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XSUNX INC  
Form 10-K  
December 14, 2006

FORM 10-K

SECURITIES EXCHANGE COMMISSION  
Washington, D.C. 20549

Annual Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

For the fiscal year ended September 30, 2006

Commission file number: 000-29621

XSUNX, INC.

-----  
(Exact name of registrant as specified in its charter)

Colorado

84-1384159

-----  
(State of incorporation)

-----  
(I.R.S. Employer Identification No.)

65 Enterprise, Aliso Viejo, CA 92656  
(Address of principal executive offices) (Zip Code)

-----  
Registrant's telephone number: (949) 330-8060

Securities registered pursuant to Section 12(b) of the Act:

Title of each class: None Name of each exchange on which registered: N/A

Securities registered pursuant to Section 12(g) of the Act:

Title of each class: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for at least the past 90 days. Yes  No

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. see definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer     Accelerated filer     Non-accelerated filer

State issuer's revenues for its most recent fiscal year. \$8,0000

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. Yes  No

Aggregate market value of the authorized voting stock held by non-affiliates of the registrant as of September 30, 2006: \$75,156,137 based on the last sale price at year end of \$.54 as reported by OTCBB.

Number of authorized outstanding shares of the registrant's no par value common stock, as of December 14, 2006: 157,137,931

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## DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980).

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, and Section 27A of the Securities Act of 1933 that reflect its current expectations about its future results, performance, prospects and opportunities. These forward-looking statements are subject to significant risks, uncertainties, and other factors, including those identified in Risk Factors (see Item 1 "Description of Business - Risk Factors") below, which may cause actual results to differ materially from those expressed in, or implied by, any forward-looking statements. The forward-looking statements within this Form 10-K may be identified by words such as "believes," "anticipates," "expects," "intends," "may," "would," "will" and other similar expressions. However, these words are not the exclusive means of identifying these statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Except as expressly required by the federal securities laws, the Company undertakes no obligation to publicly update or revise any forward-looking statements to reflect events or circumstances occurring subsequent to the filing of this Form 10-K with the SEC or for any other reason. You should carefully review and consider the various disclosures the Company make in this report and its other reports filed with the SEC that attempt to advise interested parties of the risks, uncertainties and other factors that may affect its business.

For further information about these and other risks, uncertainties and factors, please review the disclosure included in this report under Item 1 "Description of Business - Risk Factors and Item 7 "Management's Discussion and Analysis or Plan of Operation - Cautionary and Forward Looking Statements."

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## PART I

### ITEM 1. BUSINESS

#### COMPANY HISTORY

XsunX, Inc. ("XsunX," the "Company" or the "issuer") is a Colorado corporation formerly known as Sun River Mining Inc. "Sun River"). The Company was originally incorporated in Colorado on February 25, 1997. Effective September 24, 2003, the Company completed a Plan of Reorganization and Asset Purchase Agreement (the "Plan").

Pursuant to the Plan the Company acquired the following three patents for

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Seventy Million (70,000,000) shares (post reverse split one for twenty): No. 6,180,871 for Transparent Solar Cell and Method of Fabrication (Device), granted on January 30, 2001; No. 6,320,117 for Transparent Solar Cell and Method of Fabrication (Method of Fabrication), granted on November 20, 2001; and No. 6,509,204 for Transparent Solar Cell and Method of Fabrication (formed with a Schottky barrier diode and method of its manufacture), granted on January 21, 2003.

Pursuant to the Plan, the Company authorized the issuance of 110,530,000 (post reverse split) common shares. Prior to the Plan the Company had no tangible assets and insignificant liabilities. Subsequent to the Plan the Company completed its name change from Sun River Mining, Inc. to XsunX, Inc. The transaction was completed on September 30, 2003.

### GENERAL OVERVIEW

XsunX develops and markets proprietary solar cell designs and core solar cell manufacturing systems, enabling licensees to manufacture advanced thin film solar devices on various substrates. We function as a strategic solar technology partner, supplying the advanced thin film solar cell manufacturing know-how and capabilities that will enable our original equipment manufacturers ("OEM") customers to address the expanding market for thin film solar products.

The process for producing electricity from sunlight is known as Photovoltaics. Thin film photovoltaics (TFPV) are comprised of thin film of PV material deposited on various rigid or flexible substrate. Photovoltaic ("PV") is the science of capturing and converting sun light into electricity.

The product of the Company's development efforts is intended to deliver two aspects of deliverable technologies in the form of an integrated solution providing, a) commercially scalable manufactured processes and equipment designed for the specific manufacture of the Company's thin film solar technologies, and, b) proprietary thin film solar cell designs that address new application opportunities in the growing field of Building Integrated Photovoltaics.

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### BUSINESS STRATEGY

XsunX, as a technology partner to our customers, develops and delivers thin film solar cell designs and core manufacturing systems, customized to the needs of our customers. Licensees of our technology can manufacture thin film solar cells that are lightweight, flexible, and provide OEM's the opportunity for rapid returns on investment (ROI). The key aspects to XsunX's business strategy are:

XsunX is positioning itself as a leading provider of TFPV device designs and core manufacturing products to an expanding global group of existing and new entrant solar product manufacturers. The company is working to establish an environment in which XsunX products and technologies are viewed as advanced core support infrastructure to manufacturers increasing their opportunities for economic success in servicing their regional solar markets. XsunX does not sell thin film solar materials directly to the consumer market.

Preliminary marketing based on an analysis of 3,120 direct product inquires for the last 12 months illustrates a wide breadth of interest and diversity ranging from local home owners enquiring about solar glazing for their home to international automakers enquiring about solar glazing for their automobiles.

The preliminary results of the marketing queries provide insights into end-user

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support and interest from potential customers. The percentage breakdown of the queries is as follows:

- o 70% End-users: such as Architects, Building Managers, and Residential
- o 16% Distributors, Integrators, and Fabricators
- o 12% New Entrant OEMs and Manufacturers
- o 2% Existing Solar or Building Material Manufacturers
- o And of the queries, 23% were international in nature and were comprised of India, China, Japan, Mexico, Australia, France, Italy, Germany, Spain, Portugal, Belgium, Eastern Europe, Costa Rica, and Chile.

Based upon these initial results and the high degree of new entrant interest, XsunX believes that there is a market for fully integrated turnkey manufacturing lines and their end product TFPV panels. Therefore, the targeted manufacturing partners will include (but not be limited to):

- o Existing and new entrant Photovoltaic materials manufacturers
- o Construction materials manufacturers (BIPV)
- o Solar energy systems integrators
- o Global Joint Ventures

### PRODUCTS

The XsunX approach integrates technologies for the production of thin film variants of silicon (Si) solar cells using various processes to form the necessary top and bottom transparent conducting oxides (TCO) as contacts, Plasma Enhanced Chemical Vapor Deposition (PECVD) to form the photovoltaic cores, patterning techniques to generate either serially connected or discrete solar cells, and a cassette based patented reel-to-reel material handling system that allows for the use of metallic or plastic based flexible substrates.

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XsunX systems offer the efficiency attributes of in-line roll-to-roll thin film processing techniques, process automation, reliability and low maintenance while improving cell efficiencies due to reductions in cross chamber contamination. Modular in design the systems offer upgradeability for production capacities, process technology, and can be designed for delivery in either cluster or in-line system architectures. Production capacities for multi-chamber cluster tool production configurations are offered in capacities ranging from 1MW/y to 5MW/y, and in-line multi-chamber production configurations can be offered in capacities ranging from 5MW/y to in excess of 50MW/y.

Systems can be designed for integration into existing or new front and back end production lines and configured for annual production capacities to meet the needs of customers. Innovative production technologies include:

- o Multi-Chamber vacuum deposition
- o Advanced Sputtering Techniques
- o RF &VHF Plasma Enhanced Chemical Vapor Deposition (PECVD)
- o Cassette based reel-to-reel material handling
- o The use of flexible and/or rigid substrates
- o Automated robotic control systems
- o Web widths starting at 30 cm

The Company's solar cell designs, development efforts, and marketing objectives are focused on the commercialization of the following two primary solar cell device types for production:

Power Glass(R) for semi-transparent and opaque applications on both

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flexible and rigid substrates - a patented Amorphous Silicon cell structure offering the advantages of cost effective monolithically integrated solutions for use in architectural glass, building materials, and consumer products. These cells are single-junction amorphous silicon based (a-Si) solar cells that depending on the degree of light transmission, or transmissivity, can operate at up to 4% efficiencies. That is approximately 40 watts of direct current can be produced per square meter of Power Glass film. A projected cost on the order of \$2.16/W is expected for relatively conservative deposition rates and a 3.8MW/y factory. Costs are comprised by materials, equipment (cluster tool and non-cluster tool), personnel (fringes included) and a U.S. based G and A rate of 40%. Throughputs and production costs were calculated assuming 4% efficiency for different deposition rates for a-Si and ITO.

Hybrid 4-Terminal for high performance and high stability opaque applications rivaling silicon wafer efficiencies - a patent-pending cell structure combining nano crystalline (nc-Si) and amorphous silicon (a-Si) layers exceeding the performance characteristics of tandem and multi-junction Si solar cell designs without the limiting aspects of current matching, stability, and performance degradation. The initial operating efficiencies for this cell type are anticipated to produce 10% conversion efficiencies and through continued refinement of the device properties the Company anticipates improvements to produce conversion efficiencies of 12% to 14%. A projected cost on the order of \$1.65/W is expected for relatively conservative deposition rates and a 4MW/y factory. Costs are comprised by materials, equipment (cluster tool and non-cluster tool), personnel (fringes included) and a U.S. based G and A rate of 40%. Throughputs and production costs were calculated assuming 10% efficiency for different deposition rates for a-Si, nc-Si and ZnO.

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### COMPANY SPONSORED RESEARCH AND DEVELOPMENT

Management has established a plan under which the Company has and continues to work to commercializing its technologies and develop new technologies through the contracting for research, development and commercialization processes with certain qualified facilities that specialize in the Company's target market segments. Management believes this product development process has provided the Company with the fastest path to marketable products, the maximization of corporate resources, and, the broadest access to cutting edge device and material engineering facilities, and technical expertise.

In June 2004 XsunX established, and continues to maintain, a strategic relationship with Colorado based MVSystems, Inc. that designs, builds, and delivers state-of-the-art manufacturing tools designed specifically for the thin film semiconductor market. MVSystems, Inc. ("MVSystems") is equipped with both the technical staff and tools necessary for the development and commercialization of XsunX technologies. The terms of the working relationship provide XsunX with complete R&D facilities without mark-up for profit on the use of staff and equipment. In return MVSystems received warrants for the purchase of common stock in XsunX.

In September 2004 XsunX increased its patent and technology assets by acquiring an exclusive royalty free license from MVSystems to a suite of patents and technologies specific to the design and manufacture of its semi-transparent solar electric glazing initiative, Power Glass. In October of 2005 the Company further expanded its licensing rights with MVSystems to include the design and manufacture of opaque solar cell designs thereby also expanding the Company's

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intended product base to include both semi-transparent and opaque thin film solar cell designs, and manufacturing methods, (see Item 8B "Subsequent Events - Expanded License and Warrants"). The Company believes that the licensed technologies provide enhanced commercial viability for its products, and improved market opportunities.

For the year ended September 30, 2006, the Company committed 39% or \$949,472 of its cash operational expenditures towards product development, another \$220,000 was committed for use in the addition of development equipment, and \$1,765,000 was committed for the production of a marketable production system prototype that is currently in the final stages of assembly. The Company intends to continue to focus on the development and refinement of commercially appealing solar cell designs, proprietary manufacturing processes, and facilities design that could be provided to our future licensees as turnkey solutions for the core requirements necessary for the mass production of the Company's thin film designs. A large part of the Company's capital is used for on going product development efforts.

At present the Company continues to develop and optimize its solar cell designs and manufacturing process for commercial applications. Areas of on going process development include:

- (a) Device development on thin-film sheet and rolled polymers, plastics, and metals
- (b) Deposition processes to enhance device properties and reduce manufacturing costs
- (c) Enhanced reel-to-reel processing designs; and
- (d) Development of new cell segmentation process for integration into manufacturing process

The Company has and continues to make investments in the development of intellectual property assets as part of its business plan. For the year ending September 30, 2007 the Company has developed a plan of operations requiring \$5,750,000 that commits 21% of its budget or \$1,200,000 to the completion of development of a patent-pending 4-Terminal solar cell device, another 26% of its budget or \$1,500,000 to the development of new technologies licensed and/or acquired during the 2007 period, and another 16% of its budget or \$900,000 to

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the completion of its first production line system for eventual re-sale to future licensee's and for engineering and adaptation of new manufacturing devices and techniques. The purpose of these on going investments is to develop and market patented and proprietary solar electric thin film designs and manufacturing processes for sale and licensure to our target markets. No research was done by the Company prior to September 30, 2003.

### TRADEMARK, PROPRIETARY TECHNOLOGY AND PATENTS

The Company entered into an agreement for the purchase of the U.S. registered trademark "Power Glass(TM)" and Internet domain name PowerGlass.com in May 2004 from Western Gas and Electric Company, a California corporation. The Company has not been issued registered trademarks for its "XsunX" trade name. The Company may file trademark and trade name applications with the United States Office of Patents and Trademarks for its proposed trade names and trademarks.

In September 2003 the Company was assigned the rights to three patents as part of an Asset Purchase Agreement with Xoptix Inc., a California corporation. The patents acquired were No. 6,180,871 for Transparent Solar Cell and Method of Fabrication (Device), granted on January 30, 2001; No. 6,320,117 for Transparent Solar Cell and Method of Fabrication (Method of Fabrication), granted on November 20, 2001; and No. 6,509,204 for Transparent Solar Cell and Method of Fabrication (formed with a Schottky barrier diode and method of its

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manufacture), granted on January 21, 2003.

In addition, XsunX licensed the patent and technology portfolio of MVSystems, Inc., a Colorado corporation ("MVSystems") in September 2004. The license granted XsunX the royalty free exclusive rights for use by XsunX in its pursuit to establish a commercially viable process for the manufacture of semi-transparent solar cells and solar electric glazing processes and, accordingly, included all MVSystems technology, know how, and resources which are part of or related to the licensed patents and technology that was then or may become applicable or beneficial to the furtherance of the business objectives of XsunX in the future. The license was exclusive as to technology pertaining to XsunX field of use as it pertains to the business of developing, commercializing and licensing processes for the manufacture of semi-transparent (greater than 5% transparency) solar cells or photovoltaic glazing technologies.

In October of 2005 the Company further expanded its licensing rights with MVSystems to include the design and manufacture of opaque solar cell designs thereby also expanding the Company's intended product base to include both semi-transparent and non-transparent thin film solar cell designs, and manufacturing methods, (see Item 8B "Subsequent Events - Expanded License and Warrants"). The Company believes that the licensed technologies provide them with key aspects to successful completion of its product development efforts, the commercial viability of future products, and the ability to deliver those products.

The following are two of the patents licensed from MVSystems that XsunX management believes to be beneficial to the development of scalable manufacturing processes for its thin film technology. Semiconductor Vacuum Deposition System And Method Having A Reel-To-Reel Substrate Cassette: US6, 258,408 B1: July 10th, 2001. (Method of Fabrication); and US Provisional Patent Application serial number 60/536,151- three terminal and four terminal solar cells, solar cell panels, and method of manufacture. (Device and Method of Fabrication)

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As part of the October 2005 license expansion with MVSystems the Company also received the benefit of equipment manufacturing services from MVSystems under an at cost, without mark up for profit, plus ten percent pricing structure. This provided the Company with access to equipment manufacturing facilities and the ability to market and deliver integrated manufacturing systems capable of producing its thin films solar cell designs. During its operating history MVSystems has designed, constructed, installed, and provided support for over 70 systems ranging from small research and development systems to multi-megawatt production systems.

The Company continues to develop additional processes, techniques, and device designs. These research and development efforts may provide the Company with additional proprietary technology that may lead to the filing of new provisional and patent applications.

### GROWTH, REVENUE AND DISTRIBUTION PLAN

The Company intends to market its integrated manufacturing systems as turnkey solutions for the manufacture of its current and future PV thin films designs. The TFPV manufacturing systems will be licensed to manufacturers as modular systems and licensed for use in the manufacture the Company's thin film designs. The manufacturers would in turn agree to manufacture and distribute the Company's PV thin films, or incorporate the thin film PV technology into their product manufacturing process as an "original equipment manufacturer" (OEM) and sell the finished product to their consumers. Although the Company is currently



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providing proposals to interested OEM's no licenses or contracts now exist with any manufacturer.

We intend to target customers who are developing their own technology platforms in which the manufacture of or the integration of our thin film solar cells could play an important role. The Company will offer non-exclusive manufacturing licenses and expects to earn a royalty on thin films manufactured. In selling the manufacturing equipment and licensing the technology to OEM's, the Company reduces operating expenses and saves capital in plant, property and equipment. As a result, should the Company realize earnings it intends to reinvest its retained earnings in R&D in an effort to continuously develop related new technologies that will help achieve sustainable competitive advantages for the Company.

### BACKLOG OF ORDERS

There are currently no orders for sales.

### GOVERNMENT CONTRACTS

There are no government contracts at this time.

### COMPETITIVE CONDITIONS

Currently, management is aware of other technologies similar to those of the company on the market. These include vacuum chamber manufacturing technologies, plasma enhanced vapor deposition technologies, and variants of available solar cells that capture and convert solar energy into usable power. Although similar in respect to the operation and use of these technologies the Company believes that its patented solar cell designs and manufacturing methods provide marketable improvements over current other technologies. However, a number of new solar cell technologies have and are being developed by other companies. Such technologies include amorphous silicon, cadmium telluride, copper-indium-gallium-selenide (CIGS), and copper indium diselenide as well as

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advanced concepts in thin film crystalline silicon, and the use of organic materials. Given the benefit of time, investment, and advances in manufacturing technologies any of these competing technologies may achieve manufacturing costs per watt lower than the cost per watt to manufacture our thin film solar cells.

In accessing the principal competitive factors in the market for solar electric power products we use price per watt, stability and reliability, conversion efficiency, diversity in use applications and other performance metrics such as scalability of manufacturing processes and the ability to adapt new technologies into cell designs and the manufacturing process without antiquation of existing infrastructure. If we do not compete successfully with respect to these or other factors, it could materially and adversely affect our business, results of operations, and financial condition.

A number of large companies are actively engaged in the development, manufacturing and marketing of solar electric power products. The five largest PV cell suppliers are Q-Cells Shell Solar, Sharp Corporation, BP Solar, and Kyocera Corporation, which together supply the significant portion of the current PV cell market. All of these companies have greater resources to devote to research, development, manufacturing and marketing than we do.

Other competitive factors lie in the current use of other clean renewable energy technologies such as wind, ocean thermal, ocean tidal, and geo-thermal power sources, and conventional fossil fuel based technologies for the production of

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electricity. We expect our primary competition will be within the solar cell marketplace itself. Barriers to entering the solar cell manufacturing industry include the technical know-how required to produce solar cells that maintain acceptable efficiency rates and the design of efficient and scalable manufacturing processes.

### COMPLIANCE WITH ENVIROMENTAL LAWS AND REGULATIONS

The operations of the Company are subject to local, state and federal laws and regulations governing environmental quality and pollution control. To date, compliance with these regulations by the Company has had no material effect on the Company's operations, capital, earnings, or competitive position, and the cost of such compliance has not been material. The Company is unable to assess or predict at this time what effect additional regulations or legislation could have on its activities.

### ADMINISTRATIVE AND MARKETING OFFICES

As of September 30, 2006 the Company leased administrative office facilities located at 65 Enterprise, Aliso Viejo CA 92656 for approximately \$2,000 per month pursuant to a six month lease agreement renewable in 6 month or greater increments thereafter. Management anticipates that there may be a need to increase administrative office facilities in the 2007 period. There can be no assurances that the Company will be able to find the necessary additional facilities on terms similar or more advantageous to the current facility terms.

In April 2006 the Company entered into a three year lease for technical and marketing operations facilities in Golden, CO. The Company provided a \$2,615 security deposit and expensed \$79,867 in costs associated with tenant improvements to the facilities in preparation for occupancy. The following is a schedule, by years, of the minimum base payments required under this operating lease for facilities. An additional \$825 monthly is also due as a pro rata share equaling 4.12% of the operating costs for real estate taxes, assessments, and the expenses of operating and maintaining common areas within the commercial grounds surrounding the leased facilities.

Annual Rent Schedule	Rate/sf	Annualized Rent	Monthly Rent
-----	-----	----	----
7/1/06-6/30/07	\$6.75	\$20,250.00	\$1,687.50
7/1/07-6/30/08	\$6.95	\$20,850.00	\$1,737.50
7/1/08-6/30/09	\$7.16	\$21,480.00	\$1,790.00

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### EMPLOYEES AND CONSULTANTS

The Company is a development stage company and as of September 30, 2006 had 5 salaried employees. This represents an increase of 4 employees over the same period ended 2005. Through various other consultancy agreements and a strategic technology sharing and facilities use relationship with MVSystems, Inc. we use the services of approximately 15 additional technologists and support staff to assist in the development of our products. The Company projects that during the next 12 months the Company's workforce is likely to increase to 13, with 2 of the new employees being in Administrative, 2 in Marketing and Sales positions, 3 Scientific and Technical positions, and 1 in Administrative Support. In addition to the anticipated addition of new employees the Company expects to expand its use of strategic relationships to leverage industry expertise in areas of design, systems automation, manufacturing and assembly to augment product commercialization time lines and the delivery of technologies. The Company may find a need to engage additional full-time employees as necessary.

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### ADVISORY BOARD

In September 2004 the Company established the XsunX Scientific Advisory Board to attract qualified specialists from the fields of material and device engineering, and, industry specialists representing expertise in manufacturing, design, certification and applications associated with glass, plastics and building materials. It is anticipated that panel members will be engaged for a period of two years. The advisory board retained a chairman, Dr. Arun Madan to lead the panel, advise the development process and recommend additional candidates for inclusion on the panel. In 2005 the Company added a total of three additional members to the Scientific Advisory Board representing specialists in the fields of material sciences specific to our thin films development efforts. The qualifications and biographical information for the members of the panel are as follows:

#### Dr. Arun Madan, Chairman Scientific Advisory Board

Dr. Madan is a Research Professor in the Department of Metallurgical and Materials Engineering at The Colorado School of Mines, President of MVSystems Inc. and an adjunct professor at The University of Waterloo, Canada. He became one of the originators of Amorphous Silicon technologies in 1970 and fabricated the first TFT (thin film transistor) as part of his Ph.D thesis. With over 30 years of leading edge scientific accomplishments he has published well over one hundred scientific papers, published a textbook now in use at several universities and holds fourteen patents on thin film semiconductor technology as well as advanced vacuum semiconductor deposition systems. In addition to his recognized leadership in the fields of thin film semiconductors and solar cells, he is the founder of two firms, Glasstech Solar Inc. in 1985 and MVSystems, Inc. in 1989. As founder of these firms he has gained over twenty years of international business, marketing and management experience successfully establishing technology sales exceeding \$150 million dollars. Leveraging his extensive scientific, business and leadership capabilities he has led teams of scientists/engineers in multi-disciplinary programs providing contract research and development work for a multitude of domestic and international agencies and firms including the National Renewable Energy Laboratory (USA), BP-Solar (USA), Shell (The Netherlands), Kovio (USA), Zettacore (USA), QinetiQ (UK), ENEA (Italy) and Pacific Solar (Australia) etc. Dr Madan received his Ph.D. - Physics from the University of Dundee, Scotland.

#### Dr. John Moore, Member Scientific Advisory Board

Dr. John J. Moore is a Materials Scientist who holds the position of Trustees' Professor and Head of Department of Metallurgical and Materials Engineering at the Colorado School of Mines. Dr. Moore is also Director of the interdisciplinary graduate program in Materials Science and Director of the Advanced Coatings and Surface Engineering Laboratory, ACSEL, at the Colorado School of Mines in Golden. Dr. Moore established the Advanced Coatings and Surface Engineering Laboratory (ACSEL) at the Colorado School of Mines in 1994. The main objective of ACSEL is to perform fundamental research in advanced PVD and CVD systems that will aid the U.S. thin films, coatings and surface engineering industry. ACSEL is a national and international leader in research on advanced coatings, surface engineering and thin film processing. Dr. Moore was awarded a B.Sc. in Materials Science and Engineering from the University of Surrey, UK, in 1966, a Ph.D. in Industrial Metallurgy from the University of Birmingham, UK, in 1969, and a D.Eng. from the School of Materials of the University of Birmingham, UK, in 1996.

#### Dr. Arokia Nathan, Member Scientific Advisory Board

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Arokia Nathan (SM) is a Professor in Electrical and Computer Engineering, University of Waterloo, and holds the Canada Research Chair in Nanoscale Elastic Circuits. He is also the chief technology officer of Ignis Innovation Inc., Waterloo, Canada, a company he founded to commercialize technology on thin film silicon backplanes and driving algorithms for active matrix organic light emitting diode displays. Dr. Nathan has extensive experience in device physics and modeling, and materials processing and integration. He has published extensively in the field of sensor technology and CAD, and thin film transistor electronics, and has over 15 patents filed/awarded. He is a co-author of two books, Microtransducer CAD and CCD Image Sensors in Deep-Ultraviolet. He is a Senior Member of the IEEE and a member of the American Physical Society, Electrochemical Society, Materials Research Society, Society for Information Displays, International Society for Optical Engineering, and the Institute of Electrical Engineers (UK). He chairs the 2005 IEEE Lasers and Electro-Optics Society Technical Committee on Displays and the Displays Sub-Committee in both 2004 and 2005. He serves as co-chair of the Fall 2005 Materials Research Society Symposium M: Flexible and Printed Electronics, Photonics, and Biomaterials, and is currently a Guest Editor for a Special Issue on Flexible Electronics Technology in IEEE Proceedings. He received his PhD in Electrical Engineering from the University of Alberta, Edmonton, Alberta, Canada, in 1988.

### Dr. Richard Rocheleau, Member Scientific Advisory Board

Dr. Rocheleau is the director of the Hawaii Natural Energy Institute (HNEI) of the University of Hawaii designated as a US Department of Energy Center of Excellence. At HNEI Dr. Rocheleau has established the HNEI Thin Films Laboratory and developed a research program focused on thin film photovoltaics and renewable hydrogen production having near-term applications in both the commercial and military sectors. Dr. Rocheleau also serves as the PI of several programs including the Hawaii Energy and Environmental Technology Initiative; and the Hawaii Hydrogen Center for the Development and Deployment of Distributed Energy Systems. He is the author of over 30 publications in peer reviewed journals and over 20 conference proceedings in the areas of photovoltaics, photo electrochemical hydrogen production, and thin-film electronic materials. Dr. Rocheleau also holds six patents and three patent disclosures. Leveraging his extensive scientific and leadership capabilities he has led teams of scientists/engineers in multi-disciplinary programs providing contract research and development of PV and semiconductor manufacturing processes for a number of domestic and international firms including, Chronar Corporation, Solarex, First Solar, Trex Enterprises, and Global Solar Inc. Dr. Rocheleau received his BChE and PhD (1980) in Chemical Engineering from the University of Delaware and a M.S. in Ocean Engineering (1977) from the University of Hawaii.

### ITEM 1A. RISK FACTORS

**Need For Additional Financing.** The Company has limited funds, and such funds may not be adequate to develop the Company's current business plan. The ultimate success of the Company may depend upon its ability to raise additional capital. If additional capital is needed, there is no assurance that funds will be available from any source or, if available, that they can be obtained on terms acceptable to the Company. If not available, the Company's operations will be limited to those that can be financed with its modest capital.

**Regulation of Penny Stocks.** The Company's securities, when available for trading, will be subject to a Securities and Exchange Commission rule that imposes special sales practice requirements upon broker-dealers who sell such securities to persons other than established customers or accredited investors. For purposes of the rule, the phrase "accredited investors" means, in general

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terms, institutions with assets in excess of \$5,000,000, or individuals having a

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net worth in excess of \$1,000,000 or having an annual income that exceeds \$200,000 (or that, when combined with a spouse's income, exceeds \$300,000). For transactions covered by the rule, the broker-dealer must make a special suitability determination for the purchaser and receive the purchaser's written agreement to the transaction prior to the sale. Consequently, the rule may affect the ability of broker-dealers to sell the Company's securities and also may affect the ability of purchasers in this offering to sell their securities in any market that might develop therefore.

In addition, the Securities and Exchange Commission has adopted a number of rules to regulate "penny stocks." Such rules include Rules 3a51-1, 15g-1, 15g-2, 15g-3, 15g-4, 15g-5, 15g-6, 15g-7, and 15g-9 under the Securities Exchange Act of 1934, as amended. Because the securities of the Company may constitute "penny stocks" within the meaning of the rules, the rules would apply to the Company and to its securities. The rules may further affect the ability of owners of Shares to sell the securities of the Company in any market that might develop for them.

Shareholders should be aware that, according to Securities and Exchange Commission, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include (i) control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer; (ii) manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases; (iii) "boiler room" practices involving high-pressure sales tactics and unrealistic price projections by inexperienced sales persons; (iv) excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and (v) the wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the resulting inevitable collapse of those prices and with consequent investor losses. The Company's management is aware of the abuses that have occurred historically in the penny stock market. Although the Company does not expect to be in a position to dictate the behavior of the market or of broker-dealers who participate in the market, management will strive within the confines of practical limitations to prevent the described patterns from being established with respect to the Company's securities.

Lack of Operating History. The Company was formed in 1997 and has had an unprofitable operating history. The re-organization of the Company and the acquisition of solar electric glazing technology have provided the Company with a new opportunity for business development which carries continued special risks inherent in a new business opportunity. The Company must be regarded as a new or start-up venture with all of the unforeseen costs, expenses, problems, and difficulties to which such ventures are subject.

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No Assurance of Success or Profitability. There is no assurance that the Company will successfully commercialize its proprietary technology. Even if the Company should successfully commercialize its proprietary technology, there is no assurance that it will generate significant revenues or profits, or that the market price of the Company's common stock will be increased thereby.

Lack of Diversification. Because of the limited financial resources that the Company has, it is unlikely that the Company will be able to diversify its

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operations. The Company's probable inability to diversify its activities into more than one area will subject the Company to economic fluctuations within a particular business or industry and therefore increase the risks associated with the Company's operations.

**Dependence upon Management.** The Company currently has only two (2) individuals who are serving as its officers and two (2) persons as directors. The Company will be heavily dependent upon their skills, talents, and abilities to implement its business plan.

**Indemnification of Officers and Directors.** The Colorado Business Corporation Act provides for the indemnification of its directors, officers, employees, and agents, under certain circumstances, against attorney's fees and other expenses incurred by them in any litigation to which they become a party arising from their association with or activities on behalf of the Company. The Company will also bear the expenses of such litigation for any of its directors, officers, employees, or agents, upon such person's promise to repay the Company therefore if it is ultimately determined that any such person shall not have been entitled to indemnification. This indemnification policy could result in substantial expenditures by the Company which it will be unable to recoup.

**Directors' Liability Limited.** The Colorado Business Corporation Act excludes personal liability of its directors to the Company and its stockholders for monetary damages for breach of fiduciary duty except in certain specified circumstances. Accordingly, the Company will have a much more limited right of action against its directors than otherwise would be the case. This provision does not affect the liability of any director under federal or applicable state securities laws.

**Dependence upon Outside Advisors.** To supplement the business experience of its officers and directors, the Company employ's accountants, technical experts, appraisers, attorneys, or other consultants or advisors. The selection of any such advisors will be made by the Company's President without any input from stockholders. Furthermore, it is anticipated that such persons may be engaged on an "as needed" basis without a continuing fiduciary or other obligation to the Company. In the event the President of the Company considers it necessary to hire outside advisors, he may elect to hire persons who are affiliates, if they are able to provide the required services.

**Competition.** The Company expects to be at a disadvantage when competing with many firms that have substantially greater financial and management resources and capabilities than the Company.

**No Foreseeable Dividends.** The Company has not paid dividends on its common stock and does not anticipate paying such dividends in the foreseeable future.

**Limited Public Market.** There is only a limited public market for the Company's common stock, and no assurance can be given that a market will continue or that a shareholder ever will be able to liquidate his investment without considerable delay, if at all. If a market should continue, the price may be highly volatile. Factors such as those discussed in this "Risk Factors" section may have a significant impact upon the market price of the securities offered hereby. Due to the low price of the securities, many brokerage firms may not be willing to effect transactions in the securities. Even if a purchaser finds a broker willing to effect a transaction in these securities, the combination of brokerage commissions, state transfer taxes, if any, and any other selling costs may exceed the selling price. Further, many lending institutions will not permit the use of such securities as collateral for any loans.

ITEM 1B. UNRESOLVED STAFF COMMENTS

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None

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## ITEM 2. PROPERTIES

As of September 30, 2006 the Company leased administrative office facilities located at 65 Enterprise, Aliso Viejo CA 92656 for approximately \$2,000 per month pursuant to a three month lease agreement.

In April 2006 the Company entered into a three year lease for technical and marketing operations facilities in Golden, CO. The Company provided a \$2,615 security deposit and expensed \$79,867 in costs associated with tenant improvements to the facilities in preparation for occupancy. The following is a schedule, by years, of the minimum base payments required under this operating lease for facilities. An additional \$825 monthly is also due as a pro rata share equaling 4.12% of the operating costs for real estate taxes, assessments, and the expenses of operating and maintaining common areas within the commercial grounds surrounding the leased facilities.

Annual Rent Schedule -----	Rate/sf -----	Annualized Rent -----	Monthly Rent -----
7/1/06-6/30/07	\$6.75	\$20,250.00	\$1,687.50
7/1/07-6/30/08	\$6.95	\$20,850.00	\$1,737.50
7/1/08-6/30/09	\$7.16	\$21,480.00	\$1,790.00

The Company owns no real property.

## ITEM 3. LEGAL PROCEEDINGS

On March 6, 2006 Ron Sentchuck filed an action against the Company in the Superior Court of California for the County of Los Angeles. The Company was dismissed from this action on August 3, 2006. No contingency expenses were accrued by the Company for this complaint.

On April 19th 2006, a service provider Office Radio Network filed a lawsuit in the District Court in Colorado alleging that it has been damaged due to refusal to allow it to sell its shares under Rule 144. The parties entered into a settlement in December 2006 providing for the return of 150,000 shares of the 300,000 shares issued to Office Radio Network, and the provisioning by Office Radio Network of an additional six months of service to the Company.

The Company is not currently a party to any pending legal proceedings, nor is its property subject to such proceedings, at December 13, 2006.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None in the period ended September 30, 2006.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock trades on the OTC Bulletin Board under the symbol "XSUNX." The range of high, low and close trade quotations for the Company's

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common stock by fiscal quarter within the last three fiscal years, as reported by the National Quotation Bureau Incorporated, was as follows:

Year Ended September 30, 2006 -----	HIGH	LOW	CLOSE
First Quarter ended December 31, 2005	\$ .59	\$0.53	\$ .58
Second Quarter ended March 31, 2006	\$2.24	\$2.08	\$2.13
Third Quarter ended June 30, 2006	\$1.06	\$1.04	\$1.05
Fourth Quarter ended September 30, 2006	\$ .55	\$ .52	\$ .54
Year Ended September 30, 2005 -----	HIGH	LOW	CLOSE
First Quarter ended December 31, 2004	\$.51	\$.33	\$.33
Second Quarter ended March 31, 2005	\$.40	\$.08	\$.11
Third Quarter ended June 30, 2005	\$.19	\$.08	\$.15
Fourth Quarter ended September 30, 2005	\$.30	\$.13	\$.36

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Year Ended September 30, 2005 -----	HIGH	LOW	CLOSE
First Quarter ended December 31, 2003	\$2.50	\$.025	\$.51
Second Quarter ended March 31, 2004	\$1.00	\$.25	\$.47
Third Quarter ended June 30, 2004	\$.95	\$.40	\$.60
Fourth Quarter ended September 30, 2004	\$.65	\$.30	\$.45

The above quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission and may not necessarily represent actual transactions.

### NUMBER OF HOLDERS

As of September 30, 2006, there were approximately 304 record holders of the Company's common stock, not counting shares held in "street name" in brokerage accounts which is unknown. As of September 30, 2006, there were approximately 157,137,931 shares of common stock outstanding on record with the Company's stock transfer agent, Mountain Share Transfer. On September 30, 2006 the last reported sales price of its common stock on the OTCBB was \$.54 per share.

### DIVIDENDS

The Company has not declared or paid any cash dividends on its common stock and does not anticipate paying dividends for the foreseeable future.

### SALE OF UNREGISTERED SECURITIES

#### Warrant Grants

Expanded Use License stock warrant MVSsystems, Inc. - As consideration for the grant of an Expanded Use License on October 12, 2005, granting XsunX additional benefits for use of licensed technologies and patents, XsunX granted MVS a warrant, (the "Expanded Use License Stock Warrant") for the purchase of up to Seven Million (7,000,000) shares of common stock of XsunX, the warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Expanded Use License Stock Warrant allowed for the vesting of one million (1,000,000) warrants on the effective date of the agreements.



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- (2) One million (1,000,000) warrants will vest upon the satisfactory completion of a Phase 4 development program for the development of certain opaque solar technologies.
- (3) The balance of the remaining five million (5,000,000) warrants will vest upon the date the technologies licensed within the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

Debenture Warrants - In connection with the issuance of a debenture in the principal amount of \$5,000,000 in December, 2005 3,125,000 warrants were granted to Cornell Capital Partners, LP at \$.45 and 1,250,000 warrants were granted at \$.55. During the 2006 fiscal year Cornell exercised all of the available warrants granted. As of the date of this filing there were no remaining warrants available for conversion by Cornell.

Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant and to the grant of a new warrant agreement in the amount of 500,000 warrants at the then market price of \$.51. The warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Warrant shall become exercisable at the rate of 28,000 shares per month up to and through the first nine months of employment of Optionee by Company.

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- (2) One Hundred Thousand (100,000) shares shall become exercisable upon the completion and delivery of a marketing plan by Optionee to the Board of Directors.
- (3) One Hundred Forty Eight Thousand (148,000) shares shall become exercisable upon the first sale or licensure of an XSUNX, Inc. technology under the marketing plan.

The total charged in expense for the 2006 fiscal year has been \$951,250 for the issuance of the above described Expanded Use License, Debenture Warrants, and Employment Incentive Warrants.

During the years ended September 30, 2005 and September 30, 2006 the board of directors approved the issuance of warrants to purchase an aggregate of 19,112,000 shares of the Company's common stock. Such warrants are exercisable at prices ranging from \$.15 to \$1.69 per share, vest over periods from between 36 to 60 months, and expire at various times through July 2011.

During the years ended September 30, 2005 no warrant holder's exercised warrants to purchase the Company's common stock. During the year ended September 30, 2006 warrant holders exercised a total of 10,850,000 warrants in cash to purchase the Company's common stock.

A summary of warrant activity for the year ended September 30, 2005 and 2006 is as follows:

Weighted-

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	Number of Warrants	Average Exercise Price	Accrued Warrants Exercisable	
Outstanding, September 30, 2004	8,000,000	\$0.15	5,525,000	\$
Granted 2005	7,125,000	\$0.1649	7,884,167	\$
Exercised 2005	0	\$0.0		
Outstanding, September 30, 2005	15,125,000	\$0.1595	13,409,167	\$
Granted 2006	11,987,000	\$0.3419	6,143,000	\$
Exercised 2006	(10,850,000)	\$0.2923	(10,850,000)	
Outstanding, September 30, 2006	16,262,000	\$0.2170	8,702,167	\$

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At September 30, 2006, the range of warrant prices for shares under warrants not exercised and the weighted-average remaining contractual life is as follows:

Range of Warrant Exercise Price	Warrants Outstanding			Warrants Exercised	
	Number of Warrants	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (yr)	Number Of Warrants	Weighted- Average Exercise Price
\$.15	7,900,000	\$.15	2.7	6,900,000	\$.15
.20	750,000	.20	1.5	634,167	.20
.25	7,000,000	.25	4.0	1,000,000	.25
.51	500,000	.51	4.8	56,000	.51
1.69	112,000	1.69	4.5	112,000	1.69

SALES OF SHARES AND DEBENTURE

The authorized capital stock of the Company was established at 500,000,000 with no par value. On September 29, 2003 the Board of Directors authorized a reverse split of 1 for 20 shares of stock. The stocks issued in 2003, as part of the reorganization, were for accrued director fees and salaries and to pay off past debt to investors. Included in the reorganization were 70,000,000 shares of stock issued to obtain certain patent rights from Xoptix, Inc. Also shares of stock were issued in 2003 for consulting fees in arranging the formation of the

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reorganized Corporation. In 2004 2,737,954 shares of stock were issued for cash and consulting fees to fund operations. 9,840,537 shares of common stock were issued in 2005 for cash and consulting fees to fund operations. In July 2005, 26,798,418 shares of common stock were placed in XSUNX, Inc. Treasury Stocks as collateral for the long-term note with Cornell Capital Partners. On August 18, 2006 the note underlying the collateral shares was paid and requirement of collateral was discharged. In 2006 33,188,926 shares of common stock were issued for cash and 72,366 were issued for services to fund operations.

The following represents a detailed analysis of the 2006 capital stock transactions.

**Debenture Conversion** - On February 8, 2006 Cornell Capital Partners, LLP converted \$350,000 of the principal balance of \$850,000 debenture issued to Cornell in July 2005. On March 1, 2006 Cornell converted the remaining principal and accrued interest the debenture balance totaling \$510,550. Upon conversion of the notes XsunX issued 8,605,500 shares of common stock to Cornell. The conversion price for all of the above issued shares was \$.10. The remaining value of the debenture is \$0.

**Warrant Conversion** - In February 2006, a consultant exercised 100,000 of the 1,000,000 available \$.15 cent warrants. The amount of \$15,000 dollars was paid to XsunX by the consultant and 100,000 shares were issued.

**Warrant Conversion** - In March 2006 Cornell Capital Partners, LLP exercised 3,125,000 of the available 3,125,000 \$.45 warrants and 1,250,000 of the available 1,250,000 \$.55 cent warrants. The aggregate amount of \$2,093,750 dollars was paid to XsunX by Cornell. The Company issued 4,375,000 shares of common stock in association with the exercise of these warrants.

**Warrant Conversion** - In April 2006 Cornell Capital Partners, LLP exercised 4,250,000 of the available 4,250,000 \$.15 warrants and 2,125,000 of the available 2,125,000 \$.20 cent warrants. The aggregate amount of \$1,062,500 dollars was paid to XsunX by Cornell. The Company issued 6,375,000 shares of common stock in association with the exercise of these warrants.

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**Debenture Conversions** - On May 10, 2006 Cornell Capital Partners, LLP converted \$2,000,000 of the principal balance of a \$5,000,000 debenture issued to Cornell in December 2005 and the Company issued 5,263,158 shares of common stock to Cornell for the conversion. On June 12 Cornell converted another \$1,000,000 of the principal balance of the debenture and the Company issued 2,631,579 shares of common stock to Cornell. On July 17, 2006 another \$1,000,000 of the principal balance was converted by Cornell for which the Company issued 2,631,579 shares of common stock to Cornell. On August 23, 2006 Cornell converted the remaining \$1,000,000 principal balance and \$230,833 of the total accrued interest charges of the debenture for which the Company issued 3,239,035 shares of common stock to Cornell. The conversion price for all of the above issued shares was \$.38 each. The remaining balance of the Debenture as of the date of this filing is \$0.0.

**Issuance of Shares for Service** - In December 2005 the Company issued 40,441 unregistered common shares to a service provider for accrued service fees totaling \$7,500 dollars for services provided over the fourth quarter period ended September 30, 2005. In September 2006 XsunX issued an additional 31,925 unregistered common shares to the same service provider for accrued service fees totaling \$24,000 dollars for the one year period ended September 30, 2006. The shares were earned on a quarterly basis by the service provider and the conversion price for the stock issued was calculated using the average daily closing price of the Company's common stock over each quarter period of service.

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### USES OF PROCEEDS FROM SALES OF UNREGISTERED SECURITIES

The proceeds from the above sales of unregistered securities were used primarily to fund the research and development efforts and day-to-day operations of the Company and to pay the accrued liabilities associated with these operations.

### REGISTRATION OF MARKETABLE SECURITIES

On December 12, 2005, XsunX, Inc. consummated a Securities Purchase Agreement dated December 12, 2005 with Cornell Capital Partners L.P. providing for the sale by the Company to Cornell of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000 (the "Debentures") of which \$2,000,000 was advanced immediately. The second installment of \$2,000,000 was advanced prior to the filing by the Company with the Securities and Exchange Commission of a Registration Statement in January 2006. The last installment of \$1,000,000 was advanced in February 2006 upon the Registration Statement being declared effective by the Commission. Between May 2006 and August 2006 the Debentures principal balance of \$5,000,000 dollars and accrued interest charges were converted into 13,765,351 shares of Common Stock at the option of Cornell at a conversion price per share equal to \$0.38. The remaining balance of the debenture is \$0.0.

In connection with the above Cornell L.P. Securities Purchase Agreement, the Company also entered into a registration rights agreement (the "Registration Rights Agreement") providing for the filing of a registration statement (the "Registration Statement") with the Securities and Exchange Commission registering the Common Stock issuable upon conversion of the Debentures and the exercise of Warrants issued to Cornell in association with Debenture. Prior to executing the Securities Purchase Agreement, the Company had withdrawn a previously filed registration statement that included Common Stock issued to Cornell and Common Stock to be issued upon the conversion of debentures and the exercise of warrants previously sold to Cornell (collectively, the "Initial Securities") pursuant to a securities purchase agreement executed on July 14, 2005 (the "Prior Agreement") as well as Common Stock to be issued pursuant to the Standby Equity Distribution Agreement dated July 14, 2005 between the Company and Cornell (the "Distribution Agreement"). All Initial Securities were included in the Registration Statement. The Company and Cornell also agreed to terminate the July 14, 2005 Distribution Agreement. On January 11, 2006 the Company filed to register up to 72,879,263 shares in association with the above securities registration requirements. The Registration statement was made effective on or about February 9, 2006. Upon the final conversion by Cornell of the Initial Securities, the Securities Purchase Agreement, the underlying Warrants therein, and accrued interest associated with the Debentures XsunX issued the aggregate amount of 35,245,851 registered shares of common stock in the 2006 period.

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The Company's obligations under the Prior Agreement and the Securities Purchase Agreement were secured by substantially all of the Company's assets. As further security for its obligations thereunder, the Company had deposited into escrow 26,798,418 shares of Common Stock. In addition, Tom Djokovich, the Company's Chief Executive Officer, had granted a security interest in 925,000 shares of Common Stock that he owns to secure the Company's obligations under the Prior Agreement only. As of the date of this filing XsunX had received notice from Cornell of the release of the security interest in above listed security shares and assets.

### ITEM 6. SELECTED FINANCIAL DATA

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Table of Selected Financial Data

	2006	2005	2004
Net Sales	8,000	-	-
Income(Loss) from Continuing Operations	(3,441,940)	(1,400,839)	(1,509,068)
Income(Loss) from Continuing Operations per Common Share	\$ (0.02)	\$ (0.02)	\$ (0.01)
Cash	4,305,105	175,869	37,344
Total Assets	6,859,463	441,684	72,114
Long Term Obligations	-	-	-
Cash Dividends Declared per Common Share	\$ -	\$ -	\$ -

\* Less than \$0.01

In 2003, the Company completed a Plan of Reorganization and Asset Purchase Agreement and changed the name of the Company from Sun River Mining, Inc. to XsunX, Inc. Due to the Company's change in primary focus in October of 2003 and the developing nature of the business opportunities, these historical results may not necessarily be indicative of results to be expected for any future period. As such, future results of the Company may differ significantly from previous periods. The historical trends reflect this change of primary focus and the associated research and development period of the development stage company. This change in primary focus is the largest factor in the comparability of this information over time.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

#### CAUTIONARY AND FORWARD LOOKING STATEMENTS

In addition to statements of historical fact, this Form 10-K contains forward-looking statements. The presentation of future aspects of XsunX, Inc. ("XsunX," the "Company" or "issuer") found in these statements is subject to a number of risks and uncertainties that could cause actual results to differ materially from those reflected in such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Without limiting the generality of the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "intend," or "could" or the negative variations thereof or comparable terminology are intended to identify forward-looking statements.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties that may cause XsunX's actual results to be materially different from any future results expressed or implied by XsunX in those statements. Important facts that could prevent XsunX from achieving any stated goals include, but are not limited to, the following:

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Some of these risks might include, but are not limited to, the following:

- (a) volatility or decline of the Company's stock price;

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- (b) potential fluctuation in quarterly results;
- (c) failure of the Company to earn revenues or profits;
- (d) inadequate capital to continue or expand its business, inability to raise additional capital or financing to implement its business plans;
- (e) failure to commercialize its technology or to make sales;
- (f) rapid and significant changes in markets;
- (g) litigation with or legal claims and allegations by outside parties;
- (h) insufficient revenues to cover operating costs.

There is no assurance that the Company will be profitable, the Company may not be able to successfully develop, manage or market its products and services, the Company may not be able to attract or retain qualified executives and technology personnel, the Company's products and services may become obsolete, government regulation may hinder the Company's business, additional dilution in outstanding stock ownership may be incurred due to the issuance of more shares, warrants and stock options, or the exercise of warrants and stock options, and other risks inherent in the Company's businesses.

The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-QSB and Annual Report on Form 10-K filed by the Company in 2006 and Form 10KSB in 2005 and any Current Reports on Form 8-K filed by the Company.

For the year ended September 30, 2006, the Company had and continues to focus on the development and refinement of commercially appealing solar cell designs, proprietary manufacturing processes and facilities design that could be provided to OEM licensees as turn-key solutions for the mass production of thin films. A large part of the Company's capital was used for product development. However, marketing and business development efforts were launched in the later part of 2006 requiring an increase to budget requirements to fund these efforts.

### GROWTH, REVENUE AND DISTRIBUTION PLAN

The Company is marketing its integrated manufacturing systems as turnkey solutions for the manufacture of its current and future PV thin film designs. The manufacturing systems will be licensed to manufacturers as modular systems and licensed for use in the manufacture of the Company's thin film designs. The manufacturers would in turn agree to manufacture and distribute the Company's PV thin films, or incorporate the thin film PV technology into their product manufacturing process as an "original equipment manufacturer" (OEM) and sell the finished product to their consumers. Although the Company is currently providing proposals to interested OEM's no licenses or contracts now exist with any manufacturer.

We intend to target customers who are developing their own technology platforms in which the manufacture of or the integration of our thin film solar cells could play an important role. The Company will offer non-exclusive manufacturing licenses and expects to earn a royalty on thin films manufactured. In selling the manufacturing equipment and licensing the technology to OEM's, the Company reduces operating expenses and saves capital in plant, property and equipment.

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As a result, should the Company realize earnings it intends to reinvest its retained earnings in R&D in an effort to continuously develop related new technologies that will help achieve sustainable competitive advantages for the Company.

### PLAN OF OPERATIONS

XsunX anticipates the 12-month capital operational requirements of the company to be \$5,750,000 dollars. Capital will be applied to operations as follows: (i) approximately \$1,200,000 will be used to pay costs associated with the completion of development of a 4-Terminal nano-crystalline solar cell patent for commercialization purposes, (ii) approximately \$1,500,000 will be used for the development of new technologies licensed and/or acquired during the 2007 period, (iii) approximately \$400,000 will be used to complete the manufacture of a marketable prototype manufacturing system that began in January 2006, (iv) approximately \$500,000 will be used for the engineering and adaptation of certain manufacturing devices and techniques to provide product manufacturing demonstration and development capabilities, (v) approximately \$160,000 will be used to pay for third party engineering, testing, and consulting services, (vi) approximately \$835,000 will be used to pay salaries and general administrative costs, and for intellectual property protection, (vii) approximately \$625,000 will be used to pay for sales and market development, general competitive research and publicity costs, and (viii) approximately \$500,000 will be used for general working capital.

The Company may change any or all of the budget categories in the execution of its business attempts. None of the items is to be considered fixed or unchangeable.

The Company will need additional capital to support its budget. The Company has insignificant revenues to date. No representation is made that any funds will be available when needed. In the event funds cannot be raised when needed, the Company may not be able to carry out its business plan, may never achieve sales or royalty income, and could fail in business as a result of these uncertainties.

The Company may need to seek additional financing for this budget. (See "Risk Factors" at p. 13).

Management believes the summary data and audit presented herein is a fair presentation of the Company's results of operations for the periods presented. Due to the Company's change in primary business focus and new business opportunities these historical results may not necessarily be indicative of results to be expected for any future period. As such, future results of the Company may differ significantly from previous periods.

### RESULTS OF OPERATIONS FOR THE THREE FISCAL YEARS ENDED SEPTEMBER 30, 2006, COMPARED TO FISCAL YEARS ENDED SEPTEMBER 30, 2005 AND SEPTEMBER 30, 2004

The Company generated insignificant revenues in the period ended September 30, 2006 of \$8,000. The Company generated no revenues for the same period in 2005 as well as for the same period in 2004.

The Company incurred expenses totaling \$3,380,087 in 2006 compared to \$1,383,406 in 2005 and \$1,528,193 in 2004. The increase of \$1,996,681 included a onetime non-cash warrant issuance expense of \$951,250 for Warrants issued in association the licensure of technologies and the sale by the Company of convertible debentures, and a net increase of \$511,834 in loan fee expenses associated with

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the sale by the Company of convertible debentures. Excluding this non-cash warrant expense and the cash based debenture expenses in the comparative analysis between the period's results in an increase of \$508,596 in normal and customary operational expenses for the period ending September 30, 2006 as compared to the same period 2005.

Primary sources for the increase to operating expense of \$533,597 include: an increase of \$448,049 in Research and Development activities totaling \$949,472 as compared to \$501,423 incurred for the same period in 2005 and \$129,493 in 2004, an increase of \$65,738 in Public Relations activity totaling \$182,151 as compared to activity totaling \$116,413 for the same period in 2005 and \$6,640 in 2004, an increase of \$119,853 in Salaries totaling \$275,089 as compared to Salaries totaling \$155,236 for the same period in 2005 and \$119,336 for the same period 2004, an increase of \$33,044 in Legal and Accounting expenses totaling \$140,293 as compared to Legal and Accounting totaling \$107,249 for the same period in 2005 and \$27,203 for the same period 2004, an increase of \$123,707 in

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General and Administrative expenses related to an increase in travel, advertising, depreciation, business development and other General and Administrative expenses. These increases were partially offset by a decrease in Consulting expenses of \$(273,094) totaling 47,850 as compared to activity totaling \$320,944 for the same period in 2005 and \$19,900 for the same period in 2004. The \$3,355,086 in operating expenses includes non-cash charges of \$24,000 for the issuance of common shares in lieu of cash payment for services.

For the twelve months ended September 30, 2006, the Company's consolidated net loss was \$(3,441,940) as compared to a consolidated net loss of \$(1,400,839) for the same period ended September 30, 2005 and \$(1,509,068) for the same period ended September 30, 2004. The increase of \$2,041,101 resulted from a one time non-cash warrant issuance expense of \$951,250 for Warrant Expenses accounted for in the period ended September 30, 2006, and a net increase of \$511,834 in loan fee expenses associated with the sale by the Company of convertible debentures.. Excluding the one time non-cash warrant expense and net loan fee expenses, in the comparative analysis between the period's, results in an increase of \$578,017 in net loss for the period ended September 30, 2006 as compared to the same period 2005. The net loss per share was less than \$(0.02) for the twelve month period ended September 30, 2006.

Due to the Company's change in primary business focus in October 2003 and the developing nature of its business opportunities these historical results may not necessarily be indicative of results to be expected for any future period. As such, future results of the Company may differ significantly from previous periods. Since inception in 1997 the Company has an accumulated deficit totaling (\$9,171,354) to September 30, 2006.

### LIQUIDITY AND CAPITAL RESOURCES

Working capital at September 30, 2006 was \$4,065,523 as compared to a working capital (deficit) of \$(718,380) at September 30, 2005 and (\$38,819) at September 2004. There were insignificant cash flows totaling \$8,000 provided by operations during the twelve months ended September 30, 2006.

Cash and cash equivalents at September 30, 2006 were \$4,654,222, an increase of \$4,398,369 from September 30, 2005. During the year ended, September 30, 2006, the Company used \$1,942,278 net cash in operating activities as compared to using \$1,049,650 net cash for the year ended, September 30, 2005 and \$236,630 for the year ended September 30, 2004. The increase of \$892,628 between the 2006 and 2005 periods resulted from onetime non-cash expenses for a warrant issuance



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expense of \$951,250, an expense of \$31,500 for the issuance of stock in lieu of cash for services, and \$241,383 in expenses for the issuance of stock in lieu of cash for the payment of accrued interest associated with the sale of debentures by the Company accounted for in the period ended September 30, 2006. Excluding these one time non-cash expenses, in the comparative analysis between the period's, results in a decrease of \$331,505 in net cash used in operations for the period ended September 30, 2006 compared to the same period 2005. This decrease of net cash used in operations was primarily due to a decrease in consulting expenses of \$273,094 in the 2006 period.

For the twelve months ended, September 30, 2006, the Company's capital needs have primarily been met from the proceeds of (i) the issuance of Common Stock for Debenture conversion and; (ii) the issuance of Common Stock for warrant conversion. Total cash provided by financing activities for the period ended September 30, 2006 increased to \$8,171,250 from \$1,380,170 for the same period ended September 30, 2005 and \$283,895 for the period ended September 30, 2004. The increase of \$6,791,080 between the 2006 and 2005 periods was mainly attributable to an increase of \$5,000,000 from the conversion of a debenture into common stock and \$3,171,250 in the conversion of warrants for common stock.

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Contractual Obligations are shown in the following table -

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long Term Obligations	-	-	-	-	-
Capital Lease	-	-	-	-	-
Operating Lease	57,518	20,550	36,968	-	-
Purchase Obligations	1,183,680	1,183,680	-	-	-
Other Long Term Liabilities Reflected on the Registrant's Balance Sheet Under GAAP	-	-	-	-	-
<b>Total</b>	<b>1,241,198</b>	<b>1,204,230</b>	<b>36,968</b>	<b>-</b>	<b>-</b>

(1) Operating Lease Obligations consist of the lease on the Company's Administrative and Sales facility in Golden, CO

(2) Remaining accounts payable associated with the production prototype machine of \$353,000

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(3) Remaining amount due to MVSystems from the Phase IV, 4T research and development contract signed in the period ending September 30, 2006 of \$830,680

The estimated contract cost in item (2) and (3) above may be higher or lower based on final costs. The company has not booked any contingency for cost overruns

During the year ended, September 30, 2006, we used \$2,099,736 for investing activities as compared to \$191,995, for the year ended, September 30, 2005 and \$12,267 for the year ended September 30, 2004. The increased use of cash for investing activities resulted from an increase in the acquisition of assets in the form of a marketable prototype manufacturing tool and additional equipment.

We had, at September 30, 2006, working capital of \$4,065,523. We have begun marketing efforts and anticipate the sale of licenses in the 2007 period however the cash flow requirements associated with the transition to revenue recognition may exceed cash generated from operations in the current and future periods. We may seek to obtain additional financing from equity and/or debt placements. We have been able to raise capital in a series of equity and debt offerings in the past. While there can be no assurances that we will be able to obtain such additional financing, on terms acceptable to us and at the times required, or at all, we believe that sufficient capital can be raised in the foreseeable future if necessary.

### NET OPERATING LOSS

For federal income tax purposes, we have net operating loss carry forwards of approximately \$9,646,224 as of September 30, 2006. These carry forwards will begin to expire in 2010. The use of such net operating loss carry forwards to be offset against future taxable income, if achieved, may be subject to specified annual limitations.

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### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company maintains interest bearing deposits in the form of U.S. Treasury Notes in various amounts and maturity periods that allow us to maintain access to necessary capital to fund operations. These investments in Treasury Notes earn varied interest rates and upon maturity are subject to market risks associated with the increase or decrease for the then available rates comparative to the expiring rates. These investments in U.S Treasury Notes are underwritten by the United States Government and are brokered through our association with a U.S. based and Federally insured bank. We do not believe that these investments are subject to foreign currency risks.

Our products are quoted for sale and licensure in United States dollars and as our business development efforts progress we anticipate the sale and/or licensure of our products to foreign entities. To the extent that we may be exposed to foreign currency risks related to the rise and/or fall of foreign currencies against the U.S. dollar we will report in United States dollars.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Please refer to pages F-1 through F-19.

### ITEM 9. CHANGES IN AND DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Michael Johnson & Co., LLC, formerly auditors for the Company, was dismissed as

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auditor on July 18, 2005. Jaspers + Hall, PC were engaged as auditors for Company on July 18, 2005.

The Change of Accountants was approved by the Board of Directors. No audit committee exists other than the members of the Board of Directors.

In connection with audit of the two most recent fiscal years, and through the date of termination of the accountants, no disagreements exist with any former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope of procedure, which disagreements if not resolved to the satisfaction of the former accountant would have caused them to make reference in connection with his report to the subject of the disagreement(s).

The audit report by Michael Johnson & Co., LLC for the period ended September 30, 2004 contained an opinion which included a paragraph discussing uncertainties related to continuation of the Registrant as a going concern. Otherwise, the audit report by Michael Johnson & Co., LLC for the period September 30, 2004 did not contain an adverse opinion or disclaimer of opinion, nor was qualified or modified as to uncertainty, audit scope, or accounting principles.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. The evaluation included certain control areas in which we have made, and are continuing to make, changes to improve and enhance controls. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures were effective, and we have discovered no material weakness.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

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#### Internal Control Over Financial Reporting

The Securities and Exchange Commission rule making for the Sarbanes-Oxley Act of 2002 Section 404 requires that a company's internal controls over financial reporting be based upon a recognized internal control framework. While the Company has an internal control and procedures manual in place and management believes the controls and procedures are effective the manual is not based upon a recognized internal control framework, because we have not found one that fits the limited scope of operations of our Company.

During the first half of the Company's fiscal year ending September 30, 2007 management will be revising the Company's internal and controls procedure document basing this revision upon a model framework created by the Committee of Sponsoring Organizations of the Treadway Commission (or "COSO") as is appropriate to our operations. This framework is entitled Internal

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Control-Integrated Framework. The COSO Framework, which is the common shortened title, was published in 1992 and has been updated, and we believe will satisfy the Securities and Exchange Commission requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Management is committed to re-writing its internal controls and procedures manual based upon the Treadway Commission report as is appropriate to our operations during the first half of fiscal year ending September 30, 2007.

Except as noted above, there have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ITEM 9B. OTHER INFORMATION

On April 19th 2006, a service provider Office Radio Network filed a lawsuit in the District Court in Colorado alleging that it has been damaged due to refusal to allow it to sell its shares under Rule 144. The parties entered into a settlement in December 2006 providing for the return of 150,000 shares of the 300,000 shares issued to Office Radio Network, and the provisioning by Office Radio Network of an additional six months of service to the Company.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The following table lists the executive offices and directors of the Company as of September 30, 2006:

NAME	Age	POSITION HELD	TENURE
Brian Altounian (resigned 6/30)	43	Secretary, Director	Since September 2003
Tom Djokovich	49	President, CEO, CFO, Director	Since September 2003
Thomas Anderson	41	Director	Since August 2001
Joseph Grimes	49	COO	Since April 2006

The directors named above will serve until the next annual meeting of the Company's stockholders. Thereafter, directors will be elected for one-year terms at the annual stockholders' meeting. Officers will hold their positions at the pleasure of the board of directors, absent any employment agreement, of which none currently exists or is contemplated. There is no arrangement or understanding between the directors and officers of the Company and any other person pursuant to which any director or officer was or is to be selected as a director or officer.

The directors of the Company will devote such time to the Company's affairs on an "as needed" basis, but typically less than 20 hours per month. As a result, the actual amount of time which they will devote to the Company's affairs is unknown and is likely to vary substantially from month to month.

### BIOGRAPHICAL INFORMATION

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TOM DJOKOVICH, age 49, President and Chief Executive Officer as of September 30, 2003, and Director;

Mr. Djokovich was the founder and served from 1995 to 2002 as the Chief Executive Officer of Accesspoint Corporation, a vertically integrated provider of electronic transaction processing and e-business solutions for merchants. Under Mr. Djokovich's guidance, Accesspoint became a member of the Visa/MasterCard association, the national check processing association NACHA, and developed one of the payment industry's most diverse set of network based transaction processing, business management and CRM systems for both Internet and conventional points of sale. Prior to Accesspoint, Mr. Djokovich founded TMD Construction and Development in 1979. TMD provided management for multimillion-dollar projects incorporating at times hundreds of employees, subcontractors and international material acquisitions for commercial, industrial and custom residential construction services as a licensed building firm in California. In 1995 Mr. Djokovich developed an early Internet based business-to-business ordering system for the construction industry. Mr. Djokovich also currently serves as a Director and Chairman of the Audit Committee for Roaming Messenger, Inc., a publicly reporting company that provides a breakthrough software solution for delivering real-time actionable information for Homeland Security, emergency response, military and enterprise applications.

JOSEPH GRIMES, age 49, Chief Operating Officer as of April 2006;

Mr. Grimes brings to XsunX more than eight years direct experience in thin-film technology and manufacturing. He was most recently Vice President, Defense Solutions, for Envisage Technology Company, where he directed and managed the defense group business development process, acquisition strategies and vision for next generation applications. Previously he was Co-Founder, President and CEO of ISERA Group, where he established the company infrastructure and guided five development teams, finally selling the company to Envisage. His direct experience in thin-film technology came with Applied Magnetics Corporation as manager for thin-film prototype assembly. Mr. Grimes holds a Bachelor's degree in business economics and environmental studies, and a Master's in computer modeling and operation research applications, both from the University of California at Santa Barbara.

THOMAS ANDERSON, age 41, became a director of the Company in August 2001;

Mr. Anderson presently works as a Senior Environmental Scientist for the Energy and Environmental Engineering Division of Apogen Technologies in Los Alamos, New Mexico. He earned his B.S. in Geology from Denison University and his M.S. in Environmental Science and Engineering from Colorado School of Mines. Mr. Anderson has worked for past 16 years in the environmental consulting field, providing environmental compliance, characterization and remediation services to Department of Energy, Department of Defense, and industrial clients. He formerly worked as a Senior Environmental Scientist at Concurrent Technologies Corp. from November 2000 to December 2004. From March 2000 to November 2000 he was employed as a hydrologist at Stone & Webster Engineering, Inc. From July 1998 to March 2000 he was employed by advanced Integrated Management Services as an Environmental Scientist/Engineer. From 1997 to 1998 he was a graduate research assistant at Colorado School of Mines in the Environmental Science and Engineering Program.

### COMPLIANCE WITH SECTION 16(A) OF EXCHANGE ACT

Section 16(a) of the Exchange Act requires the Company's officers and directors, and certain persons who own more than 10% of a registered class of the Company's equity securities (collectively, "Reporting Persons"), to file reports of ownership and changes in ownership ("Section 16 Reports") with the Securities

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and Exchange Commission (the "SEC"). Reporting Persons are required by the SEC to furnish the Company with copies of all Section 16 Reports they file.

Based solely on its review of the copies of such Section 16 Reports received by it, or written representations received from certain Reporting Persons, the following persons were required to file forms pursuant to Section 16(a):

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Name	Form	Filed
Tom Djokovich	Form 3	October 24, 2003
Brian Altounian	Form 4	June 22, 2006
Xoptix, Inc.	Form 3*	Did not file

\* NOTE: Xoptix, Inc. was being liquidated pursuant to a Plan of Liquidation, and the shares were distributed in December, 2003 pro rata to shareholders of Xoptix, Inc. in a liquidating distribution of assets in kind. Xoptix has represented that no shareholder of Xoptix, Inc. receiving shares holds more than 10% of the issued and outstanding shares of Registrant.

### ITEM 11. EXECUTIVE COMPENSATION

#### DIRECTOR COMPENSATION

Directors received no cash compensation for their service to the Company as directors, but can be reimbursed for expenses actually incurred in connection with attending meetings of the Board of Directors.

SUMMARY COMPENSATION TABLE OF DIRECTORS  
(excludes compensation for executives)

Name	Annual Retainer Fees (\$)	Meeting Fees (\$)	Consulting Fees/Other Fees (\$)	Number of Shares (#)
Director, Tom Djokovich	\$0	\$0	\$0	0
Director, Brian Altounian (resigned June 30, 2006)	\$0	\$0	\$0	0
Director, Thomas Anderson	\$0	\$0	\$0	0

#### EXECUTIVE OFFICER COMPENSATION

The annual compensation for the executive officers of the Company for the post reorganization operations has not yet been determined, but is expected to be established by a resolution of the Company's Board of Directors in the future.

The following table and notes set forth the annual cash compensation paid to officers of the Company.

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SUMMARY COMPENSATION TABLE OF EXECUTIVES

Name & Principal Position	Fiscal Year	Annual Salary (\$)	Annual Bonus (\$)	Awards Other Annual Compensation (\$)	Restricted Stock Awards (\$)
Tom Djokovich, President (1)	2006	\$150,000	0	0	0
	2005	\$150,000	0	0	0
	2004	\$130,000	0	0	0
Joseph Grimes, COO (2)	2006	\$0	0	0	0
	2005	\$0	0	0	0
	2004	\$0	0	0	0
Brian Altounian, Secretary (3)	2006	\$0	0	0	0
	2005	\$0	0	0	0
	2004	\$0	0	0	0
Thomas Anderson, Director	2006	\$0	0	0	0
	2005	\$0	0	0	0
	2004	\$0	0	0	0

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(1) The Company has agreed to pay Mr. Djokovich \$2,884 per week for services provided as Chief Executive Officer up to and until the Company determines executive compensation pursuant to an employment agreement as determined by the Board. When necessitated by the Company's adverse financial condition Mr. Djokovich has agreed to the deferment of his monthly salary up to and until such time that the Company can repay any such deferred amounts. In the period ended September 30, 2004 Mr. Djokovich agreed to the deferment of \$65,000 dollars of his salary until such time that the Company could begin to repay him. As of the period ended September 30, 2006 the remaining balance of Mr. Djokovich's deferred salary was \$6,538.

(2) The Company has agreed to pay Mr. Grimes \$2,884 per week for services provided as Chief Operating Officer under the terms of an employment agreement effective April 5, 2006. In addition to Mr. Grimes base compensation the Company also provides Mr. Grimes with a \$400 monthly health insurance allowance. In connection with the issuance of an employment agreement to Mr. Grimes the Company granted 500,000 warrants at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant and then granted 500,000 new warrants on July 20, 2006 at the then market price of \$0.51. The new warrant will vest at the rate of 28,000 shares per month up to and through the first nine months of employment, 100,000 shares will become exercisable upon delivery of a marketing plan by Mr. Grimes to the Board of Directors, 148,000 shares will become exercisable upon the first sale or licensure of an XsunX technology under the marketing plan.

(3) Resigned as Chairman and Secretary effective June 30, 2006

Option/SAR Grants Table (None)

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Aggregated Option/SAR Exercises in Last Fiscal Year an FY-End Option/SAR value (None)

Long Term Incentive Plans - Awards in Last Fiscal Year

Long Term Incentive Plan Options/Warrants

Name	Date Issued	Number Issued	Exercise Price	Expiration Date
Joseph Grimes(1)	April 5, 2006	112,000	\$1.69	April 5, 2011
Joseph Grimes(2)	July 20, 2006	500,000	\$0.51	July 20, 2011

(1) Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant.

(2) Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants on July 20, 2006 at the then market price of \$0.51. The warrant will vest at the rate of 28,000 shares per month up to and through the first nine months of employment, 100,000 shares will become exercisable upon delivery of a marketing plan by Mr. Grimes to the Board of Directors, 148,000 shares will become exercisable upon the first sale or licensure of an XsunX technology under the marketing plan.

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2006 WARRANT ISSUANCE AND SUMMARYS

The following table sets forth information with respect to warrants to purchase common stock of the Company granted during fiscal year ended September 30, 2006.

Options/Warrants

Name	Date Issued	Number Issued	Exercise Price	Expiration Date
MVSystems, Inc.(1)	October 12, 2005	7,000,000	\$0.25	October 12, 2010
Cornell Capital, LP(2)	December 12, 2005	3,125,000	\$0.45	December 12, 2010



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Cornell Capital, LP (3)	December 12, 2005	1,250,000	\$0.55	December 12, 2010
Joseph Grimes(4)	April 5, 2006	112,000	\$1.69	April 5, 2011
Joseph Grimes(5)	July 20, 2006	500,000	\$0.51	July 20, 2011

(1) The Warrant granted to MVSystems, Inc. will vest in the amount of 1,000,000 shares upon the effective date of the Expanded Use License Agreement which was October 12, 2005. Thereafter, the Warrant will vest at the rate of 1,000,000 shares upon the satisfactory completion of a Phase 4 development program for the development of certain opaque solar technologies that began in January 2006, and the balance of 5,000,000 shares will vest upon the date the technologies licensed under the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

(2), (3) Warrant to Purchase Common Stock Cornell - On December 12, 2005, the Company consummated a Securities Purchase Agreement with Cornell providing for the sale by the Company to Cornell of its 10% secured convertible debentures in the aggregate principal amount of \$5,000,000. Under the Purchase Agreement, the Company also issued to Cornell five-year warrants to purchase 3,125,000 and 1,250,000 shares of Common Stock at \$0.45 and \$0.55, respectively (collectively, the "Warrants"). As of the date of this filing all of the Cornell warrants had been exercised.

(4) Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant.

(5) Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants on July 20, 2006 at the then market price of \$0.51. The warrant will vest at the rate of 28,000 shares per month up to and through the first nine months of employment, 100,000 shares will become exercisable upon delivery of a marketing plan by Mr. Grimes to the Board of Directors, 148,000 shares will

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become exercisable upon the first sale or licensure of an XsunX technology under the marketing plan.

During the years ended September 30, 2005 no warrant holders exercised warrants to purchase the Company's common stock. During the year ended September 30, 2006 warrant holders exercised a total of 10,850,000 warrants in cash to purchase the Company's common stock.

A summary of warrant activity for the year ended September 30, 2005 and 2006 is as follows:

Number of Warrants	Weighted-Average Exercise	Accrued
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		Price	Warrants ----- Exercisable	P
Outstanding, September 30, 2004	8,000,000	\$0.15	5,525,000	\$
Granted 2005	7,125,000	\$0.1649	7,884,167	\$
Exercised 2005	0	\$0.0		
Outstanding, September 30, 2005	15,125,000	\$0.1595	13,409,167	\$
Granted 2006	11,987,000	\$0.3419	6,143,000	\$
Exercised 2006	(10,850,000)	\$0.2923	(10,850,000)	
Outstanding, September 30, 2006	16,262,000	\$0.2170	8,702,167	\$

At September 30, 2006, the range of warrant prices for shares under warrants not exercised and the weighted-average remaining contractual life is as follows:

Range of Warrant Exercise Price	Warrants Outstanding			Warrants Exercised	
	Number of Warrants	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (yr)	Number Of Warrants	Weighted- Average Exercise Price
\$.15	7,900,000	\$.15	2.7	6,900,000	\$.15
.20	750,000	.20	1.5	634,167	.20
.25	7,000,000	.25	4.0	1,000,000	.25
.51	500,000	.51	4.8	56,000	.51
1.69	112,000	1.69	4.5	112,000	1.69

No other compensation not described above was paid or distributed during the last fiscal year to the executive officers of the Company. There are no compensatory plans or arrangements, with respect to any executive officer of the Company, which result or will result from the resignation, retirement or any other termination of such individual's employment with the Company or from a change in control of the Company or a change in the individual's responsibilities following a change in control.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth, as of the date of this Report, the number of shares of common stock owned of record and beneficially by executive officers,

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directors and persons who hold 5.0% or more of the outstanding common stock of the Company as of December 7, 2006. Also included are the shares held by all executive officers and directors as a group.

SHAREHOLDERS/ BENEFICIAL OWNERS	NUMBER OF SHARES	OWNERSHIP PERCENTAGE (1)
Tom Djokovich (2) President & Director 65 Enterprise Aliso Viejo, CA 92656	17,903,000	11.39%
Thomas Anderson 65 Enterprise Aliso Viejo, CA 92656	56,900	>.01%
Joseph Grimes (3) Chief Operating Officer 65 Enterprise Aliso Viejo, CA 92656	224,000	>.01%

(1) Applicable percentage ownership is based on 157,137,931 shares of common stock outstanding as of December 13, 2006. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock that are currently exercisable or exercisable within 60 days of December 13, 2006 are deemed to be beneficially owned by the person holding such securities for the purpose of computing the percentage of ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person.

(2) Includes 16,978,000 shares owned by the Djokovich Limited Partnership. Mr. Djokovich shares voting and dispositive power with respect to these shares with Mrs. Tamara Djokovich.

(3) Includes vested warrants that may be exercised within 60 days of the date of this filing.

### ITEM 13. CERTAIN RELATIONSHIPS, RELATED PARTY TRANSACTIONS, AND DIRECTOR INDEPENDENCE

No officer or director of the Company has or proposes to have any direct or indirect material interest in any asset proposed to be acquired by the Company through security holdings, contracts, options, or otherwise.

The Company has adopted a policy under which any consulting or finder's fee that may be paid to a third party for consulting services to assist management in evaluating a prospective business opportunity would be paid in stock, stock purchase options or in cash. Any such issuance of stock or stock purchase options would be made on an ad hoc basis. Accordingly, the Company is unable to predict whether or in what amount such a stock issuance might be made.

#### Grant of Options/Warrants to Executive Officer

Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants

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at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant and to the grant of a new warrant agreement in the amount of 500,000 warrants at the then market price of \$.51. The warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Warrant shall become exercisable at the rate of 28,000 shares per month up to and through the first nine months of employment of Optionee by Company.
- (2) One Hundred Thousand (100,000) shares shall become exercisable upon the completion and delivery of a marketing plan by Optionee to the Board of Directors.
- (3) One Hundred Forty Eight Thousand (148,000) shares shall become exercisable upon the first sale or licensure of an XSUNX, Inc. technology under the marketing plan.

### Expanded License and Warrants

Expanded Use License stock warrant MVSsystems, Inc. - As consideration for the grant of an Expanded Use License on October 12, 2005, granting XsunX additional benefits for use of licensed technologies and patents, XsunX granted MVS a warrant (the "Expanded Use License Stock Warrant") for the purchase of up to Seven Million (7,000,000) shares of common stock of XsunX, the warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Expanded Use License Stock Warrant allowed for the vesting of one million (1,000,000) warrants on the effective date of the agreements.
- (2) Another one million (1,000,000) warrants will vest upon the satisfactory completion of a Phase 4 development program for the development of technologies licensed under the Expanded Use License.

The balance of five million (5,000,000) warrants will vest upon the date the technologies licensed within the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The Company's Board acts as the audit committee and had no "pre-approval policies and procedures" in effect for the auditors' engagement for the audit year 2005 and 2006.

All audit work was performed by the auditors' full time employees.

Michael Johnson & Co., LLC, formerly auditors for the Company, was dismissed as auditor on July 18, 2005. Jaspers + Hall, PC were engaged as auditors for Company on July 18, 2005.

Jaspers + Hall, PC, is now the Company's principal auditing accountant firm. The Company's Board of Directors has considered whether the provision of the audit services is compatible with maintaining Jaspers + Hall, PC independence.

### AUDIT FEES 2006:

As of the period ended September 30, 2006 Jaspers + Hall had billed the Company \$1,500 for the following professional services: review of the interim financial statements included in quarterly reports on Form 10-QSB for the periods ended

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December 31, April 30, and June 30, 2006. No other fees we billed by Jaspers + Hall in the period ended September 30, 2006.

### AUDIT FEES 2005:

As of the period ended September 30, 2005 Jaspers + Hall had billed the Company \$1,500 for the following professional services: review of the interim financial statements included in quarterly reports on Form 10-QSB for the periods ended June 30, 2005 and annual financial statements included in annual reports on Form 10-KSB for the period ended September 30, 2005. No other fees we billed by Jaspers + Hall in the period ended September 30, 2006.

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The Company's previous auditor, Michael Johnson & Co, LLC, billed the Company \$7,500 for the following professional services: audit of the annual financial statement of the Company for the fiscal year ended September 30, 2004, review of the interim financial statements included in quarterly reports on Form 10-QSB for the periods ended December 31, 2004, March 31, 2005.

The Company's Board acts as the audit committee and had no "pre-approval policies and procedures" in effect for the auditors' engagement for the audit year 2005 and 2006.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this report:

#### 1. Reports on Form 8-K:

8-K filed 1-11-06  
8-K/A filed 1-11-06  
8-K filed 1-12-06  
8-K filed 7-6-06  
8-K filed 7-27-06

#### 2. Exhibits:

10.1 EXPANDED USE LICENSE AGREEMENT\*  
10.2 EXPANDED USE LICENSE STOCK WARRANT TO PURCHASE COMMON STOCK OF XSUNX, INC.\*  
10.3 SUBSCRIPTION FORM AND NOTICE OF EXERCISE\*  
10.4 CONSULTANCY AND ADVISORY WARRANT TO PURCHASE COMMON STOCK OF XSUNX, INC.\*  
10.5 CONSULTANCY AND ADVISORY WARRANT TO PURCHASE COMMON STOCK OF XSUNX, INC.\*  
10.6 CONSULTING AND ADVISORY AGREEMENT\*  
10.7 CONSULTING AND ADVISORY AGREEMENT\*  
10.8 CONSULTING AND ADVISORY AGREEMENT\*

31 Sarbanes-Oxley Certification  
32 Sarbanes-Oxley Certification

\* Previously filed

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## INDEX

Regulation S-K Number	Exhibit	Form 10-K Consecutive Page Number
3.1	Articles of Incorporation to Registration Statement Form 10SB12G #000-29621	Incorporated by reference
3.2	Bylaws to Registration Statement Form 10SB12G #000-29621	Incorporated by Reference

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XSUNX, INC.

(A DEVELOPMENT STAGE COMPANY)  
FINANCIAL STATEMENTS

September 30, 2006 and 2005

JASPERS + HALL, PC  
CERTIFIED PUBLIC ACCOUNTANTS

-----  
9175 E. Kenyon Avenue, Suite 100  
Denver, CO 80237  
303-796-0099

REPORT OF REGISTERED INDEPENDENT PUBLIC ACCOUNTING FIRM

Board of Directors  
XSUNX, INC.  
Aliso Viejo, CA

We have audited the accompanying balance sheets of XSUNX, Inc., (formerly Sun River Mining, Inc). (A Development Stage Company) as of September 30, 2006, and the related statements of operations, cash flows, and stockholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XSUNX, INC., (formerly Sun

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River Mining, Inc.) at September 30, 2006 and the results of their operations and their cash flows for the year ended September 30, 2006 and for the period February 25, 1997 to September 30, 2006, in conformity with accounting principles generally accepted in the United States.

The financial statements for the years ended September 30, 2004 and 2003 and from the period February 25, 1997 (inception) to September 30, 2004, were audited by other accountants, whose report dated May 5, 2005 expressed an unqualified opinion on those statements. They have not performed any auditing procedures since that date.

Denver, CO  
December 14, 2006

/s/ Jaspers + Hall, PC  
Jaspers + Hall, PC  
Denver, Colorado  
December 14, 2006

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XSUNX, INC.  
(A Development Stage Company)  
Balance Sheets

	2006
<b>ASSETS:</b>	
<b>Current assets:</b>	
Cash	\$4,305,100
Prepaid Research and Development Expense	3,200
Prepaid Professional Expense	330,910
Prepaid Legal Expenses	15,000
Total current assets	4,654,220
<b>Fixed Assets:</b>	
Office Equipment	9,770
Research and Development Equipment	392,300
Leasehold Improvement	80,490
Total Fixed Assets	482,560
Less Depreciation and Amortization	(84,940)
Net Fixed Assets	397,620

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Other Assets:	
Patents	40,000
Security Deposit	2,610
Deferred Financing Costs	25,000
Marketable Prototype	1,765,000
	-----
Total other assets	1,832,610
	-----
TOTAL ASSETS	\$6,884,460
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):	
Current liabilities:	
Accounts Payable	\$ 582,160
Accrued Expenses	6,530
Note Payable	
	-----
Total current liabilities	588,690
	-----
Stockholders' equity (deficit):	
Preferred Stock, par value \$0.01 per share; 50,000,000 shares authorized; no shares issued and outstanding	
Treasury Stock, no par value; 26,798,418 issued and outstanding	
Common Stock, no par value; 500,000,000 shares authorized;	
157,169,856 shares issued and outstanding September 30, 2006	13,290,860
123,876,633 shares issued and outstanding September 30, 2005.	
Common Stock Warrants	2,151,250
Deficit accumulated during the development stage	(9,146,350)
	-----
Total stockholders' deficit	6,295,760
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	\$6,884,460
	=====

The accompanying notes are an integral part of these financial statements.

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XSUNX, INC.  
(A Development Stage Company)  
Statements of Operations

Years Ended

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	2006	September 30, ----- 2005	2004	Sept ----- 2
Revenue	\$ 8,000	\$ -	\$ -	
Expenses:				
Abandoned Equipment	-	-	-	
Advertising	9,050	3,979	-	
Bank Charges	294	500	401	
Conferences and Seminars	11,267	-	-	
Consulting	47,850	320,944	19,900	
Depreciation and Amortization	82,941	18,435	-	
Directors' Fees	-	-	-	
Due Dilgence	-	-	-	
Equipment Rental	-	-	-	
Filing Fees	4,625	1,800	-	
Impairment loss	-	-	-	
Insurance	2,705	758	-	
Legal and Accounting	140,293	107,249	27,203	
Licenses and Fees	20	25	190	
Loan Fees	628,834	115,000	-	
Meals and Entertainment	-	-	-	
Miscellaneous Expenses	3,882	1,675	-	
Office Expenses	4,581	2,634	5,218	
Patent Fees	625	663	-	
Salaries	275,089	155,236	119,336	
Postage	1,123	2,161	-	
Printing	8,730	4,300	-	
Public Relations	182,151	116,413	6,640	
Rent	19,858	9,000	8,905	
Research & Development	949,472	501,423	129,493	
Subscription Reports	2,895	860	-	
Taxes	-	-	-	
Telephone	12,318	5,489	4,270	
Transfer Agent Expense	411	3,628	2,997	
Travel	41,823	11,234	3,640	
Warrant Option Expense	951,250	-	1,200,000	
Total Expenses	3,380,087	1,383,406	1,528,193	
Other Income and Expense				
Interest Expense	158,333	17,433	251	
Interest Income	(88,480)	-	-	
Forgiveness of Debt	-	-	(19,376)	
Net Loss	\$ (3,441,940)	\$ (1,400,839)	\$ (1,509,068)	\$
Per Share Information:				
Weighted average number of common shares outstanding	138,005,964	123,854,733	114,036,102	
Net Loss per Common Share	\$ (0.02)	\$ (0.02)	\$ (0.01)	

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\* Less than \$.01

The accompanying notes are an integral part of these financial statements.

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XSUNX, INC.  
(A Development Stage Company)  
Statement of Stockholders' Equity (Deficit)  
September 30, 2006

Continued

	Treasury Stock		Common Stock		Common Stock
	# of Shares	Amount	# of Shares	Amount	Warrants
Inception February 25, 1997	-	\$ -	-	\$ -	\$ -
Issuance of stock for cash	-	-	10,590	111,900	-
Issuance of stock to Founders	-	-	14,110	-	-
Issuance of stock for consolidation	-	-	445,000	312,106	-
Issuance of stock for cash	-	-	5,290	105,800	-
Net Loss for Year	-	-	-	-	-
Balance - September 30, 1997	-	-	474,990	529,806	-
Issuance of stock for services	-	-	1,500	30,000	-
Issuance of stock for cash	-	-	50,200	204,000	-
Consolidation stock cancelled	-	-	(60,000)	(50,000)	-
Net Loss for Year	-	-	-	-	-
Balance - September 30, 1998	-	-	466,690	713,806	-
Issuance of stock for cash	-	-	21,233	159,367	-
Issuance of stock for services	-	-	65,000	316,500	-
Issuance of stock for cash	-	-	90,225	488,546	-
Issuance of stock for services	-	-	70,000	147,000	-
Issuance of stock for cash	-	-	40,000	69,200	-
Net Loss for Year	-	-	-	-	-
Balance - September 30, 1999	-	-	753,148	1,894,419	-
Issuance of stock for cash	-	-	15,000	27,000	-
Net Loss for year	-	-	-	-	-

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Balance - September 30, 2000	-	-	768,148	1,921,419	-
Extinguishment of debt	-	-	-	337,887	-
Net Loss for year	-	-	-	-	-
Balance - September 30, 2001	-	-	768,148	2,259,306	-
Net Loss for year	-	-	-	-	-
Balance - September 30, 2002	-	-	768,148	2,259,306	-
Issuance of stock for Assets	-	-	70,000,000	3	-
Issuance of stock for Cash	-	-	9,000,000	225,450	-
Issuance of stock for Debt	-	-	115,000	121,828	-
Issuance of stock for Expenses	-	-	115,000	89,939	-
Issuance of stock for Services	-	-	31,300,000	125,200	-
Net Loss for year	-	-	-	-	-

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XSUNX, INC.  
(A Development Stage Company)  
Statement of Stockholders' Equity (Deficit)  
September 30, 2006

...Contin

	Treasury Stock		Common Stock		Warrants
	# of Shares	Amount	# of Shares	Amount	
Balance - September 30, 2003	-	-	111,298,148	2,821,726	-
Issuance of stock for Cash	-	-	2,737,954	282,670	-
Issuance of Common Stock Warrants	-	-	-	-	1,200,000
Net Loss for year	-	-	-	-	-
Balance - September 30, 2004	-	-	114,036,102	3,104,396	1,200,000
Issuance of stock for cash	-	-	6,220,037	491,135	-
Issuance of stock for services	-	-	10,000	3,000	-
Issuance of stock for services	-	-	300,000	24,000	-
Issuance of stock for cash	-	-	527,000	40,260	-
Issuance of stock for services	-	-	239,469	23,827	-
Issuance of stock for Collateral	26,798,418	-	-	-	-
Issuance of stock for services	-	-	2,544,031	310,117	-
Net Loss for year	-	-	-	-	-

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Balance - September 30, 2005	26,798,418	-	123,876,639	3,996,735	1,200,000
	-----	-----	-----	-----	-----
Issuance of stock for services	-	-	40,441	7,500	-
Issuance of common stock warrants	-	-	-	-	951,250
Issuance of stock for debenture conversion	-	-	8,500,000	850,000	-
Issuance of stock for interest on debenture	-	-	105,500	10,550	-
Issuance of stock for warrant conversion	-	-	10,850,000	3,171,250	-
Issuance of stock for debenture conversion	-	-	7,894,737	3,000,000	-
Issuance of stock for debenture conversion	-	-	5,263,158	2,000,000	-
Issuance of stock for interest on debenture	-	-	607,456	230,833	-
Issuance of stock for services	-	-	31,925	24,000	-
Net Loss for year	-	-	-	-	-
	-----	-----	-----	-----	-----
Balance - September 30, 2006	26,798,418	\$ -	157,169,856	\$13,290,868	\$ 2,151,250
	=====	=====	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

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XSUNX, INC.  
(A Development Stage Company)  
Statements of Cash Flows

(Indirect Method)

	Years Ended September 30,		
	2006	2005	2004
	-----	-----	-----
Cash Flows from Operating Activities:			
Net Loss	\$ (3,441,940)	\$ (1,400,969)	\$ (1,509,000)
Issuance of Common Stock for Services	31,500	50,827	
Issuance of Common Stock for Loan Inducement	-	310,117	
Warrant Expense	951,250	-	1,200,000
Issuance of Common Stock for Interest	241,383	-	
Depreciation Expense	82,941	18,435	
Adjustments to reconcile net loss to net cash used in operations.			
Decrease in Deposits	(2,615)	-	(22,000)
(Increase) in Deferred Financing Costs	(25,001)		
(Increase) in Prepaid Expenses	(269,133)	(59,985)	
Increase (Decrease) in Accounts Payable	503,784	(10,653)	89,000
Increase (Decrease) in Accrued Liabilities	(39,448)	42,578	5,000
	-----	-----	-----
Net Cash Flows Used by Operations	(1,942,278)	(1,049,650)	(236,000)
	-----	-----	-----

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Cash Flows from Investing Activities:			
Purchase of Fixed Assets	(314,736)	(181,995)	(2,
Purchase of Marketable Prototype and Patent	(1,785,000)	(10,000)	(9,
	-----	-----	-----
Net cash used by investing activities	(2,099,736)	(191,995)	(12,
	-----	-----	-----
Cash Flows from Financing Activities:			
Proceeds from Notes payable - Stockholder	-	3,775	1,
Payment for Notes payable - Stockholder	-	(5,000)	
Proceeds fom Warrant Conversion	3,171,250	-	
Proceeds from Debenture Conversion	5,000,000		
Proceeds from Convertible Debt	-	850,000	
Issuance of Common Stock for cash	-	531,395	282,
	-----	-----	-----
Net Cash Flows Provided by Financing Activities	8,171,250	1,380,170	283,
	-----	-----	-----
Increase in Cash	4,129,236	138,525	34,
	-----	-----	-----
Cash at Beginning of Period	175,869	37,344	2,
Cash at End of Period	\$4,305,105	\$ 175,869	\$ 37,
	=====	=====	=====
Supplemental Disclosure of Cash Flow Information			
Cash paid for Interest	\$ -	\$ -	
	=====	=====	=====
Cash paid for income taxes	\$ -	\$ -	
	=====	=====	=====
NON-CASH TRANSACTIONS			
Stock issued for services	\$ 31,500	\$ 50,827	
	=====	=====	=====
Stock issued for Loan Inducement	\$ -	\$ 310,117	
	=====	=====	=====
Stock Issued for Interest	\$ 241,383	\$ -	\$
	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

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XSUNX, INC.  
(A Development Stage Company)  
Notes to Financial Statements  
September 30, 2006

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XSUNX, INC.  
(A Development Stage Company)  
Notes to Financial Statements  
September 30, 2006

Note 1 - Organization:

XsunX, Inc. ("XsunX," the "Company" or the "issuer") is a Colorado corporation formerly known as Sun River Mining Inc. "Sun River"). The Company was originally incorporated in Colorado on February 25, 1997. Effective September 24, 2003, the Company completed a Plan of Reorganization and Asset Purchase Agreement (the "Plan").

Pursuant to the Plan the Company acquire the following three patents from Xoptix, Inc., a California corporation for Seventy Million (70,000,000) shares (post reverse split one for twenty): No. 6,180,871 for Transparent Solar Cell and Method of Fabrication (Device), granted on January 30, 2001; No. 6,320,117 for Transparent Solar Cell and Method of Fabrication (Method of Fabrication), granted on November 20, 2001; and No. 6,509,204 for Transparent Solar Cell and Method of Fabrication (formed with a Schottky barrier diode and method of its manufacture), granted on January 21, 2003.

Pursuant to the Plan, the Company authorized the issuance of 110,530,000 (post reverse split) common shares. Prior to the Plan the Company had no tangible assets and insignificant liabilities. Subsequent to the Plan the Company completed its name change from Sun River Mining, Inc. to XsunX, Inc. The transaction was completed on September 30, 2003.

XsunX, Inc. is developing solar cell designs and manufacturing process with the intent to provide commercially viable solar cell design applications that convert sun light into electrical energy. The process for producing electricity from sun light is known as Photovoltaics. Photovoltaic ("PV") is the science of capturing and converting solar energy into electricity.

The product of the Company's development efforts is intended to deliver two aspects of deliverable technologies in the form of an integrated solution providing, a) commercially scalable manufactured processes and equipment designed for the specific manufacture of the Company's thin film solar technologies, and b) proprietary thin film solar cell designs that address new application opportunities.

Note 2 - Summary of Significant Accounting Policies:

Basis of Presentation - Development Stage Company:

-----  
The Company has not earned any revenues from operations. Accordingly, the Company's activities have been accounted for as those of a "Development Stage Enterprise" as set forth in Financial Accounting Standards Board Statement No. 7 ("SFAS 7"). Among the disclosures required by SFAS 7 are that the Company's financial statements be identified as those of a development stage company, and that the statements of operations, stockholders' equity (deficit) and cash flows disclose activity since the date of the Company's inception.

Basis of Accounting:

-----

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The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States.

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XSUNX, INC.  
(A Development Stage Company)  
Notes to Financial Statements  
September 30, 2006

Note 2 - Summary of Significant Accounting Policies (Cont.):

Cash and Cash Equivalents:  
-----

For purposes of the statements of cash flows, cash and cash equivalents include cash in banks and money markets with an original maturity of three months or less.

Use of Estimates:  
-----

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Significant estimates made in preparing these financial statements include the estimate for the useful life of property and equipment, and the fair value of stock warrants. Actual results could differ from those estimates

Fair value of financial instruments  
-----

The Company's financial instruments, including cash and cash equivalents, accounts payable and accrued liabilities are carried at cost, which approximates their fair value, due to the relatively short maturity of these instruments. As of September 30, 2006 and 2005, the Company's notes payable have stated borrowing rates that are consistent with those currently available to the Company and, accordingly, the Company believes the carrying value of these debt instruments approximates their fair value.

Property and Equipment  
-----

Property and equipment are stated at cost, and are depreciated or amortized using the straight-line method over the following estimated useful lives:

Furniture, fixtures & equipment	7 years
Computer equipment	5 years
Commerce server	5 years
Computer software	3 - 5 years
Leasehold improvements	Length of the lease

Net earning (loss) per share:  
-----

Basic loss per share is computed on the basis of the weighted average number of common shares outstanding. For all periods, all of the Company's common stock

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equivalents were excluded from the calculation of diluted loss per common share because they were none dilutive, due to the Company's net losses.

### Advertising:

-----

Advertising costs are expensed as incurred. Total advertising costs were \$9,050 and \$3,979 for the years ended September 30, 2006 and 2005, respectively.

### Research and Development:

-----

Research and development costs are expensed as incurred. Total research and development costs were \$ 949,472 and \$501,423 for the years ended September 30, 2006 and 2005, respectively.

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XSUNX, INC.  
(A Development Stage Company)  
Notes to Financial Statements  
September 30, 2006

### Other Comprehensive Income:

-----

The Company has no components of other comprehensive income (loss) and accordingly, net loss is equal to comprehensive loss in all periods.

### Note 3 - Federal Income Tax:

The Company accounts for income taxes under SFAS No. 109, which requires the asset and liability approach to accounting for income taxes. Under this approach, deferred income taxes are determined based upon differences between the financial statement and tax bases of the Company's assets and liabilities and operating loss carry forwards using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are recognized if it is more likely than not that the future tax benefit will be realized.

Significant components of the Company's deferred tax liabilities and assets are as follows:

	2006	2005
	-----	-----
Deferred Tax Liability	\$ 9,646,224	\$ 5,729,284
Deferred Tax Assets		
Net Operating Loss Carry forwards	0	0
Book/Tax Differences in Bases of Assets	0	0
	-----	-----
Valuation allowance	\$ 9,646,224	\$ 5,729,284
	-----	-----
Net Deferred tax assets	\$ 0	\$ 0
	=====	=====



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### Note 3 - Federal Income Tax (Cont.):

At September 30, 2006, the Company had net operating loss carry forwards of approximately, \$9,146,353 for federal income tax purposes. These carry forwards if not utilized to offset taxable income will begin to expire in 2010.

### Note 4 - Capital Stock Transactions:

The authorized capital stock of the Company was established at 500,000,000 with no par value. On September 29, 2003 the Board of Directors authorized a reverse split of 1 for 20 shares of stock. The stocks issued in 2003, as part of a reorganization, were for accrued director fees and salaries and to pay off past debt to investors. Included in the reorganization were 70,000,000 shares of stock issued to obtain certain patent rights from Xoptix, Inc. Also shares of stock were issued in 2003 for consulting fees in arranging the formation of the reorganized Corporation. In 2004 2,737,954 shares of stock were issued for cash and consulting fees to fund operations. 9,840,537 shares of common stock were issued in 2005 for cash and consulting fees to fund operations. In July 2005, 26,798,418 shares of common stock were placed in XSUNX, Inc. Treasury Stocks as collateral for the long-term note with Cornell Capital Partners. On August 18, 2006 the note underlying the collateral shares was paid and requirement of collateral was discharged. In 2006 33,188,926 shares of common stock were issued for cash and 72,366 were issued for services to fund operations.

The following represents a detailed analysis of the 2006 capital stock transactions.

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XSUNX, INC.  
(A Development Stage Company)  
Notes to Financial Statements  
September 30, 2006

#### Issuance of Shares

-----

Debenture Conversion - On February 8, 2006 Cornell Capital Partners, LLP converted \$350,000 of the principal balance of \$850,000 debenture issued to Cornell in July 2005. On March 1, 2006 Cornell converted the remaining principal and accrued interest the debenture balance totaling \$510,550. Upon conversion of the notes XsunX issued 8,605,500 shares of common stock to Cornell. The conversion price for all of the above issued shares was \$.10. The remaining value of the debenture is \$0.

Warrant Conversion - In February 2006, a consultant exercised 100,000 of the 1,000,000 available \$.15 cent warrants. The amount of \$15,000 dollars was paid to XsunX by the consultant and 100,000 shares were issued.

Warrant Conversion - In March 2006 Cornell Capital Partners, LLP exercised 3,125,000 of the available 3,125,000 \$.45 warrants and 1,250,000 of the available 1,250,000 \$.55 cent warrants. The aggregate amount of \$2,093,750 dollars was paid to XsunX by Cornell. The Company issued 4,375,000 shares of common stock in association with the exercise of these warrants.

Warrant Conversion - In April 2006 Cornell Capital Partners, LLP exercised 4,250,000 of the available 4,250,000 \$.15 warrants and 2,125,000 of the available 2,125,000 \$.20 cent warrants. The aggregate amount of \$1,062,500 dollars was paid to XsunX by Cornell. The Company issued 6,375,000 shares of

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common stock in association with the exercise of these warrants.

Debenture Conversions - On May 10, 2006 Cornell Capital Partners, LLP converted \$2,000,000 of the principal balance of a \$5,000,000 debenture issued to Cornell in December 2005 and the Company issued 5,263,158 shares of common stock to Cornell for the conversion. On June 12 Cornell converted another \$1,000,000 of the principal balance of the debenture and the Company issued 2,631,579 shares of common stock to Cornell. On July 17, 2006 another \$1,000,000 of the principal balance was converted by Cornell for which the Company issued 2,631,579 shares of common stock to Cornell. On August 23, 2006 Cornell converted the remaining \$1,000,000 principal balance and \$230,833 of the total accrued interest charges of the debenture for which the Company issued 3,239,035 shares of common stock to Cornell. The conversion price for all of the above issued shares was \$.38 each. The remaining balance of the Debenture as of the date of this filing is \$0.0.

### Issuance of Shares for Service

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In December 2005 the Company issued 40,441 unregistered common shares to a service provider for accrued service fees totaling \$7,500 dollars for services provided over the fourth quarter period ended September 30, 2005. In September 2006 XsunX issued an additional 31,925 unregistered common shares to the same service provider for accrued service fees totaling \$24,000 dollars for the one year period ended September 30, 2006. The shares were earned on a quarterly basis by the service provider and the conversion price for the stock issued was calculated using the average daily closing price of the Company's common stock over each quarter period of service.

### Note 5 - Stock Options and Warrants:

#### Stock Option Plan:

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On July 15, 2004, the Board of Directors of XsunX resolved to establish the 2004 Stock Option Plan. The plan was adopted to provide equity incentives to employees, consultants and suppliers of the Company. The adoption of the Plan was subject to ratification by a majority of the Company's stockholders, which

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approval was to be obtained within 12 months from the date the Plan was adopted by the Board. The Plan was cancelled by the Board due to non-approval in August 2005. No stocks were issued at September 30, 2006.

### Warrant/Option Expense

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Warrant/Option Expense for the Company was computed by multiplying the value of the difference between the warrant exercise price, if less than the market price, and the market price of the stock at date of grant. This method resulted in a \$951,250 charge to expenses for the warrants granted in the year ended September 30, 2006, as follows:

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2006 WARRANT/OPTION EXPENSE CHART

Holder	# of Warrants	Exercise Price	Underlying Share Value at Date of Grant	In the Money Spread at Date of Grant	Warrant Value
MVSystems, Inc.	7,000,000	\$.25	\$.31	\$.06	\$
Cornell Capital, LP	3,125,000	\$.45	\$.60	\$.15	\$
Cornell Capital, LP	1,250,000	\$.55	\$.60	\$.05	\$
Joseph Grimes	112,000	\$1.69	\$1.69	\$0.0	
Joseph Grimes	500,000	\$.51	\$.51	\$.0	
Totals					\$

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Note 5 - Stock Options and Warrants (cont.):

Warrant Grants

Expanded Use License stock warrant MVSystems, Inc. - As consideration for the grant of an Expanded Use License on October 12, 2005, granting XsunX additional benefits for use of licensed technologies and patents, XsunX granted MVS a warrant, (the "Expanded Use License Stock Warrant") for the purchase of up to Seven Million (7,000,000) shares of common stock of XsunX, the warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Expanded Use License Stock Warrant allowed for the vesting of one million (1,000,000) warrants on the effective date of the agreements.
- (2) One million (1,000,000) warrants will vest upon the satisfactory completion of a Phase 4 development program for the development of certain opaque solar technologies.
- (3) The balance of the remaining five million (5,000,000) warrants will vest upon the date the technologies licensed within the Expanded Use License are licensed to a third party in a bona fide arms-length commercial setting.

Debenture Warrants - In connection with the issuance of a debenture in the

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principal amount of \$5,000,000 in December, 2005 3,125,000 warrants were granted to Cornell Capital Partners, LP at \$.45 and 1,250,000 warrants were granted at \$.55. During the 2006 fiscal year Cornell exercised all of the available warrants granted. As of the date of this filing there were no remaining warrants available for conversion by Cornell.

Employment Incentive Warrants - In connection with the issuance of an employment agreement to Joseph Grimes in April 2006, the Company granted 500,000 warrants at the then market price of \$1.69. On July 20, 2006 the Company and Mr. Grimes mutually agreed to the cancellation of the remaining 388,000 unvested balance of this warrant and to the grant of a new warrant agreement in the amount of 500,000 warrants at the then market price of \$.51. The warrant will expire five (5) years after the date of the grant and is subject to the following vesting provisions:

- (1) The Warrant shall become exercisable at the rate of 28,000 shares per month up to and through the first nine months of employment of Optionee by Company.
- (2) One Hundred Thousand (100,000) shares shall become exercisable upon the completion and delivery of a marketing plan by Optionee to the Board of Directors.
- (3) One Hundred Forty Eight Thousand (148,000) shares shall become exercisable upon the first sale or licensure of an XSUNX, Inc. technology under the marketing plan.

The total charged in expense for the 2006 fiscal year has been \$951,250 for the issuance of the above described Expanded Use License, Debenture warrants, and employment incentive warrants.

During the years ended September 30, 2005 and September 30, 2006 the board of directors approved the issuance of warrants to purchase an aggregate of 19,112,000 shares of the Company's common stock. Such warrants are exercisable at prices ranging from \$.15 to \$1.69 per share, vest over periods from between 36 to 60 months, and expire at various times through July 2011.

During the years ended September 30, 2005 no warrant holders exercised warrants to purchase the Company's common stock. During the year ended September 30, 2006 warrant holders exercised a total of 10,850,000 warrants in cash to purchase the Company's common stock.

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Note 5 - Stock Options and Warrants (cont.):

A summary of warrant activity for the year ended September 30, 2005 and 2006 is as follows:

Number of Warrants	Weighted- Average Exercise	Accrued -----
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		Price	Warrants ----- Exercisable	P
Outstanding, September 30, 2004	8,000,000	\$0.15	5,525,000	\$
Granted 2005	7,125,000	\$0.1649	7,884,167	\$
Exercised 2005	0	\$0.0		
Outstanding, September 30, 2005	15,125,000	\$0.1595	13,409,167	\$
Granted 2006	11,987,000	\$0.3419	6,143,000	\$
Exercised 2006	(10,850,000)	\$0.2923	(10,850,000)	
Outstanding, September 30, 2006	16,262,000	\$0.2170	8,702,167	\$

At September 30, 2006, the range of warrant prices for shares under warrants not exercised and the weighted-average remaining contractual life is as follows:

Range of Warrant Exercise Price	Warrants Outstanding			Warrants Exercised	
	Number of Warrants	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (yr)	Number Of Warrants	Weighted- Average Exercise Price
\$.15	7,900,000	\$.15	2.7	6,900,000	\$.15
.20	750,000	.20	1.5	634,167	.20
.25	7,000,000	.25	4.0	1,000,000	.25
.51	500,000	.51	4.8	56,000	.51
1.69	112,000	1.69	4.5	112,000	1.69

Note 6 - Marketable Prototype Acquisition:

Subject to the terms of the Expanded Use License Agreement dated October 12, 2005 between XsunX and MVSystems, Inc. the parties are building a first run production Machine for the purpose of proofing and demonstrating thin film solar cell manufacturing technology. The parties intend to sell this first Machine and have agreed to a 50/50 split of the net proceeds of the sale of this Machine excluding production Costs and reasonable marketing expenses.

Note 7 - Notes, Commitments, and Contingencies

Note Payable (Paid)

On July 14, 2005, XSUNX, Inc. entered into a Secured Convertible Debenture agreement with Cornell Capital Partners, LP in the amount of \$400,000. The interest accrued on the outstanding principal balance thereof at an annual rate

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equal to twelve percent (12%). The Debenture was convertible into shares of Common Stock at the option of the Holder, with a conversion price in effect on any Conversion Date was be equal to ten cents (\$.10). On August 16, 2005, XSUNX,

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Inc. received an additional \$450,000 from Cornell Capital Partners, LP with the same interest and conversion rights. During the period ended March 31, 2006 Cornell converted the entire \$850,000 principal balance and \$10,550 of the remaining accrued interest charges into 8,605,500 shares of common shares. The shares were issued subject to a registration statement effective as of February 2006. The remaining balance of the debenture is \$0.0.

On December 12, 2005, XsunX, Inc. consummated a Securities Purchase Agreement dated December 12, 2005 with Cornell Capital Partners L.P. providing for the sale by the Company to Cornell of 10% secured convertible debentures in the aggregate principal amount of \$5,000,000 (the "Debentures") of which \$2,000,000 was advanced immediately. The second installment of \$2,000,000 was advanced prior to the filing by the Company with the Securities and Exchange Commission of a Registration Statement in January 2006. The last installment of \$1,000,000 was advanced in February 2006 upon the Registration Statement being declared effective by the Commission. Between May 2006 and August 2006 the Debentures principal balance of \$5,000,000 dollars and accrued interest charges were converted into 13,765351 shares of Common Stock at the option of Cornell at a conversion price per share equal to \$0.38. The remaining balance of the debenture is \$0.0.

In connection with the above Cornell L.P. Securities Purchase Agreement, the Company also entered into a registration rights agreement (the "Registration Rights Agreement") providing for the filing of a registration statement (the "Registration Statement") with the Securities and Exchange Commission registering the Common Stock issuable upon conversion of the Debentures and the exercise of Warrants issued to Cornell in association with Debenture. Prior to executing the Securities Purchase Agreement, the Company had withdrawn a previously filed registration statement that included Common Stock issued to Cornell and Common Stock to be issued upon the conversion of debentures and the exercise of warrants previously sold to Cornell (collectively, the "Initial Securities") pursuant to a securities purchase agreement executed on July 14, 2005 (the "Prior Agreement") as well as Common Stock to be issued pursuant to the Standby Equity Distribution Agreement dated July 14, 2005 between the Company and Cornell (the "Distribution Agreement"). All Initial Securities were included in the Registration Statement. The Company and Cornell also agreed to terminate the July 14, 2005 Distribution Agreement. On January 11, 2006 the Company filed to register up to 72,879,263 shares in association with the above securities registration requirements. The Registration statement was made effective on or about February 9, 2006. Upon the final conversion by Cornell of the Initial Securities, the Securities Purchase Agreement, the underlying Warrants therein, and accrued interest associated with the Debentures XsunX issued the aggregate amount of 35,245,851 registered shares of common stock in the 2006 period.

The Company's obligations under the Prior Agreement and the Securities Purchase Agreement were secured by substantially all of the Company's assets. As further security for its obligations thereunder, the Company had deposited into escrow 26,798,418 shares of Common Stock. In addition, Tom Djokovich, the Company's

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Chief Executive Officer, had granted a security interest in 925,000 shares of Common Stock that he owns to secure the Company's obligations under the Prior Agreement only. As of the date of this filing XsunX had received notice from Cornell of the release of the security interest in above listed security shares and assets.

### Trademark Transfer Agreement:

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On May 6, 2004 a Trademark transfer agreement was signed with Western Gas and Electric Company of California. Western solely owns all rights and interest in and to the registered trademark consisting of printed words styled as "POWER GLASS" as more fully set forth herein ("Trademark") and desires to assign and transfer, subject to the terms and conditions set forth herein, all rights and interest in the Trademark to XsunX in exchange for the payment set forth in this Agreement. The purchase price for the Trademark shall be: (1) the sum of \$10,000 if paid within one (1) year from the effective date; (2) the sum of \$20,000 if paid after the conclusion of the first (1st) year but prior to the conclusion of the second (2nd) year after the effective date of this Agreement; (3) the sum of \$35,000 if paid after the conclusion of the second (2nd) year but prior to the conclusion of the third (3rd) year after the effective date of this Agreement;

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or (4) the sum of \$50,000 if paid after the conclusion of the third (3rd) year but prior to the conclusion of three (3) years and six (6) months after the effective date of this Agreement. If payment is not made prior to the conclusion of three (3) years and six (6) months after the effective date of this Agreement, XsunX shall re-assign the Trademark back to Western as set forth herein. At September 2006 the accrued balance of \$35,000 is included in Accounts Payable.

### Operating Leases

In April 2006 the Company entered into a three year lease for operations facilities in Golden, CO. The Company provided a \$2,615 security deposit and expensed \$79,867 in costs associated with tenant improvements to the facilities in preparation for occupancy. The following is a schedule, by years, of the minimum base payments required under this operating lease for facilities. An additional \$825 monthly is also due as a pro rata share equaling 4.12% of the operating costs for real estate taxes, assessments, and the expenses of operating and maintaining common areas within the commercial grounds surrounding the leased facilities.

Rent Schedule	Rate/sf	Annual Rent	Annualized Monthly Rent
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7/1/06-6/30/07	\$6.75	\$20,250.00	\$1,687.50
7/1/07-6/30/08	\$6.95	\$20,850.00	\$1,737.50
7/1/08-6/30/09	\$7.16	\$21,480.00	\$1,790.00

### Legal Proceedings

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On March 6, 2006 Ron Sentchuck filed an action against the Company in the

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Superior Court of California for the County of Los Angeles. The Company was dismissed from this action on August 3, 2006. No contingency expenses were accrued by the Company for this complaint.

### Note 8 - Subsequent Events

On April 19th 2006, Office Radio Network filed a lawsuit in the District Court in Colorado alleging that it has been damaged due to refusal to allow it to sell its shares under Rule 144. The parties entered into a settlement in December 2006 providing for the return of 150,000 shares of the 300,000 shares issued to Office Radio network, and the provisioning by Office Radio Network of an additional six months of service.

### Note 9 - Financial Accounting Developments:

#### Recently issued Accounting Pronouncements

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In February 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". The provisions of SFAS 150 are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of nonpublic entities. The Company has not issued any financial instruments with such characteristics.

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN No. 46R), which addresses how a business enterprise should evaluate, whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN No. 46R replaces FASB Interpretation No. 46, "Consolidation of Variable Interest Entities", which was issued in January 2003. Companies are required to apply FIN 46R to variable interests in variable interest entities ("VIE") created after December 31, 2003. For variable interest in VIEs created before January 1, 2004 the interpretation is applied beginning January 1, 2005. For any VIEs that must be consolidated under FIN No. 46R that were created before January 1, 2004, the assets, liabilities and non-controlling interests of the VIE initially are measured at

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their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying value is not practicable, fair value at the date FIN No. 46R first applies may be used measure the assets, liabilities and non-controlling interest of the VIE. The Company does not have any interest in VIEs.

In December 2004, the FASB issued SFAS No. 123R (revised 2004) "Share-Based Payment" which amends FASB Statement No. 123 and will be effective for public companies for interim or annual periods beginning June 15, 2005. The new statement will require entities to expense employee stock options and other share-based payments. The new standard may be adopted in one of three ways - the modified prospective transition method, a variation of the modified transition method or the modified retrospective transition method. The Company is to



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evaluate how it will adopt the standard and the evaluation the effect that the adoption of SFAS 123R will have on the financial position and results of operations.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." The statement amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4 previously stated that "under some circumstances, items such as idle facility expense, excessive spoilage, double freight and rehandling costs may be so abnormal as to require treatment as current period charges". SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal". In addition, this statement requires that allocation of fixed production overhead to the costs of conversion be based on the prospectively and are effective for inventory costs incurred during fiscal years beginning after June 15, 2005, with earlier application permitted for inventory costs incurred during fiscal years beginning after the date this Statement is issued. The adoption of SFAS No. 151 does not have an impact on the Company's financial position and results of operations.

In December 2004, the FASB issued SFAS No. 153, Exchange of Non-monetary Assets, an amendment of APB Opinion No. 29. The guidance in APB opinion No. 29, Accounting for Non-monetary Transactions, is based on the principle that exchange of non-monetary assets should be measured on the fair value of the assets exchanges. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets that do not have commercial substance. A non-monetary has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for non-monetary exchanges occurring in fiscal periods beginning June 15, 2005. The adoption of SFAS No. 153 is not expected to have an impact on the Company's financial position and results of operations.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"). FIN 47 provides guidance relating to the identification of and financial reporting for legal obligations to perform an asset retirement activity. The Interpretation requires recognition of a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 also defines when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The provision is effective no later than the end of fiscal years ending after December 15, 2005. The Company will adopt FIN 47 beginning the first quarter of fiscal year 2006 and does not believe the adoption will have a material impact on its consolidated financial position or results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154") which replaces Accounting Principles Board Opinions No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28." SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting

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principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and a correction of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of 2006. The Company is currently evaluating the effect that the adoption of SFAS 154 will have on its results of operations and financial condition but does not expect it to have a material impact.

In June 2005, the Emerging Issues Task Force, or EITF, reached a consensus on Issue 05-6, Determining the Amortization Period for Leasehold Improvements, which requires that leasehold improvements acquired in a business combination purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF 05-6 is effective for periods beginning after July 1, 2005. We do not expect the provisions of this consensus to have a material impact on the financial position, results of operations or cash flows.

In February 2006 the amendment to FASB Statement No 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities was issued as SFAS 155, Accounting for Certain Hybrid Financial Instruments.

This Statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of our first fiscal year that begins after September 15, 2006.

The fair value election provided for in paragraph 4(c) of this Statement may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under paragraph 12 of Statement 133 prior to the adoption of this Statement. Earlier adoption is permitted as of the beginning of our fiscal year, provided we have not yet issued financial statements, including financial statements for any interim period, for that fiscal year. Provisions of this Statement may be applied to instruments that we hold at the date of adoption on an instrument-by-instrument basis. The Company is currently reviewing the effects of adoption of this Statement but it is not expected to have a material impact on our financial statements.

In March 2006 the amendment to FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities was issued as SFAS 156, Accounting for Servicing of Financial Assets.

This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations, requires all separately recognized servicing assets and servicing liabilities to be initially

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measured at fair value, if practicable and permits an entity to choose either the amortization method or the fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in

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some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value. Requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. Adoption of this Statement is required as of the beginning of the first fiscal year that begins after September 15, 2006. The adoption of this statement is not expected to have a material impact on our financial statement.

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### SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: December 14, 2006

XsunX, INC.

/s/ Tom Djokovich

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Tom Djokovich  
President

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DIRECTORS:

/s/ Tom Djokovich

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/s/ Thomas Anderson

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