash and cash equivalents at beginning of year		**4,531,974**	7,877,094	**3,552,144**	6,330,300
Cash and cash equivalents at end of year	15(b)	**7,718,498**	4,531,974	**5,248,426**	3,552,144

1. Corporate information

The annual report of Sunshine Heart, Inc. ('Company' or 'Sunshine Heart') for the year ended 30 June 2007 was authorised for issue in accordance with a resolution of the directors on 23 August 2007.

Sunshine Heart, Inc. ('Company' or 'Sunshine Heart') is a company limited by shares incorporated in Delaware. Its shares are publicly traded on the Australian stock exchange, ASX code: SHC.

The nature of the operations and principal activities of the Group are to design and develop a heart assist device.

2. Summary of significant accounting policies

(a) Basis of Preparation

Sunshine Heart is a foreign company registered under Part 5B.2 of the *Corporations Act 2001*. The financial report is a general purpose financial report and has been prepared to satisfy the requirements of the *Corporations Act 2001* and Australian Accounting Standards. The financial report is presented in Australian dollars and has been prepared on a historical cost basis.

(b) Statement of compliance

The financial report complies with Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards (AIFRS).

Certain Australian Accounting Standards and UIG interpretations have been recently issued or amended but are not yet effective. These other standards have not been adopted by the Group for the year ended 30 June 2007. The Directors have yet to finalise their assessment of the impact of these new or amended standards (to the extent relevant to the Group) and interpretations.

(c) Going Concern

The Group's financial statements have been prepared and presented on a basis assuming it continues as a going concern.

During the years ended 30 June 2007 and 30 June 2006, the Group incurred an operating loss before tax and net cash outflows from operating activities as disclosed in the income statement and cash flow statement, respectively.

The Group's ability to continue as a going concern is dependent on the Group's ability to raise additional capital based on the achievement of its existing milestones. The directors, after due consideration, believe that the Group will be able to raise new equity capital to fund its business plan. Should the future capital raising not be successful, the Group may not be able to continue as a going concern. Furthermore, the ability of the Group to continue as a going concern is subject to the ability of the Group to develop and successfully commercialise the product being developed. If the Group is unable to obtain such funding of an amount and timing necessary to meet its future operational plans, or to successfully commercialise its intellectual property, the Group may be unable to continue as a going concern. No adjustments have been made relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Group not continue as a going concern.

(d) Basis of consolidation

The consolidated financial statements comprise the financial statements of Sunshine Heart, Inc. and its subsidiary as at 30 June each year (the Group). The financial statements of the subsidiary are prepared for the same reporting period as the parent Company, using consistent accounting policies. In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group

(e) Significant accounting estimates and assumptions

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

Share-based payment transactions

The consolidated Group provides benefits to employees, consultants and directors in the form of share-based payment transactions, whereby employees render services in exchange for share options ('equity-settled transactions') under the 2002 Stock Plan ('the Plan'). The Group measures the cost of equity-settled transactions by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using the Black-Scholes formula taking into account the terms and conditions upon which the instruments were granted, as discussed in Note 17.

(f) Revenue recognition

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

(i) Grant income

Grants from the government are recognised at their fair value where there is reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Where the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs it intends to compensate. When the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual installments. Where government payments are received in advance of expenditure, a present obligation exists to repay the government under the conditions of the grant. This is recognised as deferred income, refer Note 13. Where government grants are received in arrears of expenditure, a future economic benefit exists with funds owed by the government under the conditions of the grant. This is recognised within other receivable, refer Note 6

(ii) Interest income

Interest revenue is recognised as it accrues, taking into account the effective yield on the financial asset.

(g) Borrowing costs

Borrowing costs are recognised as an expense when incurred.

(h) Leases

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

Group as a lessee

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Lease incentives are recognised in the income statement as an integral part of the total lease expense.

(i) Cash and cash equivalents

Cash and short term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less. For the purposes of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(j) Other receivables

Other receivables generally have 30 – 90 day terms and are recognised and carried at nominal contractual amounts less an allowance for any uncollectible amounts. The doubtful debts allowance is made when objective evidence suggests the Group will be unable to collect the debts and bad debts are written off when identified.

2. Summary of significant accounting policies (Cont'd)

(k) Foreign currency translation

Both the functional and presentation currency of Sunshine Heart, Inc. and it Australian subsidiary is Australian dollars (A$). Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. All exchange differences in the consolidated report are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

(l) Income tax

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

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

Deferred income tax liabilities are recognised for all taxable differences except when the taxable temporary difference is associated with an investment in a subsidiary and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised except when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

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

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

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

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

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

(m) Other taxes

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

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

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

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

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

(n) Property, plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight line basis over the estimated useful life of the asset. The depreciation rates used for each class of asset are as follows:

	2007	2006
Office furniture and equipment	10 – 15 years	10 – 15 years
Computer equipment	3 – 4 years	3 – 4 years
Laboratory and research equipment	3 – 15 years	3 – 15 years

Leasehold improvements are stated at cost less accumulated amortisation and any impairment in value. Amortisation is calculated on a straight line basis over the shorter of the estimated useful life of the asset or the lease term.

(i) Impairment

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash generating units are written down to their recoverable amount.

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

(ii) Derecognition and disposal

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

(o) Other financial assets

Investment in a controlled entity is carried at the lower of cost or recoverable amount and reviewed at each balance date to reflect the Company's interest in the underlying net asset value of the controlled entity.

Impairment

The carrying value is reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash generating units are written down to their recoverable amount. The amount of the loss is recognised in the Income Statement

2. Summary of significant accounting policies (Cont'd)

(p) Intangible assets

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is charged against profits in the year in which the expenditure is incurred. The amortisation period and method are reviewed annually, to ensure that they reflect the expected pattern of consumption of embodied, future economic benefits.

(i) Research and development expenditure

The consolidated Group expenses all research and development expenditure as incurred including expenditure made on the C-Pulse and other related technologies. Development expenditure is carried forward when its future recoverability can be regarded as assured.

(ii) Patents and trademarks

All patent, licence and trademarks expenditure is expensed as incurred as the Group has not yet developed a commercial product.

(q) Trade and other payables

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

(r) Provisions

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

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

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

(s) Employee leave benefits

(i) Wages, salaries, annual leave and sick leave

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date are recognised in provisions in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Long service leave

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

(t) Pensions and other post employment benefits

All Australian employees are entitled to varying levels of benefits on retirement, disability or death. The superannuation plans provide accumulated benefits. Employees contribute to the plans at various percentages of their wages and salaries. Contributions by the consolidated entity of up to 9% of employees' wages and salaries are legally enforceable in Australia.

(u) Share-based payment transactions

Equity settled transactions

The Group provides benefits to employees (including Directors) in the form of share-based payments, whereby employees render services in exchange options over shares (equity settled transactions) under Sunshine Heart's 2002 Stock Plan ('the Plan').

The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined using a Black-Scholes model, details of which are given in Note 17. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Sunshine Heart (market conditions).

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

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

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

If the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification that increases the total fair value of the share based payment arrangement, or is otherwise beneficial to the employee, as measured at the date of modification.

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

The dilutive effect, if any of options is reflected as additional share dilution in the computation of earnings per share (see Note 20).

(v) Contributed equity

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

(w) Warrants

Warrants are classified as equity as the number of ordinary shares that will be issued upon their exercise is fixed. The fair value was determined using the Black-Scholes model.

2. Summary of significant accounting policies (Cont'd)

(x) Earnings Per Share

Basic EPS is calculated as a net loss attributable to members, adjusted to exclude costs of servicing equity (other than dividends) and preference share dividends, divided by the weighted average number of ordinary shares, adjusted for any bonus element.

Diluted EPS is calculated as net loss attributable to members, adjusted for:

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

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

At present the potential ordinary shares are anti-dilutive and have not been included in the dilutive earnings per share calculation.

	Notes	CONSOLIDATED 2007 $	CONSOLIDATED 2006 $	SUNSHINE HEART, INC. 2007 $	SUNSHINE HEART, INC. 2006 $

3. Revenues and Expenses

	Notes	CONSOLIDATED 2007 $	CONSOLIDATED 2006 $	SUNSHINE HEART, INC. 2007 $	SUNSHINE HEART, INC. 2006 $
(a) Revenue and other Income					
Government grants *		**2,694,224**	1,380,509	**–**	–
Finance revenue – bank interest		**526,498**	308,223	**485,291**	241,247
		3,220,722	1,688,732	**485,291**	241,247
(b) Write-down of investments in subsidiary		**–**	–	**11,243,813**	6,654,386
(c) Depreciation and amortisation					
Depreciation – plant and equipment		**55,747**	44,993	**–**	–
Amortisation – leasehold improvements		**8,522**	1,314	**–**	–
		64,269	46,307	**–**	–
(d) Operating lease rental					
Sub-lease payments		**155,817**	113,912	**3,588**	–
(e) Employee benefits expense					
Share based payments	14(f)	**319,760**	292,628	**–**	–
Employee benefits		**27,908**	6,893	**–**	–
Superannuation		**97,820**	58,369	**–**	–
Salaries and consultants		**1,925,594**	1,220,012	**–**	144,990
		2,371,082	1,579,902	**–**	144,990
(f) Research and development expenses		**10,295,675**	5,929,034	**–**	–
(g) Foreign exchange differences					
Net foreign exchange (gain)/loss		**(20,875)**	(24,670)	**(20,875)**	(35,572)

* Various government grants relating to research and development have been received during the year. Refer to Note 18 for contingent arrangements associated with government grants.

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007	2006	**2007**	2006
	$	$	**$**	$
4. Income Tax				
The major components of income tax benefit are:				
Income Statement				
Current income tax				
Current income tax charge	**–**	–	**–**	–
Adjustments in respect of current income tax of previous years – R&D tax offset	**–**	(289,822)	**–**	–
Deferred income tax				
Relating to origination and reversal of temporary differences	**–**	–	**–**	–
Income tax benefit reported in the income statement	**–**	(289,822)	**–**	–
A reconciliation between tax expense and the product of accounting loss before income tax multiplied by the Group's applicable income tax rate is as follows:				
Accounting loss before tax from continuing operations	**(11,539,413)**	(7,325,270)	**(11,539,413)**	(7,035,448)
At the Group statutory income tax rate of 39% (2006:39%)	**(4,500,371)**	(2,856,855)	**(4,500,371)**	(2,743,825)
Expenditure not allowed for income tax purposes				
– share based payments	**124,706**	114,125	**–**	–
– write-down of investment in subsidiary	**–**	–	**4,385,088**	2,595,211
Difference in overseas tax rates	**974,837**	588,922	**–**	–
Other	**40,134**	(34,151)	**96,378**	(34,648)
Current year tax losses not booked as a future tax benefit	**3,360,694**	1,898,137	**18,905**	183,262
Income tax benefit reported in the consolidated income statement	**–**	(289,822)	**–**	–
Income Tax Losses				
Future deferred tax asset arising from tax losses not recognised at reporting date as realisation of the benefit is not regarded as probable	**7,601,576**	4,453,504	**650,188**	631,283

The unrecognised Deferred Tax Assets relating to deductible temporary differences at 30 June 2007 is $46,558 (2006: $18,948).
The unrecognised Deferred Tax Liabilities relating to assessable temporary differences at 30 June 2007 is nil (2006: nil).
The aggregate temporary differences associated with the investment in Sunshine Heart Company Pty Ltd are nil (2006: nil).

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007	2006	**2007**	2006
	$	$	**$**	$

5. Other Assets (Current)

Prepayments and deposits	**120,725**	1,287,451	**22,654**	42,798

Following development by the Group of a new proprietary driver, capitalised lease payments in respect of an existing driver amounting to $451,697 have been expensed.

6. Other Receivables (Current)

Other receivables (i)	**26,051**	17,065	**12,246**	5,127
Finance revenue receivables – bank interest	**14,290**	15,138	**14,290**	15,138
Intercompany loan (ii)	**–**	–	**–**	307,735
Government grant (Note 18)	**143,044**	–	**–**	–
	183,385	32,203	**26,536**	328,000

(i) Other receivables are non-interest bearing and generally on 30 – 90 day terms.

(ii) Intercompany loan extended to Sunshine Heart Company Pty Limited for payment of trade payables which was repaid on 24 July 2006.

7. Other Non-Current Assets

Prepayments and deposits	**–**	301,143	**–**	–

8. Other Financial Assets (Non-Current)

Investments at cost comprise:

Investment in controlled entity	**–**	–	**27,763,244**	16,013,244
Share based payments – options issued (i)	**–**	–	**1,264,828**	945,068
Less provision for write-down in investment	**–**	–	**(26,121,986)**	(14,878,160)
Total investments (Note 9)	**–**	–	**2,906,086**	2,080,152

(i) Share options issued to employees in Sunshine Heart Company Pty Ltd. Refer to Note 14.

9. Interests in Subsidiaries

NAME	COUNTRY OF INCORPORATION	EQUITY INTEREST HELD BY THE CONSOLIDATED ENTITY		INVESTMENT	
		2007 %	2006 %	**2007 $**	2006 $
Sunshine Heart Company Pty Limited	Australia	**100**	100	**2,906,086**	2,080,152

During the year ended 30 June 2007, Sunshine Heart, Inc. subscribed for an additional 11,750,000 ordinary fully paid shares in Sunshine Heart Company Pty Limited. The cost of acquisition was $11,750,000. Furthermore, Sunshine Heart, Inc. made additional non-cash investments into its wholly owned subsidiary during the year in recognition of the share based payments expense (options remuneration) that was charged to the subsidiary's income statement for $319,760 and accumulated losses account for prior years for $945,068. The carrying value of this investment has been written down to its recoverable amount, as the subsidiary has continued to make losses, being the net assets of the subsidiary at balance date.

		CONSOLIDATED		SUNSHINE HEART, INC.	
	Notes	**2007 $**	2006 $	**2007 $**	2006 $
10. Property, Plant and Equipment					
Leasehold improvements					
At cost		**77,241**	33,677	**–**	–
Accumulated amortisation		**(10,098)**	(1,577)	**–**	–
	10(a)	**67,143**	32,100	**–**	–
Office furniture and equipment					
At cost		**87,942**	59,548	**–**	–
Accumulated depreciation		**(9,357)**	(3,786)	**–**	–
	10(a)	**78,585**	55,762	**–**	–
Computer equipment					
At cost		**126,450**	93,272	**–**	–
Accumulated depreciation		**(65,702)**	(47,643)	**–**	–
	10(a)	**60,748**	45,629	**–**	–
Laboratory and research equipment					
At cost		**288,757**	219,644	**–**	–
Accumulated depreciation		**(136,334)**	(104,214)	**–**	–
	10(a)	**152,423**	115,430	**–**	–
Total property, plant and equipment					
Cost		**580,390**	406,141	**–**	–
Accumulated depreciation and amortisation		**(221,491**)	(157,220)	**–**	–
Total written down amount		**358,899**	248,921	**–**	–

	2007 $	2006 $

10. Property, Plant and Equipment (Cont'd)

(a) Reconciliations

Reconciliations of the carrying amounts of property, plant and equipment at the beginning and end of the current financial year.

	2007 $	2006 $
Leasehold Improvements		
Carrying amount at beginning	**32,100**	5,968
Additions	**43,565**	27,446
Amortisation expense	**(8,522)**	(1,314)
Net Carrying Amount	**67,143**	32,100
Office furniture and equipment		
Carrying amount at beginning	**55,762**	21,552
Additions	**28,395**	36,933
Depreciation expense	**(5,572)**	(2,723)
Net Carrying Amount	**78,585**	55,762
Computer equipment		
Carrying amount at beginning	**45,629**	26,785
Additions	**33,175**	31,932
Depreciation expense	**(18,056)**	(13,088)
Net Carrying Amount	**60,748**	45,629
Laboratory and research equipment		
Carrying amount at beginning	**115,430**	119,519
Additions	**69,112**	25,093
Depreciation expense	**(32,119)**	(29,182)
Net Carrying Amount	**152,423**	115,430
Total Property, plant and equipment		
Carrying amount at beginning	**248,921**	173,824
Additions	**174,247**	121,404
Depreciation expense	**(64,269)**	(46,307)
Net Carrying Amount	**358,899**	248,921

	Notes	CONSOLIDATED 2007 $	CONSOLIDATED 2006 $	SUNSHINE HEART, INC. 2007 $	SUNSHINE HEART, INC. 2006 $
11. Trade and Other Payables (Current)					
Trade creditors	11(a)	**–**	25,519	**–**	22
Sundry creditors	11(a)	**189,242**	270,308	**79,954**	95,336
		189,242	295,827	**79,954**	95,358
(a) Trade and sundry creditors are non-interest bearing and are normally settled on 30 day terms.					
12. Provisions (Current)					
Annual leave		**66,517**	40,608	**–**	–
Long service leave		**2,000**	–	**–**	–
		68,517	40,608	**–**	–
Movement in Annual leave provision					
Balance 1 July 2006		**40,608**	33,715	**–**	–
Arising during the year		**85,041**	46,413	**–**	–
Utilised		**(59,132)**	(39,520)	**–**	–
Balance at 30 June 2007		**66,517**	40,608	**–**	–
Movement in Long service leave provision					
Balance 1 July 2006		**–**	–	**–**	–
Arising during the year		**2,000**	–	**–**	–
Balance at 30 June 2007		**2,000**	–	**–**	–
13. Government Grants					
Deferred Income		**–**	157,521	**–**	–

Refer to Note 18 for contingent arrangements associated with government grants.

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007	2006	**2007**	2006
	$	$	**$**	$

14. Contributed Equity and Reserves

(a) Issued and paid up capital

	2007 $	2006 $	**2007 $**	2006 $
Shares, fully paid	**35,694,928**	22,259,263	**35,694,928**	22,259,263
Warrants	**1,379,200**	1,379,200	**1,379,200**	1,379,200
	37,074,128	23,638,463	**37,074,128**	23,638,463

(b) Movements in shares on issue

	2007 NUMBER OF SHARES	**$**	2006 NUMBER OF SHARES	$
Shares, fully paid				
Beginning of the financial year	**81,917,328**	**22,259,263**	64,994,251	19,186,753
Issued on 20 December 2005 for cash as first tranche of placement	**–**	**–**	8,442,500	1,646,288
Issued on 16 January 2006 for cash as final tranche of placement	**–**	**–**	8,480,577	1,653,712
Issued on 15 November 2006 for cash as first trance of placement (refer note 14g)	**92,013,641**	**13,802,391**	–	–
Transaction costs on share issue	**–**	**(366,726)**	–	(227,490)
End of the financial year	**173,930,969**	**35,694,928**	81,917,328	22,259,263
Warrants				
Beginning of the financial year	**800**	**1,379,200**	800	1,379,200
Issued during the year	**–**	**–**	–	–
End of the financial year	**800**	**1,379,200**	800	1,379,200

(c) Share Options

Employee Options

During the financial year Sunshine Heart, Inc. issued 15,398,784 options over ordinary shares with an issue term of 10 years. The options had an average exercise price of $0.27 and average vesting period of three years. During the financial year 194,000 share options with an issue term of 4 years and an exercise price of $0.30 expired, unexercised and were subsequently cancelled.

At the end of the year there were 26,760,202 (2006: 11,817,418) unissued ordinary shares in respect of which employee options were outstanding as remuneration to directors, consultants and employees of the Company (refer Note 17).

Placement Options

During the financial year Sunshine Heart, Inc. issued 27,604,079 options over ordinary shares with an issue term of 3 years as part of trance 1 of the capital raising. These options were issued on 15 November 2006 and had an exercise price of $0.20.

At the end of the year there were 27,604,079 (2006: nil) unissued ordinary shares in respect of which placement options were outstanding.

14. Contributed Equity and Reserves (Cont'd)

(d) Terms and conditions of contributed equity

Ordinary shares

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

Warrants

Warrants to purchase ordinary shares were issued in connection with an $800,000 29 June 2004 convertible promissory notes issued as a bridging loan prior to the Initial Public Offer. These warrants were issued to related party entities affiliated with directors Dr Geoffrey Brooke, Crispin Marsh and Dr William Peters and to one unrelated party. The Warrants entitle the holders to subscribe for a total of 3,200,000 shares at $0.25. The warrants have an exercise period of ten years and expire on 20 June 2014. No warrants were exercised during the year.

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007 $	2006 $	**2007 $**	2006 $
(e) Accumulated Losses				
Movement in accumulated losses were as follows:				
Balance 1 July	**(18,675,795)**	(11,640,347)	**(18,675,795)**	(11,640,347)
Net loss attributable to members of Sunshine Heart, Inc.	**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Balance 30 June	**(30,215,208)**	(18,675,795)	**(30,215,208)**	(18,675,795)

	CONSOLIDATED		SUNSHINE HEART, INC.	
	Employee equity benefits reserve	**Total**	**Employee equity benefits reserve**	**Total**
(f) Reserves				
Movement in reserves were as follows:				
At 1 July 2005	(652,440)	(652,440)	(652,440)	(652,440)
Share-based payments	(292,628)	(292,628)	(292,628)	(292,628)
At 30 June 2006	(945,068)	(945,068)	(945,068)	(945,068)
Share-based payments	(319,760)	(319,760)	(319,760)	(319,760)
At 30 June 2007	(1,264,828)	(1,264,828)	(1,264,828)	(1,264,828)

(g) Forward Binding Commitment for Equity Issue – Tranche 2 of Institutional Capital Raising

As announced to the ASX on 12 September 2006, the Group closed a capital raising by way of an institutional placement ('placement') that resulted in binding commitments of $19,802,046 million in a two tranche deal structure. Tranche 1 was completed on 15 November 2006 and raised $13,802,046 before issue costs.

Tranche 2 of the placement was approved by shareholders at an Extraordinary General Meeting held on 20 October 2006. Tranche 2 is a concurrent binding commitment by two Directors' associated entities and the Group to subscribe for and issue shares and share options in the Group. The legal form of the Tranche 2 agreements between the Group and the subscribers is by way of unlisted option instruments to subscribe for a total of 40,000,000 fully paid ordinary shares and 12,000,000 options over fully paid ordinary shares (with an exercise price of twenty cents and a three year term) to be issued for $6,000,000 in equity proceeds, before issue costs. The option instruments have an expiry date of 15 November 2007. The unlisted options do not provide dividend or voting rights. Under the terms of the option agreements, the option holder, or the Entity, may exercise the option by subscribing for, or requiring the subscription for, shares after the FDA approves or conditionally approves the Group's application to conduct an IDE human clinical trial in the United States on or before 15 November 2007. The table that follows summarises Tranche 2 of the placement.

Director	Option Holder	Number of underlying fully paid ordinary shares	Number of options to subscribe for shares	Consideration/ Exercise Price ($)
Mr John M Brennan (1)	CM Capital VT4A PTY Limited as trustee of CM Capital Venture Trust 4A	10,666,667	3,200,000	2,240,000
Mr John M Brennan (1)	CM Capital VT4B PTY Limited as trustee of CM Capital Venture Trust 4B	10,666,666	3,200,000	2,240,000
Dr Geoffrey Brooke (2)	GBS Venture Partners Ltd as managers and trustee of the GBS BioVentures II Trust	5,333,334	1,600,000	1,120,000
Dr Geoffrey Brooke (2)	GBS Venture Partners Ltd as managers and trustee of the GBS BioVentures III Trust	13,333,333	4,000,000	2,800,000
Total		40,000,000	12,000,000	8,400,000

(1) Mr Brennan has an indirect interest as a member and Partner of CM Capital Investments, which manages both option holding entities.

(2) Dr Brooke has an indirect interest as a member and the Managing Director of GBS Venture Partners Limited.

	Notes	CONSOLIDATED 2007 $	CONSOLIDATED 2006 $	SUNSHINE HEART, INC. 2007 $	SUNSHINE HEART, INC. 2006 $
15. Cash and Cash Equivalents					
(a) Reconciliation of the net loss after tax to the net cash flows from operations					
Net loss		**(11,539,413)**	(7,035,448)	**(11,539,413)**	(7,035,448)
Non-Cash Items					
Write down of investments in subsidiaries	3(b)	**–**	–	**11,243,813**	6,654,386
Depreciation and amortisation of non-current assets	3(c)	**64,269**	46,307	**–**	–
Share based payments expense		**319,760**	292,628	**–**	–
Unrealised net foreign exchange differences		**77,408**	(35,956)	**77,408**	(35,956)
Changes in assets and liabilities					
(Increase)/decrease in prepayments and other receivables		**1,316,682**	348,802	**13,873**	(254,293)
(Decrease)/increase in trade and other payables		**(264,106)**	44,592	**(15,396)**	7,905
Increase in provisions		**27,908**	6,893	**–**	–
Net cash flow from operating activities		**(9,997,492)**	(6,332,182)	**(219,715)**	(663,406)
(b) Reconciliation of cash					
Cash balance comprises:					
– cash at bank		**2,878,884**	3,031,974	**408,812**	2,052,144
– term deposits		**4,839,614**	1,500,000	**4,839,614**	1,500,000
Closing cash balance		**7,718,498**	4,531,974	**5,248,426**	3,552,144

(c) Terms and conditions

For the purposes of the cash flow statement, cash comprises short term deposits with an original maturity of three months or less and cash at bank.

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007 **$**	2006 $	**2007** **$**	2006 $

16. Commitments

(a) Lease expenditure commitments – Group as lessee

(i) Operating leases (non-cancellable):				
Minimum lease payments				
– not later than one year	**105,165**	67,246	**–**	–
– later than one year and not later than five years	**–**	–	**–**	–
Aggregate lease expenditure contracted for at reporting date	**105,165**	67,246	**–**	–

Operating lease expenditure commitments include two property leases. The St Leonards property lease expires on 15 February 2008. The Orange County, California property lease is a one year lease that expires in November 2007. Both property leases are expected to be renewed on similar terms at expiration.

(b) Other expenditure commitments

During the year, the Group made a commitment to one of its manufacturing supply partners for various production batches of clinical cuffs to be supplied on a staggered and as needs basis. The unfilled portion of this commitment was $81,897 at 30 June 2007.

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007 **$**	2006 $	**2007** **$**	2006 $
Commitments contracted for at reporting date but not recognised as liabilities are as follows:				
– not later than one year	**81,897**	103,470	**–**	–
– later than one year and not later than five years	**–**	–	**–**	–
Aggregate lease expenditure contracted for at reporting date	**81,897**	103,470	**–**	–

17. Share Based Payments Plan

Employee Share Incentive Scheme

The 2002 Stock Plan ('the Plan') has been established, pursuant to which Sunshine Heart may, at the discretion of the Board or a committee appointed by the Board to administer the Plan, grant options to purchase Shares of Sunshine Heart to directors, employees, advisors and consultants ('employees') of the consolidated entity.

The options are issued for a term stated in the option agreement, not exceeding ten years from the date of the grant. The options are not quoted on the ASX.

At 30 June 2007 there were 11 retained Key Management Personnel and 7 staff members eligible for the Plan. Any vesting requirements are set out in the option agreements and are determined at the discretion of the Board or a Board-appointed administration committee.

Information with respect to the number of options granted under the Plan is as follows. It is noted that where the exercise price is dominated in US dollars, it has been translated to Australian dollars using the exchange rate applicable on 30 June 2007, being $0.8488. All options issued and outstanding under the Plan do not carry dividend and/or voting rights.

	2007		2006	
	NUMBER OF OPTIONS	**WEIGHTED AVERAGE EXERCISE PRICE $**	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE $
Balance at beginning of year	**11,817,418**	**0.25**	10,418,918	0.23
– granted	**15,398,784**	**0.27**	1,408,200	0.36
– forfeited/cancelled	**(406,000)**	**0.39**	(9,700)	0.62
Balance at end of year	**26,810,202**	**0.26**	11,817,418	0.25

Options held as at the end of the reporting period:

The following table summarises information about options held by the employees as at 30 June 2007. The Options granted do not provide dividend and or voting rights. No consideration was paid to the entity from employees on granting of the Options.

Number of options	Grant date	Vesting commencement date	Expiry date	Weighted average exercise price
1,049,208	7 Nov 02	1 Jan 01 to 9 Sep 02	1 Jun 06 to 6 Nov 07	0.51
2,033,238	19 Dec 02 to 13 Oct 03	19 Dec 02 to 1 Nov 03	18 Dec 12 to 12 Oct 13	0.02
1,783,282	31 Jan 03	31 Jan 03	30 Jan 13	0.09
38,800	29 Apr 03	31 Jan 03	28 Apr 13	0.16
814,800	19 May 04	30 Mar 04	18 May 14	0.10
3,691,490	23 Jun 04	28 Sep 04	23 Jun 14	0.28
485,000	20 Jul 04	28 Sep 04	20 Jul 14	0.50
19,400	31 May 05	31 May 05	30 May 10	0.60
194,000	21 Jun 05	10 Jan 05 to 21 Jun 05	20 June 10	0.48
909,000	9 Feb 06	7 Nov 05 to 3 Jan 06	8 Feb 16	0.36
335,000	21 Apr 06	31 Mar 06	20 Apr 16	0.37
58,200	2 Jun 06	1 Jun 06	1 Jun 16	0.25
1,338,784	1 Nov 06	1 Nov 06	31 Oct 16	0.20
5,160,000	31 Jan 07	31 Jan 07	30 Jan 07	0.27
1,800,000	16 Apr 07	30 Jun 07	15 Apr 17	0.29
7,050,000	18 Apr 07	30 Jun 07	17 Apr 17	0.28
50,000	24 May 07	24 May 07	23 May 17	0.20

Options granted as part of employee remuneration have been valued using the Black-Scholes option pricing methodology, to provide the fair value of the options. This methodology takes into account factors such as the share price at grant date, the exercise price, the term of the option, the expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option. With regards to the performance conditions, options to individuals are assumed to vest, and therefore it is not appropriate to reduce fair value estimates of options that may not vest.

Fair value of options

The fair value of each option is estimated on the grant date using a Black-Scholes option pricing model with the following weighted average assumptions used:

	2007	2006
Dividend yield (%)	0%	0%
Risk-free Interest rate (%)	6.10%	5.27%
Expected volatility (%)	45%	70%
Expected life of option (years)	5 years	10 years
Weighted average exercise price	$0.26	$0.25

The amount of options remuneration is determined on a pro-rata basis, by amortising the fair value estimate of each option, over the vesting period of the individual option grant. The fair value of options granted as compensation is recognised as an expense on a pro-rata basis over the vesting period in the income statement with a corresponding adjustment to equity.

18. Contingent Liabilities

Commercial Ready Grant

On 21 October 2005, Sunshine Heart Company Pty Ltd (SHCP) received a Commercial Ready Grant from the Australian Government through AusIndustry. The grant contributes fifty cents for each dollar spent on eligible project spends, to a maximum funding of $2.23 million.

On 13 June 2006, SHCP received a further Commercial Ready Grant from the Australian Government through AusIndustry. The grant contributes fifty cents for each dollar spent on eligible project spends, to a maximum funding of $2.16 million.

Under the terms of both agreements, the government may require SHCP to repay all or some of the amount, including interest, in any of the following circumstances:

(a) SHCP fails to use its best endeavours to commercialise the relevant grant project within a reasonable time of completion of the project; or

(b) Upon termination of a grant due to breach or insolvency; or

(c) At any time for up to five years, a change in control occurs whereby either Sunshine Heart, Inc.'s ownership of the subsidiary (grant recipient) falls below fifty percent or Australian ownership of Sunshine Heart, Inc falls below fifty per cent.

SHCP continues the development and commercialisation of all projects funded by the Commercial Ready program. The total amount received under the Commercial Ready Programs as at 30 June 2007 was $3.93 million.

19. Subsequent Events

There were no material events occurring after balance date which may affect either the Group's operations or results of those operations or the Group's state of affairs.

	2007 $	2006 $

20. Earnings / (Loss) Per Share

The following reflects the income and share data used in the calculations of basic and diluted loss per share:

	2007 $	2006 $
Net loss	**(11,539,412)**	(7,035,448)
Weighted average number of ordinary shares used in calculating basic and dilutive earnings per share (Note that, had the dilutive shares been factored, this would have reduced the net loss per share):	**139,142,250**	73,268,923

The following type and number of shares are not included in the weighted average number of ordinary shares noted above as they are anti-dilutive in nature:

– Warrants 3,200,000 – Options 54,414,281

21. Auditors' Remuneration

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007 $	2006 $	**2007 $**	2006 $
Amounts received or due and receivable by Ernst & Young Australia for:				
– an audit or review of the financial report of the entity and any other entity in the consolidated entity	**128,780**	98,464	**128,780**	98,464
– an audit or review of the financial report of the entity and any other entity in the consolidated entity that relates to prior year	**34,880**	–	**34,880**	–
– other services in relation to the entity and any other entity in the consolidated entity				
– Tax compliance services	**23,372**	30,989	**14,022**	8,422
– Advisory services	**2,500**	–	**–**	–
	189,532	129,453	**177,682**	106,886

22. Director and Executive Disclosures

(a) Details of Key Management Personnel

(i) Directors

Mr Malcolm McComas	Chairman (non-executive)
Dr Geoffrey Brooke	Director (non-executive)
Dr Richard Lin	Director (non-executive)
Mr Crispin Marsh	Director (non-executive)
Mr Donal O'Dwyer	Director (non-executive)
Dr William Peters	Medical Director and Chief Technology Officer
Mr John Brennan	Director (non-executive) appointed 1 November, 2006
Mr Donald Rohrbaugh	Chief Executive Officer

(ii) Executives

Mr Victor Windeyer	Chief Operating Officer
Mr Brian Bolton	Chief Financial Officer and Company Secretary, appointed 16 April 2007
Mr Gary Frugard	VP of Regulatory and Quality Affairs
Mr Andrew Blunden	Chief Financial Officer and Company Secretary, resigned 31 January 2007

	CONSOLIDATED		SUNSHINE HEART, INC.	
	2007 $	2006 $	**2007 $**	2006 $
(b) Compensation of Key Management Personnel				
Short-Term	**1,450,617**	1,192,129	**187,500**	201,646
Post Employment	**24,467**	6,813	**–**	–
Share-based Payment	**256,266**	229,521	**12,143**	31,901
	1,731,350	1,428,463	**199,643**	233,547

Sunshine Heart, Inc. has applied the option under Corporations Amendments Regulation 2006 to transfer Key Management Personnel remuneration disclosures required by AASB 124 Related Party Disclosures paragraphs Aus 25.4 to Aus 25.7.2 to the Remuneration report section of the Directors' report. These transferred disclosures have been audited.

(c) Option holdings of Key Management Personnel

June 2007	Balance at beginning of period 1 July 2006	Granted as Remuneration*	Granted as Placement Options	Options Forfeited	Balance at end of period 30 June 2007	Total	Vested at 30 June 2007 Not Exercisable	Vested and Exercisable
Directors								
M. McComas (1)	388,000	–	–	–	388,000	388,000	–	388,000
G. Brooke (2)	97,000	–	8,400,000	–	8,497,000	8,497,000	8,400,000	97,000
R. Lin (3)	116,400	–	2,000,000	–	2,116,400	2,116,400	2,000,000	116,400
C. Marsh	797,881	308,784	1,000,000	–	2,106,665	2,106,665	1,258,784	847,881
D. O'Dwyer	97,000	–	–	–	97,000	97,000	–	97,000
W. Peters	1,573,881	2,440,000	–	–	4,013,881	4,013,881	2,749,801	1,264,080
J. Brennan (4)	–	–	9,600,000	–	9,600,000	9,600,000	9,600,000	–
D. Rohrbaugh (5)	3,934,923	5,640,000	–	–	9,574,923	9,574,923	7,001,389	2,573,534
Executives								
V. Windeyer	800,000	2,040,000	–	–	2,840,000	2,840,000	2,493,333	346,667
B. Bolton	–	1,800,000	–	–	1,800,000	1,800,000	1,789,000	11,000
A. Blunden	350,000	–	–	–	350,000	350,000	35,417	314,583
G. Frugard	506,490	635,000	–	–	1,141,490	1,141,490	819,067	322,423
Total	8,661,575	12,863,784	21,000,000	–	42,525,359	42,525,359	36,146,791	6,378,568

* Approximately 5,000,000 options are performance based and will be forfeited if performance criteria is not achieved.

June 2006	Balance at beginning of period 1 July 2006	Granted as Remuneration*	Options Forfeited	Balance at end of period 30 June 2006	Total	Vested at 30 June 2006 Not Exercisable	Vested and Exercisable
Directors							
M. McComas (1)	388,000	–	–	388,000	388,000	–	388,000
G. Brooke (2)	97,000	–	–	97,000	97,000	40,417	56,583
R. Lin (3)	116,400	–	–	116,400	116,400	40,417	75,983
C. Marsh	797,881	–	–	797,881	797,881	116,358	681,523
D. O'Dwyer	97,000	–	–	97,000	97,000	40,417	56,583
W. Peters	1,573,881	–	–	1,573,881	1,573,881	520,525	1,053,356
D. Rohrbaugh (5)	3,934,923	–	–	3,934,923	3,934,923	1,206,829	2,728,094
Executives							
V. Windeyer	–	800,000	–	800,000	800,000	800,000	–
A. Blunden	300,000	50,000	–	350,000	350,000	50,000	300,000
G. Frugard	481,490	25,000	–	506,490	506,490	275,776	230,714
Total	7,786,575	875,000	–	8,661,575	8,661,575	3,090,739	5,570,836

(1) Options issued to Movilli Pty Limited as trustee for the McComas Family Trust. M. McComas has an indirect interest as a member of a class of potential beneficiaries.

(2) Options issued to GBS Venture Partners Limited in its capacity as manager and trustee of the GBS Bioventures II and III Trusts. Dr G. Brooke has an indirect interest as a member and the Managing Director of GBS Venture Partners Limited.

(3) Options issued to Three Arch Management III L.P. Dr R. Lin is a member.

(4) Options issued to CM Capital Investments in its capacity as trustee of CM Capital Venture Trust 4A and CM Capital Venture Trust 4B. Mr J. Brennan has an indirect interest as a member and Partner of CM Capital Investments.

(5) Options held by The Rohrbaugh Trust. Mr Rohrbaugh is a trustee.

22. Director and Executive Disclosures (Cont'd)

(d) Share holdings of Key Management Personnel in Sunshine Heart, Inc.

30 June 2007	Balance 1 July 2006 Ord	Net Change Ord Purchased	Balance 30 June 2007 Ord
Directors			
M. McComas (1)	100,000	–	100,000
G. Brooke (2)	13,184,835	28,000,000	41,184,835
R. Lin (3)	9,205,801	6,666,667	15,872,468
C. Marsh (4)	3,930,235	3,333,333	7,263,568
D. O'Dwyer (5)	305,000	320,000	625,000
W. Peters (6)	7,001,161	–	7,001,161
J. Brennan (7)	–	32,000,000	32,000,000
Executives			
V. Windeyer	28,825	–	28,825
Total	**33,755,857**	**70,320,000**	**104,075,857**

(1) Shares held by Bunyula Super Pty Ltd as trustee for the Bunyula Superannuation Fund. M. McComas has an indirect interest as a member of a class of potential beneficiaries.

(2) Shares are held by GBS Venture Partners Limited in its capacity as manager and trustee of the GBS Bioventures II and III Trusts. Dr G. Brooke has an indirect interest as a member and the Managing Director of GBS Venture Partners Limited.

(3 809,816 shares are held by Three Arch Associates III LP and 15,052,652 shares held by Three Arch Partners III LP. Dr R. Lin is a member of the general partner of each entity, Three Arch Management III, LLC.

(4) 5,287,002 shares are held by PCLM Investments Pty Ltd and 1,976,566 shares held by SCP Investments Pty Ltd. Mr Marsh is a member and Director of each entity.

(5) 575,000 shares are held by Dundrum Investments Pty Ltd as trustee for the O'Dwyer family trust. D. O'Dwyer has an indirect interest as a member of a class of potential beneficiaries. D. O'Dwyer holds 50,000 shares directly.

(6) 1,940,000 shares are held by Szigetvary Trustee Services Ltd. Dr Peters is a beneficiary of this entity. 5,061,161 shares are held by WSP Holdings Limited. Dr Peters is a member and director of this entity.

(7) 32,000,000 shares are held by CM Capital Investments. J. Brennan has an indirect interest as a member and Partner of CM Capital Investments.

30 June 2006	Balance 1 July 2005 Ord	Net Change Ord Purchased	Balance 30 June 2006 Ord
Directors			
M. McComas (1)	100,000	–	100,000
G. Brooke (2)	9,334,835	3,850,000	13,184,835
R. Lin (3)	9,205,801	–	9,205,801
C. Marsh (4)	2,603,119	1,327,116	3,930,235
D. O'Dwyer (5)	50,000	255,000	305,000
W. Peters (6)	6,901,161	100,000	7,001,161
Executives			
V. Windeyer	–	28,825	28,825
A. Blunden	–	103,000	103,000
Total	**28,194,916**	**5,663,941**	**33,858,857**

(1) Shares held by Bunyula Super Pty Ltd as trustee for the Bunyula Superannuation Fund. M. McComas has an indirect interest as a member of a class of potential beneficiaries.
(2) Shares held by GBS Venture Partners Limited in its capacity as manager and trustee of the GBS Bioventures II Trust. Dr G Brooke has an indirect interest as a member and the Managing Director of GBS Venture Partners Limited.
(3) 469,683 shares held by Three Arch Associates III LP and 8,736,118 shares held by Three Arch Partners III LP. Dr R. Lin is a member of the general partner of each entity, Three Arch Management III, LLC.
(4) 1,453,669 shares held by PCLM Investments Pty Ltd and 1,149,450 shares held by SCP Investments Pty Ltd. Mr Marsh is a member and Director of each entity.
(5) 1,194,000 shares held by Szigetvary Trustee Services Ltd. Dr Peters is a beneficiary of this entity. 4,137,050 shares held by WSP Holdings Australia Pty Ltd and 824,111 shares held by WSP Holdings Limited. Dr Peters is a member and Director of each entity.

(e) Other transactions and balances with Key Management Personnel

During the year ended 30 June 2007, Sunshine Heart Company Pty Limited paid $13,219 (2006: $10,175) to SCP Technology and Growth Pty Limited, a company controlled by C Marsh, for the provision of intellectual property and patent services. At as 30 June 2007, there were no monies outstanding with Key Management Personnel (2006: $nil).

23. Related Party Disclosures

Ultimate parent

Sunshine Heart, Inc. (incorporated in Delaware, USA) is the ultimate parent entity.

The following related party transactions occurred during the financial year:

(i) Wholly-owned Group transactions

During the year ended 30 June 2007, Sunshine Heart, Inc. subscribed for an additional 11,750,000 ordinary fully paid shares in Sunshine Heart Company Pty Limited. The cost of acquisition was $11,750,000. Furthermore, Sunshine Heart, Inc. made additional non-cash investments into its wholly owned subsidiary during the year in recognition of the share based payments expense (options remuneration) of $319,760 (2006: $292,628), refer Note 14.

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

24. Segment Information

(a) Segment products and locations

The consolidated entity operates in one industry segment, which is the research and development of heart assist devices, and in two geographical segments, which are Australia and the United States.

(b) Segment accounting policies

Segment accounting policies are the same as the consolidated entities policies described in Note 2. During the year there have been no changes in segment accounting policies that had a material effect on the segment information.

(c) Geographic segments

	Australia		United States		Unallocated		Elimination		Consolidated	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	$A	$A	**$A**	$A	**$A**	$A	**$A**	$A	**$A**	$A
Segment revenue	**2,694,224**	1,380,509	**–**	–	**526,498**	308,223	**–**	–	**3,220,722**	1,688,732
Segment results	**(11,539,413)**	(7,081,642)	**(11,940,830)**	(7,206,237)	**526,498**	308,223	**11,243,813**	6,654,386	**(11,539,413)**	(7,325,270)
Tax benefit									**–**	289,822
									(11,539,413)	(7,035,448)
Other segment information:										
Depreciation	**55,747**	44,993	**–**	–	**–**	–	**–**	–	**55,747**	44,993
Amortisation	**8,522**	1,314	**–**	–	**–**	–	**–**	–	**8,522**	1,314
Investments write-down	**–**	–	**11,243,813**	6,654,386	**–**	–	**(11,243,813)**	(6,654,386)	**–**	–
Segment assets	**8,362,200**	5,833,050	**2,953,651**	2,633,656	**14,290**	15,138	**(2,948,634)**	(2,080,152)	**8,381,507**	6,401,692
Segment liabilities	**177,805**	403,598	**79,954**	90,358	**–**	–	**–**	–	**257,759**	493,956
Acquisition of plant and equipment	**174,246**	121,404	**–**	–	**–**	–	**–**	–	**174,246**	121,404
Cash flow information:										
Net cash flow used in operating activities	**(9,827,820)**	(6,139,300)	**(697,017)**	(551,851)	**527,345**	358,969	**–**	–	**(9,997,492)**	(6,332,182)
Net cash flow used in investing activities	**(174,246)**	(121,404)	**–**	–	**–**	–	**–**	–	**(174,246)**	(121,404)
Net cash flow from financing activities	**13,435,670**	3,072,510	**–**	–	**–**	–	**–**	–	**13,435,670**	3,072,510

25. Financial Instruments

The Group's principal financial instruments comprise cash and short-term deposits. The Group does not utilise derivatives, holds no debt and does not trade in financial instruments. The Group has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

The main risks arising from the Groups financial instruments are foreign currency risk and liquidity risk. The Board policies for managing these risks are summarised below.

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

(a) Credit Risk Exposures

The credit risk on financial assets of the economic entity, which have been recognised on the balance sheet, is equivalent to their carrying amount. There is no concentration of credit risk.

(b) Interest Rate Exposure

The economic entity's exposure to interest rate risk and the effective weighted average interest rate for each class of financial assets and financial liabilities is set out below.

	Floating interest rate		Fixed interest maturing in							
			1 year or less		Over 1 to 5 years		Non-interest bearing		Total	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006	**2007**	2006
	$A	$A	**$A**	$A	**$A**	$A	**$A**	$A	**$A**	$A
Financial assets										
Cash and deposits	**7,718,498**	4,531,974	**–**	–	**–**	–		–	**7,718,498**	4,531,974
Other receivable	**–**	–	**–**	–	**–**	–	**169,095**	17,065	**169,095**	17,065
Interest receivable	**–**	–	**–**	–	**–**	–	**14,290**	15,138	**14,290**	15,138
Prepayments	**–**	–	**–**	–	**–**	–	**120,725**	1,588,594	**120,725**	1,588,594
	7,718,498	4,531,974	**–**	–	**–**	–	**304,110**	1,620,747	**8,022,608**	6,152,771
Weighted average Interest rate	**6.31%**	5.19%								
Financial liabilities										
Trade and sundry creditors	**–**	–	**–**	–	**–**	–	**257,759**	493,956	**257,759**	493,956
		–	**–**	–	**–**	–	**257,759**	493,956	**257,759**	295,827
Net financial assets (liabilities)	**7,718,498**	4,531,974	**–**	–	**–**	–	**561,869**	2,114,703	**8,280,367**	5,555,801

(c) Net Fair Value of Financial Assets and Financial Liabilities

The net fair value of all financial assets and financial liabilities of the economic entity approximates their carrying value.

(d) Foreign Currency Risk

The Group is exposed to a small amount of foreign currency risk as a result of holding a US bank account and paying some expenses in US dollars. The Group did not seek to hedge this exposure in the current or prior year, primarily due to the uncertainty of the magnitude and timing of foreign denominated expenses being incurred. Where the Group can reasonably forecast likely future US Dollar denominated expenses being incurred in advance, it may consider holding a similar magnitude of funds in the US dollar bank account for ease of administration. The Board reviews the ongoing appropriateness of the Group's policy on managing foreign currency risk based on the level of foreign operations.

(e) Liquidity Risk

The Group's objective is to maintain a balance between continuity of funding for meeting its operating costs and maximising financing revenue through at call bank deposits in line with budget requirements. The Group's policy is to minimise its forward commitments in achieving this objective.

Directors' Declaration

In accordance with a resolution of the Directors of Sunshine Heart, Inc, I state that:

In the opinion of the Directors:

(a) the financial statements, notes and the additional disclosures included in the directors report designated as audited, of the Company and of the consolidated entity are in accordance with the *Corporations Act 2001*, including:

  (i) giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2007 and of their performance for the year ended on that date; and

  (ii) complying with Accounting Standards and Corporations Regulations 2001; and

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

This declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the *Corporations Act 2001* for the year ending 30 June 2007.

On behalf of the Board

Donald Rohrbaugh
Director

Sydney, 23 August 2007

ERNST & YOUNG

■ Ernst & Young Centre
680 George Street
Sydney NSW 2000
Australia

GPO Box 2646
Sydney NSW 2001

■ Tel 61 2 9248 5555
Fax 61 2 9248 5959
DX Sydney Stock
Exchange 10172

Auditor's Independence Declaration to the Directors of Sunshine Heart, Inc

In relation to our audit of the financial report of Sunshine Heart, Inc for the financial year ended 30 June 2007, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

Gamini Martinus

Gamini Martinus
Partner
Sydney
23 August 2007

ERNST & YOUNG

Ernst & Young Centre
680 George Street
Sydney NSW 2000
Australia

GPO Box 2646
Sydney NSW 2001

Tel 61 2 9248 5555
Fax 61 2 9248 5959
DX Sydney Stock Exchange 10172

Independent auditor's report to the members of Sunshine Heart, Inc.

We have audited the accompanying financial report of Sunshine Heart, Inc. (the company), which comprises the balance sheet as at 30 June 2007, and the income statement, statement of recognised income and expense and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entity it controlled at year's end or from time to time during the financial year.

The company has disclosed information as required by paragraphs Aus 25.4 to Aus 25.7.2 of Accounting Standard 124 *Related Party Disclosures* ("remuneration disclosures"), under the heading "Remuneration Report" on pages 14 to 21 of the directors' report, as permitted by Corporations Regulation 2M.6.04.

Directors' Responsibility for the Financial Report
The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. The directors are also responsible for the remuneration disclosures contained in the directors' report.

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 and that the remuneration disclosures comply with Accounting Standard AASB 124 *Related Party Disclosures*.

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

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

Independence
In conducting our audit we have met the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included on page 59 of the financial report. In addition to our audit of the financial report and the remuneration disclosures, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Auditor's Opinion
In our opinion:

1. the financial report of Sunshine Heart, Inc. is in accordance with:

(a) the *Corporations Act 2001*, including:

(i) giving a true and fair view of the financial position of Sunshine Heart, Inc. and the consolidated entity at 30 June 2007 and of their performance for the year ended on that date; and

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

(b) other mandatory financial reporting requirements in Australia.

2. the remuneration disclosures that are contained on pages 14 to 21 of the directors' report comply with Accounting Standard AASB 124 *Related Party Disclosures*.

Inherent Uncertainty Regarding Continuation of Going Concern
Without qualification to the opinion expressed above, attention is drawn to the following matter. As a result of the matters described in Note 2 (c) "Going Concern" to the financial statements, there is significant uncertainty whether the company and/or the consolidated entity will be able to continue as going concerns and therefore whether they will be able to pay their debts as and when they fall due and realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report. The financial report does no include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the company and/or the consolidated entity not continue as going concerns.

Ernst & Young

Ernst & Young

Gamini Martinus

Gamini Martinus
Partner
Sydney
23 August 2007

ASX Additional Information

Additional Additional information required by the Australian Stock Exchange Ltd and not shown elsewhere in this report is as follows.

For the purposes of this report, Chess Depository Instrument (CDI) holders and certificated shareholders are shown as one class of shareholder, notwithstanding CDI holders having beneficial interests in the underlying shares, rather than legal title.

Chess Depository Nominees Pty Ltd (CDN) as a subsidiary of the Australian Stock Exchange Ltd holds the legal title in the Company's shares, for and on behalf of CDI holders, to effect broker-to-broker settlement of trading in the underlying shares. Holders of CDIs are entitled to all the economic benefits of the underlying shares as though they were holders of the legal title. For the purposes of the information below, CDN has been excluded and the terms CDI/fully paid ordinary shares or shares are interchangeable.

This information is current as at 20 August 2007.

(a) Distribution of equity securities

(i) Ordinary share capital

- 173,930,969 fully paid ordinary shares are held by 807 individual security holders.

CDI holders are not entitled to vote at shareholder meetings as CDN holds legal title to the Company's shares, for and on their behalf. CDI holders should direct CDN on how to vote on proposed resolutions at shareholder meetings. CDN must exercise its right to vote by proxy at shareholder meetings in accordance with the directions of CDI holders.

All issued ordinary shares carry one vote per share without restriction.

(ii) Warrants

- 3,200,000 unquoted warrants over ordinary shares are held by 4 individual security holders. Warrants do not carry a right to vote.

(iii) Options

- 54,414,281 unquoted options over ordinary shares are held by 53 individual security holders. Options do not carry a right to vote.

The number of security holders, by size of holding, in each class are:

	Fully paid ordinary shares	Warrants	Options
1 – 1,000	6	–	–
1,001 – 5,000	145	–	1
5,001 – 10,000	187	–	–
10,001 – 100,000	384	–	32
100,001 and over	85	4	20
	807	4	53
Holding less than a marketable parcel of shares are:	58	–	–

(b) Substantial shareholders

Ordinary shareholder	Fully paid Number	Percentage
GBS Venture Partners Limited (GBS Bioventures II A/C)	21,184,835	12.18
GBS Venture Partners Limited (GBS Bioventures III A/C)	20,000,000	11.50
Australian Executor Trustees Ltd (CM Capital Venture 4A A/C)	16,000,000	9.20
Australian Executor Trustees Ltd (CM Capital Venture 4A A/C)	16,000,000	9.20
Three Arch Partners III LP	15,062,652	8.66

(c) Twenty largest holders of quoted equity securities

Ordinary shareholder	Fully paid Number	Percentage
GBS Venture Partners Limited (GBS Bioventures II A/C)	21,184,835	12.18
GBS Venture Partners Limited (GBS Bioventures III A/C)	20,000,000	11.50
Australian Executor Trustees Ltd (CM Capital Venture 4A A/C)	16,000,000	9.20
Australian Executor Trustees Ltd (CM Capital Venture 4A A/C)	16,000,000	9.20
Three Arch Partners III LP	15,062,652	8.66
ANZ Nominees Limited	9,028,583	5.19
Asia Union Investments Pty Ltd	6,511,331	3.74
WSP Holdings Limited	5,061,161	2.91
National Nominees Limited	4,363,814	2.51
Asia Union Investments Pty Ltd	4,042,313	2.32
PCLM Investments Pty Ltd	3,333,333	1.92
Invia Custodian Pty Limited	3,000,000	1.72
Australian Biotechnology and Healthcare Fund No 3 Limited	2,672,889	1.54
The Australian National University	2,423,766	1.39
PCLM Investments Pty Ltd	1,953,669	1.12
Szigetvary Trustee Services Ltd	1,940,000	1.12
Australian Biomedical Fund No 2 Limited	1,581,305	0.91
Mirrabooka Investments Limited	1,250,000	0.72
SCP Investments Pty Limited	1,149,450	0.66
Australian Biomedical Fund No 1 Limited	1,113,864	0.64
	137,672,965	79.15

Corporate Directory

ABN 79 109 440 888

Directors
Mr Malcolm McComas (Chairman)
Dr Geoffrey Brooke
Dr Richard Lin
Mr Crispin Marsh
Mr Donal O'Dwyer
Dr William Peters
Mr Donald Rohrbaugh (Chief Executive Officer)
Mr John Brennan

Company Secretary
Mr Brian Bolton

Registered Office in Australia
3/12 Frederick Street
St Leonards NSW 2065

Australian Solicitors
Henry Davis York
44 Martin Place
Sydney NSW 2000

Bankers
National Australia Bank

Share Registry
Link Market Services Limited
Level 12
680 George Street
Sydney NSW 2000

Auditors
Ernst & Young
680 George Street
Sydney NSW 2000

Internet Address
www.sunshineheart.com