



25 August 2006

Companies Section  
Australian Stock Exchange Limited  
530 Collins Street  
MELBOURNE VIC 3000

Dear Sir

PRELIMINARY FINAL REPORT – APPENDIX 4E  
YEAR ENDED 30 JUNE 2006

In accordance with Listing Rule 4.3A we enclose the Preliminary Final Report for Optiscan Imaging Limited for the year ended 30 June 2006.

The loss for the year was \$3,936,760, a reduction of 25% on the previous corresponding period (\$5,264,532).

The improved result reflects sales release of the ISC 1000 by collaboration Pentax in March 2006. Optiscan recorded sales of \$3,232,015 for the year, up 304% on the previous year.

A detailed commentary on results is included in the attached Appendix 4E report.

Yours Faithfully

A handwritten signature in blue ink, appearing to read "Bruce R. Andrew", is written over a light blue circular stamp.

Bruce R. Andrew  
Company Secretary

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## OPTISCAN IMAGING LIMITED

ABN 81 077 771 987

### ANNOUNCEMENT OF RESULTS AND PRELIMINARY FINAL REPORT FOR YEAR ENDED 30 JUNE 2006

Optiscan received its first significant product revenues during the 2005/06 year, a pivotal milestone on the path to becoming a high growth medical technology business.

The major achievements completed during 2005/2006 included:

- Strong sales and revenue growth
  - Product sales revenue of \$3.23M, up 304%
  - Total revenue of \$5.63M, up 198%
- Full product release of the Pentax ISC 1000 flexible endo-microscope
- Accelerated Pentax sales and marketing activity
- Further outstanding clinical trial results for flexible endo-microscopy
- Design and development of a second business stream with the Optiscan FIVE 1 endo-microscope for pre-clinical research markets
- Successful pilot clinical trials with rigid endo-microscopes
- A significant upgrade in regulatory certification
- Strengthening of the innovative product pipeline

As expected, these achievements have resulted in a re-rating of the company and a stronger share price.

Optiscan is now established as a medical device company producing innovative, well-patented instruments that have demonstrated efficacy and generate sales revenue from a global market valued at greater than US\$ 1+ Billion.

#### **Flexible Endo-microscope**

##### Pentax ISC 1000 sales release

On 1st March 2006, Pentax announced the global sales release of the Pentax ISC 1000 flexible endo-microscope system.

This signalled the completion of almost four years of collaborative product development and transfer into volume manufacture of Optiscan's patented endo-microscopy technology. Full sales release was a watershed achievement for our company, delivering our technology into the US\$1.2billion flexible endoscope market.

By 30 June the instrument had been released for four months, and Optiscan had been manufacturing and supplying product to Pentax for more than five months. This enabled Optiscan to complete product sales of \$3.23 million for the year, up more than 300% on the previous financial year. A total of 47 systems with 71 miniaturised scanner sets were sold to Pentax during the year.



### Sales and market development activity

Sales by Pentax of ISC 1000 instruments commenced almost immediately after product launch. Leading research and teaching hospitals in Europe, USA, Asia and the Middle East were quick to take delivery and commence use of these new breakthrough endo-microscope systems.

In the lead up to Pentax's full sales release of the ISC 1000 instrument Optiscan and Pentax established quality accredited production facilities capable of supporting volume manufacturing.

We ship the scanners and the CIS sub-systems to Pentax's endoscope assembly factory in Miyagi, Japan. Pentax then assemble the scanner into a flexible endoscope and incorporate standard endoscope components such as the miniaturised video camera, light sources for camera, working channel and air and suction ports.

The finished endo-microscopes are then combined with a CIS sub-system and a standard Pentax video processor unit ready for shipment to customers.

We agreed with Pentax during the year that our invoice sent at the time of product shipment will incorporate an amount equivalent to the royalty payment due to Optiscan under the terms of our original agreement. This arrangement has the benefit that we receive all cash revenue in accordance with payment terms of 45 days from date of shipment.

### Clinical efficacy

Excellent clinical efficacy data demonstrating the diagnostic capabilities of the ISC 1000 flexible endo-microscope continued to be presented in peer review forums throughout the last financial year.

The clinical trials sponsored by Pentax also continued during the year. There were increased patient numbers in established clinical trials and several new and important applications were established.

Pentax progress with their multi-centre trials was slower than anticipated during the year. Important differences in the way USA and European pathologists diagnose disease from biopsy tissue samples made it difficult to initiate an intended single endo-microscope trial involving trial sites from both countries.

At year end, Pentax were developing separate plans for USA and European trials. We anticipate the first of these multi-centre trials will be completed during the 2006/07 year.

### Sales Outlook with Pentax

Since its release in 1 March 2006, Pentax sales and shipment of ISC 1000 instruments has been progressing solidly. Enquiry levels remain high and we expect shipments will increase after the northern hemisphere summer period.



We are confident that sales in H1 2006/07 will be stronger than the second half of last year. However, after only a few months of sales, we believe it is still too early to provide a meaningful or accurate forecast of sales for the full 2006/2007 year.

### **Optiscan FIVE 1**

Design and development of Optiscan's second commercial product using our unique endo-microscope technology was completed during the year.

This product is the Optiscan FIVE 1 endo-microscope and it is targeted at pre-clinical research markets. FIVE is an anagram of Fluorescent In Vivo Endo-microscope.

Our analysis of target markets has revealed strong interest from two customer groups. One is drug companies conducting pre-clinical analysis of new drug therapies and the other is doctors wanting to complete research spanning both clinical and pre-clinical settings.

We are confident that ease of use and ability to do high resolution *in-vivo* imaging will enable Optiscan FIVE 1 customers to improve the content and quality of their pre-clinical research programs.

The market size for these pre-clinical research instruments is significantly smaller than for medical markets. However, carrying our own brand on the instrument creates significantly greater margin opportunity. We therefore view the Optiscan FIVE 1 as an adjunct commercial opportunity.

### **Partnerships and Business Development**

The process of securing a second major partnership covering the US\$1+ billion rigid endoscope markets also progressed during the year.

The key area of progress was the commencement of pilot clinical trials in rigid endo-microscope applications. These pilot trials are designed to reduce the perceived business risk of potential partners by enabling doctors to use an instrument in a clinical setting and provide direct feedback to partners on ease of use in a sterile environment, form and function of the instrument and indications of its clinical efficacy.

During the year excellent progress had been made in the pilot trials commenced in Australia at Bankstown-Lidcombe Hospital in Sydney and Mainz University Hospital in Germany. Discussions with potential partners have continued during the year, with two of the prospective companies having visited trial sites. The pilot clinical trial activity and Pentax successfully commencing sales in flexible endo-microscopes have heightened the interest of potential partners. However, at year end discussions were ongoing and we are unable to provide a firm timeline of when an appropriate agreement on a second partnership will be concluded.



Accessing a second major medical market remains important for unlocking the value in endo-microscopy and hence it will continue to receive significant levels of input until secured.

### **Product Development Pipeline and Intellectual Property Growth**

It is important for Optiscan's longer-term commercial success that our innovative R&D team continue to improve our endo-microscope technology and products. Our partners require this innovation to ensure they remain market leaders in the field. The functionality improvements and reductions in manufacturing costs targeted will positively influence longer term sales.

During the year the time and effort we expended on design and development of the Pentax ISC 1000 instrument eased significantly. This freed up resources to focus on future product development and creation of new intellectual property, and by year end, we had advanced our product development pipeline significantly.

A key feature of our company's commercial position is its strong and robust patent portfolio. During the year our patent portfolio was further extended with new filings covering key features of the endo-microscope and Optiscan patents covering new miniaturised scanner technology.

Considerable effort has been expended on pursuing patent infringements following last year's decisions by the Japanese and European Patent offices to uphold our fibre optic confocal microscope patents. Although finalising negotiations with all parties is taking time to complete, some settlements have been concluded, and once off payments amounting to \$439,620 have been received to date.

### **Investor Relations Activity**

Over the past year Optiscan's shares received a re-rating from the market as Pentax finally released product for sale and Optiscan product revenues commenced in earnest. This resulted in a significant increase in our share price, especially following release of third quarter sales revenue figures.

We expect that future share price increases will be driven primarily by revenue growth generated from sales to Pentax and from creating a path to realising the value that our unique technology has in rigid endoscope applications.

We will continue to engage with the investment markets to ensure the significant progress being made by the company on its path to commercial success remains fully appreciated and understood.

### **Optiscan Outlook**

At the Optiscan annual general meeting last year we advised that the business needs to sell approximately 200 systems per year to breakeven. We estimate that this represents a market share in flexible endoscope systems of less than 3%.



Pentax are committed to taking a minimum of 80+ systems in the first year of product release through to end February 2007. This commitment progresses us well towards achieving the required sales to breakeven. However, before we can provide data based guidance on timelines to profitability, we will need to see evidence that the strong initial market take up for endo-microscopy is continuing to grow.

Put simply it is still too early for us to accurately predict when our company will become profitable.

The demonstrated clinical utility for flexible endo-microscopy makes us extremely optimistic that with Pentax's continued market development activities sales will indeed continue to grow to, and well beyond, the levels required to breakeven.

Furthermore our pre-clinical and early stage clinical trial results with rigid endo-microscopy make us confident that we have a significant additional business opportunity within this market.

## OPTISCAN IMAGING LIMITED

ABN : 81 077 771 987

### APPENDIX 4E

#### Preliminary Final Report

#### Year ended 30 June 2006

Previous corresponding period: Year ended 30 June 2005

#### INDEX

1. Results for announcement to the market
2. Brief explanation of results
3. Commentary on results
4. Other information
5. Audit Report
6. Financial data

#### 1. Results for announcement to the market

The results of Optiscan Imaging Limited for the year ended 30 June 2006 are as follows:

##### Results

Sales revenue increased 304% to \$3.232M, reflecting final product release of the ISC 1000 in March 2006 by collaboration partner, Pentax.

Other income from royalties, interest and grants increased 34% to \$2.402M.

Total expenses, excluding cost of goods sold, decreased marginally, by 3%, to \$7.002M.

Total expenses including cost of goods sold increased 18% to \$9.458M as a consequence of production activity.

Loss from ordinary activities after tax attributable to members was down 25% to \$3.937M.

Net loss after tax attributable to members was down 25% to \$3.937M.

##### Dividends

No dividends have been paid or declared by the entity since the beginning of the reporting period. No dividends were paid or declared in the previous corresponding period.

## 2. Brief explanation of results

Following product release in March 2006 by collaboration partner, Pentax, the financial result of Optiscan in 2006 featured significant sales revenue for the first time.

Sales revenue was \$3,232,015, compared to \$1,064,603 in 2005, an increase of 304% and gross profit was up 280% to \$776,706.

Royalty revenue was up 23% to \$1,511,060 due to receipt of infringement settlements in addition to ongoing royalty income. Other income in 2006 is comprised of interest (\$471,214), grants received (\$419,728) and sundry revenue (\$315). Grant income represents the Commercial Ready Grant, which commenced early in the financial year.

Total expenses, excluding the cost of goods sold, amounted to \$7,002,756, a decrease of \$246,279 (3%) compared to last year. Most of the reduction was in R&D expenditure, which slowed marginally as the company reached product release with Pentax. Toward year end, the R&D expenditure spend rate tended back to historical levels as new development projects were activated. Administration expenses were steady and there was a small decline in other expenses.

The net loss before tax for the year was \$3,823,733. After allowing for income tax, (which represents the write off of withholding tax deductions amounting to \$113,027), the net loss for the year is \$3,936,760, which is 25% lower than the loss of \$5,264,732 in 2005.

## 3. Commentary on result

The Overview of 2005/2006 on pages 1 to 5 of this report is to be read as forming part of this Preliminary Final Report.

## 4. Other information to be included in Appendix 4E

### Net Tangible Assets per ordinary Security

Net tangible assets per ordinary security at 30 June 2006 amount to \$0.08 (2005, \$0.12).

### Subsidiaries, associates and joint ventures

There were no changes in subsidiaries, associates and joint ventures during the year.

### Status of audit of accounts

This Appendix 4E is based on accounts which have been audited.

### Annual General Meeting

The annual general meeting will be held at the offices of the company at 15 – 17 Normanby Road, Notting Hill, Victoria on Wednesday 8 November 2006 at 2.00pm.

5. Audit Report

The audit report is set out on pages 9 and 10 of this report.

6. Financial information

Audited financial information is set out on pages 11 to 60 of this report.



Bruce Andrew  
Company Secretary

24 August 2006

## Independent audit report to members of Optiscan Imaging Limited

### Scope

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

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

The company has disclosed information about the remuneration of directors and executives ("remuneration disclosures"), as required by Accounting Standard AASB 124 *Related Party Disclosures*, under the heading "remuneration report" in the directors' report, as permitted by the *ASIC CO 06/50*. These remuneration disclosures are identified in the directors' report as being subject to audit. The remuneration report also contains information not subject to audit, which has been identified as such.

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

### *Audit approach*

We conducted an independent audit of the financial report in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with Accounting Standard AASB 124 *Related Party Disclosures*. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

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

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

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report and the remuneration disclosures; and

- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

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

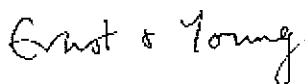
### Independence

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

### Audit opinion

In our opinion:

1. the financial report of Optiscan Imaging Limited is in accordance with:
  - (a) the *Corporations Act 2001*, including:
    - (i) giving a true and fair view of the financial position of Optiscan Imaging Limited and the consolidated entity at 30 June 2006 and of their performance for the year ended on that date; and
    - (ii) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*; and
  - (b) other mandatory financial reporting requirements in Australia.
2. The remuneration disclosures, that are contained in the directors' report and identified as being subject to audit, comply with Accounting Standard AASB 124 *Related Party Disclosures*.



Ernst & Young



Denis Thorn  
 Partner  
 Melbourne  
 24 August 2006

**Income Statement**  
**FOR THE YEAR ENDED 30 JUNE 2006**

	Note	CONSOLIDATED		PARENT	
		2006 \$	2005 \$	2006 \$	2005 \$
<b>Continuing operations</b>					
Sale of goods		3,188,164	1,019,353	-	-
Rendering of services		43,851	45,250	-	-
Royalty revenue		1,511,060	1,225,577	-	-
<b>Revenue</b>		<b>4,743,075</b>	<b>2,290,180</b>	<b>-</b>	<b>-</b>
Cost of sales		(2,455,309)	(789,005)	-	-
<b>Gross Profit</b>		<b>2,287,766</b>	<b>1,501,175</b>	<b>-</b>	<b>-</b>
Other income	4(a)	891,257	561,921	40,650	343,359
Marketing expenses		(181,705)	(173,873)	-	-
Research & development expenses		(3,121,821)	(3,307,619)	-	-
Administrative expenses		(3,357,402)	(3,317,196)	(549,916)	(390,720)
Other expenses		(339,503)	(450,347)	-	-
Investing expenses		-	-	(3,427,494)	(5,217,171)
Fair value change in derivatives		(2,325)	-	-	-
<b>Loss before income tax</b>		<b>(3,823,733)</b>	<b>(5,185,939)</b>	<b>(3,936,760)</b>	<b>(5,264,532)</b>
Income tax expense	5	(113,027)	(78,593)	-	-
<b>Loss attributable to members of the parent</b>		<b>(3,936,760)</b>	<b>(5,264,532)</b>	<b>(3,936,760)</b>	<b>(5,264,532)</b>
Loss per share (cents per share)	6				
- basic loss per share for the year attributable to ordinary equity holders of the parent		(3.9)	(6.1)		
- diluted loss per share for the year attributable to ordinary equity holders of the parent		(3.9)	(6.1)		

**Balance Sheet**  
**AS AT 30 JUNE 2006**

	Note	CONSOLIDATED		PARENT	
		2006	2005	2006	2005
		\$	\$	\$	\$
<b>ASSETS</b>					
<b>Current Assets</b>					
Cash and cash equivalents	7	6,651,382	11,716,819	314,947	745,620
Trade and other receivables	8	1,336,705	227,579	3,391,149	6,702,969
Inventories	9	1,540,691	671,625	-	-
Prepayments		32,443	42,325	-	-
<b>Total Current Assets</b>		<b>9,561,221</b>	<b>12,658,348</b>	<b>3,706,096</b>	<b>7,448,589</b>
<b>Non-current Assets</b>					
Other financial assets	10	-	-	6,607,398	6,607,398
Plant and equipment	11	395,546	428,638	-	-
Intangible assets - Software	12	39,588	25,222	-	-
Goodwill	13	1,981,467	1,981,467	-	-
<b>Total Non-current Assets</b>		<b>2,416,601</b>	<b>2,435,327</b>	<b>6,607,398</b>	<b>6,607,398</b>
<b>TOTAL ASSETS</b>		<b>11,977,822</b>	<b>15,093,675</b>	<b>10,313,494</b>	<b>14,055,987</b>
<b>LIABILITIES</b>					
<b>Current Liabilities</b>					
Trade and other payables	16	970,537	622,501	-	-
Provisions	18	371,305	235,716	-	-
Derivatives	21	2,325	-	-	-
Unearned income		9,549	-	-	-
<b>Total Current Liabilities</b>		<b>1,353,716</b>	<b>858,217</b>	<b>-</b>	<b>-</b>
<b>Non-current Liabilities</b>					
Provisions	18	310,612	179,471	-	-
<b>Total Non-current Liabilities</b>		<b>310,612</b>	<b>179,471</b>	<b>-</b>	<b>-</b>
<b>TOTAL LIABILITIES</b>		<b>1,664,328</b>	<b>1,037,688</b>	<b>-</b>	<b>-</b>
<b>NET ASSETS</b>		<b>10,313,494</b>	<b>14,055,987</b>	<b>10,313,494</b>	<b>14,055,987</b>
<b>EQUITY</b>					
<b>Equity attributable to equity holders of the parent</b>					
Contributed equity	19	39,142,650	39,136,800	39,142,650	39,136,800
Retained earnings	19	(29,217,236)	(25,280,476)	(29,217,236)	(25,280,476)
Reserves	19	388,080	199,663	388,080	199,663
<b>TOTAL EQUITY</b>		<b>10,313,494</b>	<b>14,055,987</b>	<b>10,313,494</b>	<b>14,055,987</b>

**Statement of Recognised Income and Expense**  
**FOR THE YEAR ENDED 30 JUNE 2006**

	<i>Note</i>	<i>CONSOLIDATED</i>		<i>PARENT</i>	
		<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
		<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
Loss for the period		(3,936,760)	(5,264,532)	(3,936,760)	(5,264,532)
<b>Total recognized income and expense for the period attributable to equity holders of the parent</b>		<b>(3,936,760)</b>	<b>(5,264,532)</b>	<b>(3,936,760)</b>	<b>(5,264,532)</b>

## Cash Flow Statement

### FOR THE YEAR ENDED 30 JUNE 2006

	<i>Note</i>	<i>CONSOLIDATED</i>		<i>PARENT</i>	
		<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
		<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
<b>Cash flows from (used in) operating activities</b>					
Receipts from customers		2,338,409	982,451	-	-
Payments to suppliers and employees		(9,308,700)	(6,898,751)	(353,737)	(293,033)
Royalties received		1,308,662	1,436,310		
Interest received		491,482	521,949	42,704	372,962
Income tax paid		(113,027)	(78,593)	-	-
Receipt of government grants		472,204	35,212	-	-
<b>Net cash flows from (used in ) operating activities</b>	<b>7</b>	<b>(4,810,970)</b>	<b>(4,001,422)</b>	<b>(311,033)</b>	<b>79,929</b>
<b>Cash flows from investing activities</b>					
Proceeds from sale of plant and equipment		315	975	-	-
Purchase of plant and equipment	11	(242,136)	(285,567)	-	-
Purchase of intangible assets - software	12	(32,317)	(28,290)	-	-
Loans to controlled entity	8	-	-	(125,490)	(13,505,072)
<b>Net cash flows used in investing activities</b>		<b>(274,138)</b>	<b>(312,882)</b>	<b>(125,490)</b>	<b>(13,505,072)</b>
<b>Cash flows from financing activities</b>					
Proceeds from issue of shares	19	5,850	6,575,000	5,850	6,575,000
Transaction costs of issue of shares	19	-	(263,159)	-	(263,159)
<b>Net cash flows from (used in) financing activities</b>		<b>5,850</b>	<b>6,311,841</b>	<b>5,850</b>	<b>6,311,841</b>
Net increase (decrease) in cash and cash equivalents		(5,079,258)	1,997,537	(430,673)	(7,113,302)
Net foreign exchange differences		13,821	13,583		
Cash and cash equivalents at beginning of period		11,716,819	9,705,699	745,620	7,858,922
<b>Cash and cash equivalents at end of period</b>	<b>7</b>	<b>6,651,382</b>	<b>11,716,819</b>	<b>314,947</b>	<b>745,620</b>

## Notes to the Financial Statements

### FOR THE YEAR ENDED 30 JUNE 2006

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#### 1 CORPORATE INFORMATION

The financial report of Optiscan Imaging Limited (the Company) for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors on 24 August 2006.

Optiscan Imaging Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian stock exchange.

The nature of the operations and principal activities of the Group are described in note 3.

#### 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### a) Basis of Preparation

The financial report is a general-purpose financial report, which has been prepared in accordance with the requirements of the Corporations Act 2001 and Australian Accounting Standards. The financial report has also been prepared on a historical cost basis, except for derivative financial instruments which have been measured at fair value.

##### b) Statement of compliance

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

This is the first annual financial report prepared based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly except for the adoption of AASB 132 Financial Instruments: Disclosure and Presentation and AASB 139 Financial Instruments: Recognition and Measurement. The Company has adopted the exemption under AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards from having to apply AASB 132 and AASB 139 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report and at transition to AIFRS are detailed in note 26.

Except for the revised AASB 119 *Employee Benefits* (issued in December 2004) and the consequential amendments contained in AASB 2004-3, the adoption of which had no impact on the Group's financial report, Australian Accounting Standards and UIG Interpretations that have recently been amended but are not yet effective have not been adopted by the Group. Those relevant to the Group are outlined in the following table.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### (b) Statement of compliance (continued)

Ref	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
AASB 2005-1	Amendments to Australian Accounting Standard AASB 139	Amendment to allow the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in certain circumstances.	For annual reporting periods beginning on or after 1 January 2006	As the Group does not apply hedge accounting, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006
AASB 2005-4	Amendments to Australian Accounting Standards [AASB 139, AASB 132, AASB 1, AASB 1023 & AASB 1038]	Amendments relate to the restriction on designating financial instruments at fair value through profit and loss.	For annual reporting periods beginning on or after 1 January 2006	As the Group has not elected to designate any financial instruments as at fair value through the profit and loss, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006
AASB 2005-5	Amendments to Australian Accounting Standards [AASB 1 & AASB 139]	Consequential amendments made to AASB 1 due to the issue of UIG Interpretation 4 <i>Determining whether an Arrangement contains a Lease</i> . Consequential amendments made to AASB 139 due to the issue of UIG Interpretation 5 <i>Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds</i> .	For annual reporting periods beginning on or after 1 January 2006	These requirements are consistent with the Group's existing accounting policies or relate to transactions that the Group has not entered into and therefore these amendments are not expected to have any impact on the Group's financial report.	1 July 2006

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Statement of compliance (continued)**

Ref	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
AASB 2005-6	Amendments to Australian Accounting Standards [AASB 3]	The definition of 'contribution by owners' is removed and the AASB 3 scope exclusion for business combinations involving entities or businesses under common control is adopted.	For annual reporting periods beginning on or after 1 January 2006	These requirements are consistent with the Group's existing accounting policies or relate to transactions that the Group has not entered into and therefore these amendments are not expected to have any impact on the Group's financial report.	1 July 2006
AASB 2005-9	Amendments to Australian Accounting Standards [AASB 4, AASB 1023, AASB 139 & AASB 132]	The amendments provide guidance as to which standard applies to financial guarantee contracts under certain circumstances.	For annual reporting periods beginning on or after 1 January 2006	The impacts of these amendments on the Group's financial report have not yet been determined.	1 July 2006
AASB 2005-10	Amendments to Australian Accounting Standards [AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 & AASB 1038]	These amendments arise from the release in August 2005 of <i>AASB 7 Financial Instruments: Disclosures</i>	For annual reporting periods beginning on or after 1 January 2007	AASB 7 is a disclosure standard so will have no direct impact on the amounts included in the Group's financial statements. However, the amendments will result in changes to the disclosures included in the Group's financial report in relation to financial instruments.	1 July 2007

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Statement of compliance (continued)**

Ref	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
AASB 2006-1	Amendments to Australian Accounting Standards [AASB 121]	These amendments clarify the requirements relating to an entity's investment in foreign operations and assist the financial reporting of entities with investments in operations that have a different functional currency.	For annual reporting periods ending on or after 31 December 2006	These requirements are consistent with the Group's existing accounting policies or relate to transactions that the Group has not entered into and therefore these amendments are not expected to have any impact on the Group's financial report.	1 July 2006
UIG 4	Determining whether an Arrangement contains a Lease	This Interpretation specifies criteria for determining whether an arrangement is, or contains, a lease.	For annual reporting periods beginning on or after 1 January 2006	The impacts of these amendments on the Group's financial report have not yet been determined.	1 July 2006
UIG 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	This Interpretation addresses the accounting for rights to interests arising from decommissioning, restoration and rehabilitation funds and for additional contributions to such a fund.	For annual reporting periods beginning on or after 1 January 2006	As the Group has no interests in such funds, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Statement of compliance (continued)**

Ref	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
UIG 7	Applying the Restatement Approach under AASB 129 <i>Financial Reporting in Hyperinflationary Economies</i>	This Interpretation addresses the requirement in AASB 129 for financial statements to be stated in terms of the measuring unit current at the reporting date when they are reported in the currency of a hyperinflationary economy.	For annual reporting periods beginning on or after 1 March 2006	As the Group has no investments in foreign operations operating in hyperinflationary economies, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006
UIG 8	Scope of AASB 2 <i>Share-based Payment</i>	This Interpretation clarifies that the scope of AASB 2 includes transactions in which the entity cannot identify specifically some or all of the goods or services received as consideration for the equity instruments of the entity or other share-based payment.	For annual reporting periods beginning on or after 1 May 2006	Unless the Group enters into share-based payment arrangements unrelated to employee services in future reporting periods, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Statement of compliance (continued)**

Ref	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
UIG 9	Reassessment of Embedded Derivatives	This Interpretation clarifies that an entity reassesses whether an embedded derivative contained in a host contract is required to be separated from the host contract and accounted for as a derivative under AASB 139 only when there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required.	For annual reporting periods beginning on or after 1 June 2006	Unless the Group enters into arrangements containing embedded derivatives in future reporting periods, these amendments are not expected to have any impact on the Group's financial report.	1 July 2006

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

**c) Basis of consolidation**

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

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

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

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

**d) Significant accounting estimates and assumptions**

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

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash generating units to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill are discussed in note 14.

##### Share-based payment transactions

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using a Black Scholes valuation model, using the assumptions detailed in note 15.

#### e) Revenue recognition

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

##### *(i) Sale of goods*

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Risks and rewards of ownership are considered passed to the buyer at the time of delivery of the goods to the customer.

##### *(ii) Rendering of services*

Revenue from service and product support activities is recognised by reference to the stage of completion of a contract. Stage of completion is measured by reference to labour hours incurred to date as a percentage of total estimated labour hours for each contract. When the contract outcome cannot be estimated reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable.

##### *(iii) Royalty income*

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

##### *(iii) Interest income*

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

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

Revenue is recognised as interest accrues using the effective interest method.

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

Revenue is recognised when the Group controls a right relating to the consideration payable for the investment of its assets.

#### f) Government grants

Government grants are recognised when there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

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

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### g) Leases

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

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

##### h) Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less. Cash and short term deposits are stated at nominal values.

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

##### i) Trade and other receivables

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

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

Trade receivables, which generally have 30-45 day terms, are non interest bearing and are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

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

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

Trade receivables were recognised and carried at original invoice amount less a provision for any uncollectible debts. An estimate for doubtful debts will be made when collection of a receivable is no longer probable.

##### j) Inventories

Inventories are valued at the lower of cost and net realisable value.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

Raw materials – purchase cost on a first-in, first-out basis; and  
Finished goods and work-in-progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity.

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

##### k) Derivative financial instruments and hedging

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

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

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

The Group uses derivative financial instruments in the form of forward currency contracts to economically hedge its risks associated with foreign currency fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured to fair value. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

As the Group economically hedges but does not meet the strict criteria for hedge accounting under AASB 139, any gains or losses arising from changes in the fair value of derivatives are taken directly to net profit or loss for the year. For information on the Group's financial risk management objectives and policies with respect to its economic hedging program, refer to Note 20.

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

The Group did not enter into hedge arrangements or derivative transactions prior to the current reporting period and therefore no accounting policies applicable thereto were necessary.

#### **(I) Impairment of financial assets**

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

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

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

##### *(i) Financial assets carried at amortised cost*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (ie the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for a individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### *(ii) Financial assets carried at cost*

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value (because its fair value cannot be reliably measured), or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the current market rate of return for a similar financial asset.

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

Unquoted equity investments, being investment in subsidiaries are carried at the lower of cost or net realisable value.

##### **(m) Foreign currency translation**

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

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

All exchange differences in the consolidated financial report are taken to profit or loss.

On disposal of a foreign entity, the deferred cumulative amount recognised in equity, if any, relating to that particular foreign operation is recognised in profit or loss.

##### **(n) Income tax**

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

Deferred income tax on all temporary differences between the tax bases of assets and liabilities and their carrying amounts at the balance sheet date are identified for financial reporting purposes. These amounts will be recorded in the accounts should they exceed identified deferred tax assets.

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

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

Deferred income tax assets are identified for all deductible temporary differences, carry-forward unused tax assets and unused tax losses, but are not recognised in the accounts unless it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilized. Exceptions to this position arise:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

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

The carrying amount of deferred income tax assets is reviewed at each balance sheet date to determine whether it is probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

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

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

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

If deferred tax assets and deferred tax liabilities are recorded in the accounts, they are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

#### (o) Other taxes

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

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

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

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

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

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### (p) Plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is calculated on a straight-line basis over the estimated useful life of the assets. The depreciation rates applied to the main classes of plant and equipment are:

<u>Class of plant and equipment</u>	<u>Depreciation rate</u>
Office furniture & equipment	20% - 40%
Production equipment	20%
R&D equipment	30% - 40%

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at each financial year end.

##### *(i) Impairment*

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

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

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

An impairment exists when the carrying value of an asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount, with the impairment loss being recognised in the income statement.

##### *(iii) Derecognition and disposal*

An item of plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the year the asset is derecognised.

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

Other financial assets consist of investments in controlled entities, which are carried at cost less any impairment in the parent company's financial statements.

The carrying values of investments in controlled entities are reviewed for impairment at each reporting date. The recoverable amount of investments in controlled entities is determined by reference to their estimated fair value less costs to sell.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### (r) Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

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

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

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. When the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. When goodwill forms part of a cash-generating unit (group of cash-generating units) and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the cash generating unit retained.

Impairment losses recognised for goodwill are not subsequently reversed.

##### Transition to AIFRS

The group has elected not to apply AASB 3 Business Combinations retrospectively. As a consequence, prior year amortisation of goodwill will not be written back. The group has carried forward the amortised balance of goodwill at the date of transition to AIFRS.

##### (s) Intangible assets

The only intangible assets other than goodwill recognised by the group are software assets, formerly disclosed under "Plant, Equipment and Software". Under AASB 138, Intangible Assets, software is now required to be disclosed as an intangible asset. Notwithstanding this disclosure change, there has been no change in policy in relation to software. The amounts capitalised (refer note 12) represent the acquisition cost of software packages used in the design, development and administrative activities of the group. These amounts are amortised over a period of no more than three years.

##### *Research and development costs*

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, the cost model will be applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is to be

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

amortised over the period of expected benefits from the related project. No such expenditure has yet been capitalised by the Group.

##### (t) Trade and other payables

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

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

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

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

Trade payables and other payables are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity.

##### (u) Provisions

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

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

If the effect of the time value of money is material, provisions are discounted using a current pretax rate that reflects the risks specific to the liability.

##### (v) Employee leave benefits

###### *(i) Wages, salaries, superannuation, and annual leave*

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

###### *(ii) Long service leave*

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

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

##### (w) Share-based payment transactions

###### (i) Equity settled transactions:

The Group provides benefits to employees (including senior executives) of the Group in the form of share-based payments, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

There is an Employee Share Option Plan (ESOP) in place, which provides benefits to employees. The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined using a Black Scholes valuation model, further details of which are given in note 15.

In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Optiscan Imaging Limited (market conditions) if applicable.

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

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

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

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

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

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share (see note 6).

##### (x) Contributed equity

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

##### (y) Earnings (Loss) per share

Basic earnings (loss) per share is calculated as net profit (loss) attributable to members of the parent, adjusted to exclude any costs of servicing equity (other than dividends) divided by the weighted average number of ordinary shares.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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

Diluted earnings (loss) per share is calculated as net profit (loss) attributable to members of the parent, adjusted for:

costs of servicing equity (other than dividends) and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and  
other non-discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares; divided by the weighted average number of ordinary shares and dilutive potential ordinary shares, adjusted for any bonus element.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

### 3 SEGMENT INFORMATION

The Group operates predominantly in one industry and geographical segment, those being medical device technology and Australia respectively.

### 4 REVENUES AND EXPENSES

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
<b>Revenue and Expenses</b>				
<b>(a) Other income</b>				
Finance income – bank interest received	471,214	523,375	40,650	343,359
Government grants	419,728	35,212	-	-
Net gains on disposal of plant and equipment	315	975	-	-
Sundry income	-	2,359	-	-
	<u>891,257</u>	<u>561,921</u>	<u>40,650</u>	<u>343,359</u>
<b>(b) Depreciation and amortisation</b>				
- Depreciation included in Cost of sales	52,480	44,940	-	-
- Depreciation included in Marketing expenses	9,434	11,164	-	-
- Depreciation included in R&D expenses	147,932	184,044	-	-
- Depreciation included in Administration expenses	65,383	84,871	-	-
	<u>275,229</u>	<u>325,019</u>	-	-
- Amortisation of software included in Administration expenses	17,951	29,809	-	-
	<u>293,179</u>	<u>354,828</u>	-	-
<b>(c) Employee benefits expense</b>				
Wages and salaries	3,520,740	3,189,349	220,000	160,000
Workers' compensation costs	71,431	52,528	-	-
Defined contribution plan expense	367,847	317,653	-	-
Annual leave provision	44,408	4,106	-	-
Long service leave provision	131,140	(5,991)	-	-
Termination benefits	-	104,562	-	-
Share-based payments expense	188,417	108,762	188,417	108,762
	<u>4,323,983</u>	<u>3,770,969</u>	<u>408,417</u>	<u>268,762</u>

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
<b>4 REVENUES AND EXPENSES (continued)</b>				
<b>(d) Cost of inventories recognised as an expense</b>				
Consumed in R&D	186,487	153,600	-	-
Provision for obsolescence	123,597	151,677	-	-
	<u>310,084</u>	<u>305,277</u>	-	-
<b>(e) Other expenses included in income statement</b>				
Minimum lease payments – operating lease	282,762	266,265	-	-
Warranty provision (note 18)	91,182	-	-	-
<b>(f) Impairment losses</b>				
Impairment loss in respect of investment in subsidiaries (Refer note 2(q))	-	-	3,427,434	5,217,171

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**5 INCOME TAX**

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
The components of income tax expense are:				
<b>Income Statement</b>				
<i>Current income tax</i>				
Current income tax charge	-	-	-	-
Adjustments in respect of current income tax of previous year	-	-	-	-
Withholding tax deducted from royalty revenue	(113,027)	(78,593)	-	-
<i>Deferred income tax</i>				
Relating to origination and reversal of temporary differences	-	-	-	-
Income tax expense reported in the income statement	<u>(113,027)</u>	<u>(78,593)</u>	-	-
<b>Statement of Income and expense</b>				
<i>Deferred income tax related to items charged or credited directly to equity</i>				
	-	-	-	-
Income tax expense reported in equity	<u>(113,027)</u>	<u>(78,593)</u>	-	-

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
<b>5 INCOME TAX (continued)</b>				
A reconciliation between tax expense and the product of accounting loss before income tax multiplied by the Group's applicable income tax rate is as follows:				
Accounting loss before income tax	(3,823,733)	(5,185,939)	(3,936,760)	(5,264,532)
At the Group's statutory income tax rate of 30% (2005: 30%)	(1,147,120)	(1,555,782)	(1,181,028)	(1,579,360)
Adjustments in respect of current income tax of previous years	-	-	-	-
Deferred tax assets not recognised	1,290,171	2,186,298	96,255	-
Tax losses utilised	-	(18,420)	-	(18,420)
Share based payments not deductible	56,525	32,629	56,525	32,629
R&D Tax Concession allowance	(209,451)	(648,184)	-	-
Expenditure not allowable for income tax purposes	9,875	3,459	1,028,248	1,565,151
Foreign withholding tax deductions from royalties	113,027	78,593	-	-
Income tax expense reported in the consolidated income statement	113,027	78,593	-	-
	<i>Balance sheet</i>		<i>Income Statement</i>	
	2006 \$	2005 \$	2006 \$	2005 \$
<b>Deferred income tax - not brought to account</b>				
Deferred income tax at 30 June relates to the following items and has not been brought to account (Refer note 2(n)):				
<i>CONSOLIDATED</i>				
<i>Deferred tax assets</i>				
Undeducted patent costs	108,004	87,065	20,939	19,186
Employee benefit & warranty provisions	204,575	124,556	80,019	(6,782)
Expenses not yet deductible	68,537	45,541	22,996	30,541
Inventory impairment provision	180,960	206,625	(25,665)	13,156
Deferred deductible equity issue costs	64,095	80,119	(16,024)	80,119
Tax Losses and foreign tax credits available for offset against future taxable income	9,937,632	8,929,925	1,007,707	1,927,036
Gross deferred income tax assets	10,563,803	9,473,831		
Less amounts not recognised in accounts	(10,563,803)	(9,473,831)		
Gross deferred income tax assets	-	-		
Deferred tax income/ (expense) incurred			1,089,972	2,063,256
Less deferred income tax not recognised in accounts			(1,089,972)	(2,063,256)
Deferred tax income/ (expense)			-	-

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**5 INCOME TAX (continued)**

	<i>Balance Sheet</i>		<i>Income Statement</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	\$	\$	\$	\$
<i>PARENT</i>				
<i>Deferred tax liabilities</i>				
Deferred assessment of receivables	-	616	(616)	616
	-	-		
	-	616		
<i>Deferred tax assets</i>				
Deferred deductible equity issue costs	47,368	63,158	(15,790)	63,158
<i>Deferred tax assets not brought to account</i>	<u>47,368</u>	<u>62,542</u>		
Increase (Decrease) in Deferred tax asset not recognised in accounts			<u>(15,174)</u>	<u>62,542</u>

**Tax Losses**

The Group has unconfirmed, unrecouped tax losses in Australia of \$28,227,053 (2005: \$25,168,637) that are available indefinitely for offset against future taxable profits of the companies in which the losses arose. These amounts have not been brought to account as it is not yet probable, the context of AASB112 Income Taxes, that the losses will be utilized.

**Withholding tax**

A total of \$1,469,516 has been deducted from remittances of royalties to the group in accordance with the withholding tax obligations of the payers. These deductions represent foreign tax credits which may be available to reduce Australian income tax payable in future years. These amounts have not been brought to account as it is not yet probable, the context of AASB112 Income Taxes, that the tax credits will be utilized.

**Tax Consolidation**

Optiscan Imaging Limited and its 100% owned Australian resident subsidiary have elected not to form a tax consolidated group.

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

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**6 EARNINGS PER SHARE**

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

	<i>CONSOLIDATED</i>	
	<i>2006</i>	<i>2005</i>
	<u>\$</u>	<u>\$</u>
Net loss attributable to ordinary equity holders of the parent from continuing operations	<u>(3,936,760)</u>	<u>(5,264,532)</u>
Net loss attributable to ordinary equity holders of the parent	<u>(3,936,760)</u>	<u>(5,264,532)</u>
	<u>2006</u>	<u>2005</u>
	<u>Number</u>	<u>Number</u>
Weighted average number of ordinary shares for basic earnings per share	100,144,765	86,017,554
Effects of dilution:		
Share options	-	-
Weighted average number of ordinary shares adjusted for the effect of dilution	<u>100,144,765</u>	<u>86,017,554</u>
Weighted average number of converted, lapsed or cancelled potential ordinary shares included in diluted earnings per share	-	-

Options on issue have been determined to be not dilutive, as a loss was incurred during the year.

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements, other than the issue of 10,000 ordinary shares pursuant to the exercise of 10,000 employee options at an exercise price of \$0.39 per option.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 7 CASH AND CASH EQUIVALENTS

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. At balance date the weighted average interest rate is 5.88% (2005, 5.36%), and the weighted average term to maturity is 27 days (2005, 10 days).

#### Reconciliation to Cash Flow Statement

For the purposes of the Cash Flow Statement, cash and cash equivalents comprise the following at 30 June:

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Cash at bank and in hand	2,933,567	595,139	314,947	745,620
Short-term deposits	3,728,365	11,126,055	-	-
Amounts owing on credit card facilities	(10,550)	(4,375)	-	-
	<u>6,651,382</u>	<u>11,716,819</u>	<u>314,947</u>	<u>745,620</u>

#### Reconciliation of net loss after tax to net cash flows from operations

Net loss	(3,936,760)	(5,264,532)	(3,936,760)	5,264,532)
<i>Adjustments for:</i>				
Depreciation	293,179	354,828	-	-
Net (profit) on disposal of plant and equipment	(315)	(975)	-	-
Net fair value change on derivatives	2,325	-	-	-
Impairment of non current assets	-	-	3,427,494	-
Net exchange differences	(13,821)	(13,583)	-	-
Share options expensed	188,417	108,762	188,417	108,762
<i>Changes in assets and liabilities</i>				
(Increase)/decrease in trade and other receivables	(1,109,126)	187,430	9,816	18,528
(Increase)/decrease in inventories	(869,066)	131,701	-	-
(Increase)/decrease in prepayments	9,882	272,804	-	-
(Increase)/decrease in derivatives	-	-	-	-
(Decrease)/increase in trade and other payables	348,036	244,749	-	-
(Decrease)/increase in unearned income	9,549	-	-	-
(Decrease)/increase in provisions	266,730	(22,606)	-	-
(Decrease)/increase in government grants	-	-	-	-
Net cash from operating activities	<u>(4,810,970)</u>	<u>(4,001,422)</u>	<u>(311,033)</u>	<u>79,929</u>

Disclosure of financing facilities - Refer to note 17.

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**8 TRADE AND OTHER RECEIVABLES (CURRENT)**

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
Trade receivables	992,731	90,996	-	-
Royalty receivables	202,398	-	-	-
GST refund receivable	110,826	78,234		11,075
Other receivables	30,750	58,349	3,321	2,062
	<u>1,336,705</u>	<u>227,579</u>	<u>3,321</u>	<u>13,137</u>
Related party receivables – wholly owned group				
Amounts receivable from controlled entities (note 23)	-	-	32,173,957	32,048,467
Accumulated impairment	-	-	(28,786,129)	(25,358,635)
	-	-	<u>3,387,828</u>	<u>6,689,832</u>
Total Receivables	<u>1,336,705</u>	<u>227,579</u>	<u>3,391,149</u>	<u>6,702,969</u>

(i) Trade receivables are non-interest bearing and are generally on 30-60 day terms. An allowance for doubtful debts will be made if there is objective evidence that a trade receivable is impaired. No such allowance has yet been made. Receivables other than trade receivables are also non interest bearing.

(ii) Royalties are payable within 60 days of the half years ended in March and September. Royalty receivables are an accrual of the quarter that has not been reported by licensees.

(iii) For terms and conditions relating to related party receivables refer to note 23.

(iv) Details regarding credit risk of current receivables are disclosed in note 20.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 9 INVENTORIES

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Raw materials (at net realisable value)	1,139,174	540,090	-	-
Work in progress (at cost)	394,768	68,379	-	-
Finished goods (at cost)	6,749	63,156	-	-
Total inventories at the lower of cost and net realisable value	1,540,691	671,625	-	-

Inventory write-downs of potentially obsolete raw materials are recognised as an expense totalled \$123,597 (2005: \$151,677). See note 4(d).

#### 10 OTHER FINANCIAL ASSETS (NON-CURRENT)

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Investments in controlled entities at cost (Note 23)	-	-	6,607,398	6,607,398

#### 11 PLANT AND EQUIPMENT

##### CONSOLIDATED \*

	Office Furniture & Equipment 2006 \$	Production Equipment 2006 \$	R&D Equipment 2006 \$	Total Plant & Equipment 2006 \$
<b>Year ended 30 June 2006</b>				
Opening balance, net of accumulated depreciation and impairment	94,828	142,036	191,774	428,638
Additions	91,337	80,043	70,756	242,136
Disposals	-	-	-	-
Impairment	-	-	-	-
Depreciation charge for the year	(73,384)	(54,812)	(147,032)	(275,228)
At 30 June 2006, net of accumulated depreciation and impairment	112,781	167,267	115,498	395,546
<b>At 1 July 2005</b>				
Cost	226,342	236,868	543,684	1,006,894
Accumulated depreciation and impairment	(131,514)	(94,832)	(351,910)	(578,256)
Net carrying amount	94,828	142,036	191,774	428,638
<b>At 30 June 2006</b>				
Cost	223,400	253,251	210,860	687,511
Accumulated depreciation and impairment	(110,620)	(85,983)	(95,362)	(291,965)
Net carrying amount	112,780	167,268	115,498	395,546

\* Consolidated totals only. The parent entity has no plant and equipment.

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**
**11 PLANT AND EQUIPMENT (continued)**

<b>CONSOLIDATED *</b>	<i>Office Furniture &amp; Equipment</i>	<i>Production Equipment</i>	<i>R&amp;D Equipment</i>	<i>Total Plant &amp; Equipment</i>
	<i>2005</i>	<i>2005</i>	<i>2005</i>	<i>2005</i>
<b>Year ended 30 June 2005</b>	\$	\$	\$	\$
Opening balance, net of accumulated depreciation and impairment	105,578	99,396	263,119	468,093
Additions	85,316	87,666	112,582	285,564
Disposals	-	-	-	-
Impairment	-	-	-	-
Depreciation charge for the year	(96,066)	(45,026)	(183,927)	(325,019)
At 30 June 2005, net of accumulated depreciation and impairment	<u>94,828</u>	<u>142,036</u>	<u>191,774</u>	<u>428,638</u>
<b>At 1 July 2004</b>				
Cost	341,579	170,936	518,037	1,030,552
Accumulated depreciation and impairment	(236,001)	(71,540)	(254,918)	(562,459)
Net carrying amount	<u>105,578</u>	<u>99,396</u>	<u>263,119</u>	<u>468,093</u>
<b>At 30 June 2005</b>				
Cost	226,342	236,868	543,684	1,006,894
Accumulated depreciation and impairment	(131,514)	(94,832)	(351,910)	(578,256)
Net carrying amount	<u>94,828</u>	<u>142,036</u>	<u>191,774</u>	<u>428,638</u>

The useful life of the assets for both for 2005 and 2006 is estimated to be between 2 and 5 years.

\* Consolidated totals only. The parent entity has no plant and equipment.

**12 INTANGIBLE ASSETS – SOFTWARE**

	<b>CONSOLIDATED</b>		<b>PARENT</b>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	\$	\$	\$	\$
Opening balance	25,222	26,741	-	-
Additions during year	32,317	28,290	-	-
Amortisation	(17,951)	(29,809)	-	-
Net carrying amount	<u>39,588</u>	<u>25,222</u>	<u>-</u>	<u>-</u>
At cost	62,002	43,022	-	-
Accumulated depreciation	(22,414)	(17,800)	-	-
Net carrying amount	<u>39,588</u>	<u>25,222</u>	<u>-</u>	<u>-</u>

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**13 GOODWILL**

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	\$	\$	\$	\$
Cost (gross carrying amount)	6,746,613	6,746,613	-	-
Accumulated amortisation and impairment	(4,765,146)	(4,765,146)	-	-
Net carrying amount	1,981,467	1,981,467	-	-

Goodwill was purchased as part of a business combination in 1997. As from 1 July 2005, goodwill is no longer amortised but is now subject to annual impairment testing (see note 14). No impairment loss was recognised in the 2006 financial year.

**14 IMPAIRMENT TESTING OF GOODWILL**

The segment information in Note 3 describes the operations of the business as consisting of only one segment, that of medical device technology. Cash flows within that business have historically related to royalty income from licensing of intellectual property developed for the medical device technology. More recently, in the latter part of the reporting period, the business commenced the sale of OEM product destined for ultimate sale to end users of medical devices.

For the purposes of impairment testing of goodwill at balance date, value in use has been assessed by reference to cash flows from licensing of intellectual property to the research confocal market. These are established cash flows that can be meaningfully extrapolated and estimated. The cash flows to be derived from the sale of OEM product are considered to be too immature to enable reliable measurement at balance date.

The pre tax discount rate applied to the cash flow projections is 10%, (2005, 10%) and the growth rate used to extrapolate the cash flows is zero. Management considers the market for benchtop research confocal devices in which licensees operate to be mature, and unlikely to be characterised by significant growth in the near term.

**Key assumptions used in value in use calculations for 30 June 2006 and 30 June 2005**

The following describes the key assumptions on which management has based its cash flow projections when determining the value in use of the licensing revenue streams.

- There will be no significant decline in unit sales of research confocal microscopes by licensees that are the subject of the intellectual property.
- Foreign exchange rates will remain stable at the current level over the forecast period.
- Infringement actions will realise budgeted outcomes

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 15 SHARE-BASED PAYMENT PLANS

##### Employee Share Option Plan

Share options are granted to all employees including senior executives with more than 12 months service. The exercise price of the options is calculated as the weighted average market price of the shares in the two weeks prior to the date of grant, increased by a minimum of 10%. Options vest in gradual amounts over two to four years and no options can be exercised within one year of the date of grant. The contractual life of each option granted is five years. There are no cash settlement alternatives.

The expense recognised in the income statement in relation to share-based payments is disclosed in note 4(c).

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

	No Options 2006	WAEP 2006	No Options 2005	WAEP 2005
Outstanding at the beginning of the year	4,554,780 <sup>1</sup>	0.67	4,467,170	0.79
Granted during the year	2,340,750	0.33	750,000	0.40
Forfeited during the year	(1,018,250)	0.69	(512,390)	0.90
Exercised during the year	(15,000) <sup>2</sup>	0.39	-	-
Expired during the year	(291,380)	1.92	(150,000)	1.99
Outstanding at the end of the year	<u>5,570,900<sup>1</sup></u>	<u>0.46</u>	<u>4,554,780<sup>1</sup></u>	<u>0.67</u>
Exercisable at the end of the year	1,230,048	0.47	1,688,964	0.90

<sup>1</sup> Included within this balance are options over 529,000 shares (2005: 954,380 shares) that have not been recognised in accordance with AASB 2 as the options were granted on or before 7 November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with AASB 2.

<sup>2</sup> The weighted average share price at the date of exercise is \$0.52.

The outstanding balance as at 30 June 2006 is represented by:

Options expiring in the year ended :	No Options	WAEP \$
- 2006/2007	340,000	1.08
- 2007/2008	1,627,750	0.56
- 2008/2009	589,650	0.45
- 2009/2010	729,000	0.40
- 2010/2011	2,284,500	0.33
	<u>5,570,900</u>	<u>0.46</u>

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 15 SHARE BASED PAYMENT PLANS (continued)

The weighted average remaining contractual life for the share options outstanding as at 30 June 2006 is 3 years, 2 months (38 months).

The range of exercise prices for options outstanding at the end of the year was \$0.32-\$1.33 (2005: \$0.39 - \$2.10).

The weighted average fair value of options granted during the year was \$0.09 (2005: \$0.12).

The fair value of the equity-settled share options granted under the option plan is estimated as at the date of grant using a Black Scholes valuation model taking into account the terms and conditions upon which the options were granted.

The following tables list the inputs to the model used for the years ended 30 June 2006 and 30 June 2005:

<b>Issue to Staff 12 September 2005</b>	<u>2006</u>	<u>2005</u>
Number of options	120,000	-
Dividend yield (%)	-	-
Expected volatility (%)	40.0	-
Risk-free interest rate (%)	5.11	-
Expected life of option (years)	4.5	-
Option exercise price (\$)	0.36	-
Share price at grant date (\$)	0.325	-

<b>Issue to Staff 18 October 2005</b>	<u>2006</u>	<u>2005</u>
Number of options	1,770,750	750,000
Dividend yield (%)	-	-
Expected volatility (%)	40.0	45.0
Risk-free interest rate (%)	5.22	5.18
Expected life of option (years)	4.5	4.5
Option exercise price (\$)	0.32	0.40
Share price at grant date (\$)	0.295	0.36

<b>AGM Approved issue to executive director</b>	<u>2006</u>	<u>2005</u>
Number of options	450,000	-
Dividend yield (%)	-	-
Expected volatility (%)	40.0	-
Risk-free interest rate (%)	5.42	-
Expected life of option (years)	4.5	-
Option exercise price (\$)	0.33, 0.34, 0.41	-
Share price at grant date (\$)	0.30	-

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. No other features of options granted were incorporated into the measurement of fair value.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 16 TRADE AND OTHER PAYABLES (CURRENT)

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Trade payables (i)	531,394	156,718	-	-
Accrued expenses	439,143	465,783	-	-
	<u>970,537</u>	<u>622,501</u>	-	-

(i) Trade payables are non-interest bearing and are normally settled on 30-day terms.

#### 17 BANK FACILITIES AND BORROWINGS

The Group does not have any interest bearing loans or borrowings, with the exception of amounts that may be outstanding from time to time under commercial credit card facilities provided by the bank. The group has a number of non-borrowing bank facilities required for a range of commercial transactions. These are disclosed in the following table.

##### *Financing facilities available*

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

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Total facilities provided by the group's bankers:				
- foreign currency hedging	400,000	400,000	-	-
- credit cards	120,000	70,000	-	-
- bank guarantees and indemnities	110,000	110,000	-	-
- electronic transaction facility	50,000	50,000	-	-
	<u>680,000</u>	<u>630,000</u>	-	-
Facilities used at reporting date:				
- foreign currency hedging	48,000	-	-	-
- credit cards	10,550	4,375	-	-
- bank guarantees and indemnities	90,500	45,500	-	-
- electronic transaction facility	-	-	-	-
	<u>149,050</u>	<u>49,875</u>	-	-
Facilities unused at reporting date:				
- foreign currency hedging	352,000	400,000	-	-
- credit cards	109,450	65,625	-	-
- bank guarantees and indemnities	19,500	64,500	-	-
- electronic transaction facility	50,000	50,000	-	-
	<u>530,950</u>	<u>580,125</u>	-	-
Total facilities	680,000	630,000	-	-
Facilities used at reporting date	149,050	49,875	-	-
Facilities unused at reporting date	<u>491,950</u>	<u>580,125</u>	-	-

##### *Assets pledged as security*

The bank facilities are secured by charges over specific term deposits amounting to \$800,000.

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**18 PROVISIONS**

	<i>Annual Leave</i> \$	<i>Long Service Leave</i> \$	<i>Warranty</i> \$	<i>Total</i> \$
<i>CONSOLIDATED *</i>				
At 1 July 2005	235,716	179,471	-	415,187
Arising during the year	44,407	131,141	91,182	266,730
Utilised	-	-	-	-
Unused amounts reversed	-	-	-	-
Discount rate adjustment	-	-	-	-
At 30 June 2006	<u>280,123</u>	<u>310,612</u>	<u>91,182</u>	<u>681,917</u>
Current 2006	280,123	-	91,182	371,305
Non-current 2006	-	310,612	-	310,612
	<u>280,123</u>	<u>310,612</u>	<u>91,182</u>	<u>681,917</u>
Current 2005	235,716	-	-	235,716
Non-current 2005	-	179,471	-	179,471
	<u>235,716</u>	<u>179,471</u>	<u>-</u>	<u>415,187</u>

\* There are no provisions in the parent entity

*Annual Leave Provision*

The annual leave provision is for the unused entitlements to annual leave for employees. Staff are encouraged to take leave when due or entitled, but workflow considerations sometimes prevent all entitlements being utilised.

*Long Service Leave*

Long service leave provision provides for the future entitlements of employees to long service leave or, where sanctioned by legislation, entitlement to pro rata payment upon termination. No employees have yet reached entitlement to long service leave.

*Warranty*

A provision for warranty at the rate of 3% of sales has been provided since commencement of product sales in the latter part of the year. There is insufficient transaction history at balance date to determine the amount or timing of potential future warranty cash flows.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 19 CONTRIBUTED EQUITY AND RESERVES

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
Ordinary shares - Issued and fully paid	39,142,650	39,136,800	39,142,650	39,136,800
<p>Effective 1 July 1998, the Corporations legislation abolished the concepts of authorised capital and par value shares. Accordingly, the Parent does not have authorised capital nor par value in respect of its issued shares.</p> <p>Fully paid ordinary shares carry one vote per share and carry the right to dividends.</p>				
	<i>No of Shares</i>	<i>\$</i>	<i>No of Shares</i>	<i>\$</i>
<i>Movement in ordinary shares on issue</i>				
At 1 July 2004	80,220,723	32,824,959	80,220,723	32,824,959
Issued on 23 December 2004 for cash pursuant to institutional placement	11,800,000	3,894,000	11,800,000	3,894,000
Issued on 22 February 2005 for cash pursuant to share purchase plan	8,123,850	2,681,000	8,123,850	2,681,000
Transaction costs on share issue	-	(263,159)	-	(263,159)
At 1 July 2005	100,144,573	39,136,800	100,144,573	39,136,800
Issued on 28 April 2006 upon exercise of employee options	15,000	5,850	15,000	5,850
At 30 June 2006	100,159,573	39,142,650	100,159,573	39,142,650

#### *Share options*

The company has a share based payment option plan under which options to subscribe for the company's shares have been granted to employees (refer note 15).

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

**19 CONTRIBUTED EQUITY AND RESERVES (continued)**

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	\$	\$	\$	\$
<i>Retained earnings</i>				
Movements in retained earnings were as follows:				
Balance 1 July	(25,280,476)	(20,015,944)	(25,280,476)	(20,015,944)
Application of AASB 132 and AASB 139	-	-	-	-
Net loss for the year	(3,936,760)	(5,264,532)	(3,936,760)	(5,264,532)
Balance 30 June	<u>(29,217,236)</u>	<u>(25,280,476)</u>	<u>(29,217,236)</u>	<u>(25,280,476)</u>
<i>Reserves</i>				
Movements in reserves were as follows:				
Employee Equity Benefits Reserve				
Balance 1 July	199,663	90,901	199,663	90,901
Share based payments	188,417	108,762	188,417	108,762
Balance 30 June	<u>388,080</u>	<u>199,663</u>	<u>388,080</u>	<u>199,663</u>

**Nature and purpose of reserves**

*Employee equity benefits reserve*

This reserve is used to record the value of equity benefits provided to employees as part of their remuneration. Refer to note 15 for further details of the option plan.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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## 20 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, are cash and short-term deposits.

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

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

#### *Foreign currency risk*

The Group has transactional currency exposures arising from sales and purchases in US\$, a currency different to the functional currency, AUD\$. All of the Group's sales, other than some minor service revenue, are denominated in US\$.

Group policy is to hedge a minimum of 50% of sales, by use of forward exchange contracts or currency option contracts. These contracts usually have a term that reflects the underlying receivable terms of 45 day payment.

It is the Group's policy not to enter into forward contracts until a firm commitment is in place.

At 30 June 2006, the Group had economic hedges of US\$480,000 in respect of gross US\$ receivables amounting to US\$696,000, representing of 69% of the foreign currency exposure. The contracts expire during July and August 2006, reflecting the underlying payment terms.

#### *Credit risk*

The Group trades only with recognised, creditworthy third parties.

It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

There is a significant concentration of credit risk in relation to the exclusive licensing agreement with Pentax. All sales of the ISC-1000 are made to Pentax.

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, the Group's exposure to credit risk arises from the possibility of default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. This is considered unlikely as the Group places cash and cash equivalents only with recognised Australian trading banks.

Since the Group trades only with recognised third parties, there is no requirement for collateral.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

## 21 FINANCIAL INSTRUMENTS

### Economic hedging activities

#### Cash flow hedges

At 30 June 2006, the Group held two currency option contracts and three forward exchange contracts designated as economic hedges of contracted sales to customers in United States dollars.

The terms of the forward contracts were as follows:

	<i>Maturity</i>	<i>Exchange rate</i>
Forward contracts to hedge US\$ sales		
<i>Sell</i>		
US\$100,000	7 July 2006	A\$/US\$0.7466
US\$50,000	14 July 2006	A\$/US\$0.7480
US\$50,000 *	14 July 2006	A\$/US\$0.7480
US\$140,000	15 August 2006	A\$/US\$0.7505
US\$140,000 *	15 August 2006	A\$/US\$0.7505

\* Option contract

The terms of the forward contracts have been negotiated to match the terms of the expected receipts.

The forward exchange contracts, where the Group is obliged to settle, were marked to fair value at balance date, with a loss of \$2,325 (refer Note 2).

At 30 June 2005, there were no hedge contracts in existence.

### Fair value change in derivatives

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	\$	\$	\$	\$
Non-hedging foreign currency payable	2,325	-	-	-
	2,325	-	-	-

Non-hedging foreign currency payable represents the net payable arising from foreign currency forward contracts.

**Notes to the Financial Statements (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2006**

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**22 COMMITMENTS AND CONTINGENCIES**

***Operating lease commitments – Group as lessee***

The Group has committed to enter into a commercial property lease over the premises it currently occupies. The lease term is expected to expire in September 2007, with a renewal option of a further 3 years from that date.

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

	<i>CONSOLIDATED</i>		<i>PARENT</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>\$</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
Within one year	274,000	274,000	-	-
After one year but not more than five years	45,667	319,667	-	-
	<u>319,667</u>	<u>593,667</u>	<u>-</u>	<u>-</u>

**Capital commitments**

At 30 June 2006 there were no material capital commitments outstanding.

**Contingent Liabilities**

The group has contingent liabilities in relation to bank guarantees on issue at balance date amounting to \$90,500 (2005, \$45,500).

**Contingent Assets**

There is a potential entitlement to additional royalty income following patent office decisions in Japan and Europe during 2004/2005 that upheld the validity of the company's patents. At present it is not possible to assess the likelihood of success in pursuing additional royalties, nor is it possible to reliably estimate the amounts that may be received or the timing of such receipts.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 23 RELATED PARTY DISCLOSURE

The consolidated financial statements include the financial statements of Optiscan Imaging Limited and the subsidiaries listed in the following table:

Name	Country of incorporation	% Equity interest		Investment \$	
		2006	2005	2006	2005
Optiscan Pty Ltd	Australia	100	100	6,605,396	6,605,396
Optiscan Inc	United States	100	100	2,002	2,002
				<u>6,607,398</u>	<u>6,607,398</u>

Optiscan Imaging Limited is the ultimate Australian parent entity.

#### *Transactions with Subsidiaries*

Inter-company transactions between the parent entity, Optiscan Imaging Limited and subsidiary, Optiscan Pty Ltd amounted to \$125,490, (2005, \$13,505,072). Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

The amounts outstanding at year end are set out in Note 8. An impairment assessment is undertaken each financial year by examining the financial position of the subsidiaries to determine whether there is objective evidence that a related party receivable is impaired. When such objective evidence exists, an impairment loss is recognised.

#### 24 EVENTS AFTER THE BALANCE SHEET DATE

The directors are not aware of any events after balance date that would have a material impact on the financial statements at 30 June 2006.

#### 25 AUDITORS' REMUNERATION

The auditor of Optiscan Imaging Limited is Ernst & Young.

	CONSOLIDATED		PARENT	
	2006 \$	2005 \$	2006 \$	2005 \$
<i>Amounts received or due and receivable by Ernst &amp; Young (Australia) for:</i>				
• An audit or review of the financial report of the entity and any other entity in the consolidated group	45,990	39,495	1,970	1,456
• Other services in relation to the entity and any other entity in the consolidated group - tax compliance	36,502	36,561	-	-
	<u>82,492</u>	<u>76,056</u>	<u>1,970</u>	<u>1,456</u>

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

## 26 DIRECTOR AND EXECUTIVE DISCLOSURES

### Details of Key Management Personnel

#### (i) Directors

G. Latta	Chairman (non-executive)
M. Barnett	Chief Executive Officer
P. Delaney	Director of Technology
K. Daniel	Director (non-executive)
A. Rogers	Director (non-executive)

#### (ii) Executives

J. Allen	Licensing & Commercialisation Manager
B. Andrew	Chief Financial Officer & Company Secretary
R. Pattie	Research & Development Manager

There were no changes of the CEO or key management personnel after reporting date and the date the financial report was authorised for issue.

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

### Compensation of Key Management Personnel

Details relating to compensation and option holdings of key management personnel have been audited.

Table 1: Compensation of Key Management Personnel for the year ended 30 June 2006

30 June 2006	Short-Term		Cash Bonus % <sup>1</sup>	Post Employment		Long-Term	Share-based	Total	Total Performance Related
	Salary & Fees	Cash Bonus		Superannuation	Termination	Long Service Leave	Options		
	\$	\$		\$	\$	\$	\$	\$	%
<b>Directors</b>									
G. Latta	100,000	-	-	-	-	-	-	100,000	-
M. Barnett	266,055	22,936	34%	26,009	-	-	10,239	325,239	7.05
P. Delaney	177,000	23,094	62%	18,008	-	5,485	13,831	237,418	15.55
K. Daniel	60,000	-	-	5,400	-	-	-	65,400	-
A. Rogers	60,000	-	-	5,400	-	-	-	65,400	-
<b>Executives</b>									
J. Allen	163,500	23,082	67%	16,792	-	-	11,011	214,385	10.77
B. Andrew	163,500	23,082	67%	16,792	-	-	10,041	213,415	10.82
R. Pattie	145,000	24,640	81%	15,268	-	-	9,735	194,643	12.66
	1,135,055	116,834	-	103,669	-	5,485	54,857	1,415,900	9.23

<sup>1</sup> Bonus % represents the percentage of available bonus that was earned during the year, with the remainder representing the percentage forfeited because performance criteria were not met.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

Table 2: Compensation of Key Management Personnel for the year ended 30 June 2005

30 June 2005	Short-Term		Cash Bonus % <sup>1</sup>	Post Employment		Long-Term	Share-based	Total	Total Performance Related
	Salary & Fees	Cash Bonus		Superannuation	Termination	Long Service Leave	Options		
	\$	\$		\$	\$	\$	\$	\$	%
<b>Directors</b>									
G. Latta	80,000	-	-	-	-	-	1,526	81,526	-
M. Barnett	252,294	36,697	53%	26,009	-	-	32,419	347,419	10.6
P. Delaney	170,150	19,550	55%	17,073	-	3,994	-	210,767	9.3
K. Daniel	40,000	-	-	3,600	-	-	-	43,600	-
A. Rogers	40,000	-	-	3,600	-	-	669	44,269	-
<b>Executives</b>									
J. Allen	145,917	20,000	64%	14,933	-	-	4,735	185,584	10.8
B. Andrew	157,000	19,990	61%	15,929	-	-	3,776	196,695	10.2
R. Pattie	73,922	19,375	74%	8,397	-	-	3,416	105,110	18.4
	1,034,030	125,622	-	96,449	77,847	3,994	46,541	1,384,483	9.1

<sup>1</sup> Bonus % represents the percentage of available bonus that was earned during the year, with the remainder representing the percentage forfeited because performance criteria were not met.

#### Compensation of Key Management Personnel by Category:

	CONSOLIDATED		PARENT	
	2006	2005	2006	2005
	\$	\$	\$	\$
Short term	1,251,889	1,159,652	220,000	160,000
Post Employment	103,670	96,449	10,800	7,200
Other Long-Term	5,485	3,994	-	-
Termination Benefits	-	77,847	-	-
Share-based payment	54,857	46,541	-	2,195
	1,415,900	1,384,483	230,800	169,395

#### Shares issued on exercise of compensation options

No shares have been issued as a result of the exercise of options granted as compensation to key management personnel during the years ended 30 June 2006 and 30 June 2005.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### Option holdings of Key Management Personnel

*Options holdings of Key Management Personnel for the year ended 30 June 2006*

*Vested at 30 June 2006*

<b>30 June 2006</b>	<i>Balance at beginning of period 01-Jul-05</i>	<i>Granted as Remuneration</i>	<i>Options Cancelled</i>	<i>Options Expired</i>	<i>Balance at end of period 30-Jun-06</i>	<i>Total Vested</i>	<i>Exercisable</i>	<i>Not Exercisable</i>
<b>Directors</b>								
G. Latta	500,000	-	(500,000)	-	-	-	-	-
M. Barnett	1,000,000	-	-	-	1,000,000	666,666	666,666	-
P. Delaney	-	450,000	-	-	450,000	-	-	-
K. Daniel	200,000	-	(200,000)	-	-	-	-	-
A. Rogers	200,000	-	(200,000)	-	-	-	-	-
<b>Executives</b>								
J. Allen	260,000	100,000	-	-	360,000	150,000	150,000	-
B. Andrew	225,750	100,000	-	(18,250)	307,500	111,250	111,250	-
R. Pattie	145,000	100,000	-	-	245,000	53,333	53,333	-
<b>Total</b>	<b>2,530,750</b>	<b>750,000</b>	<b>(900,000)</b>	<b>(18,250)</b>	<b>2,362,500</b>	<b>981,249</b>	<b>981,249</b>	<b>-</b>

No options were exercised during the year ended 30 June 2006.

*Options holdings of Key Management Personnel for the year ended 30 June 2005*

*Vested at 30 June 2005*

<b>30 June 2005</b>	<i>Balance at beginning of period 01-Jul-04</i>	<i>Granted as Remuneration</i>	<i>Options Exercised</i>	<i>Options Expired</i>	<i>Balance at end of period 30-Jun-05</i>	<i>Total Vested</i>	<i>Exercisable</i>	<i>Not Exercisable</i>
<b>Directors</b>								
G. Latta	500,000	-	-	-	500,000	333,333	333,333	-
M. Barnett	1,000,000	-	-	-	1,000,000	333,333	333,333	-
P. Delaney	-	-	-	-	-	-	-	-
K. Daniel	200,000	-	-	-	200,000	150,000	150,000	-
A. Rogers	200,000	-	-	-	200,000	133,333	133,333	-
<b>Executives</b>								
J. Allen	205,000	55,000	-	-	260,000	68,333	68,333	-
B. Andrew	178,750	55,000	-	(8,000)	225,750	65,333	65,333	-
R. Pattie	90,000	55,000	-	-	145,000	30,000	30,000	-
<b>Total</b>	<b>2,373,750</b>	<b>165,000</b>	<b>-</b>	<b>(8,000)</b>	<b>2,530,750</b>	<b>1,113,665</b>	<b>1,113,665</b>	<b>-</b>

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### Shareholdings of Key Management Personnel

Shares held in Optiscan Imaging Limited for the year ended 30 June 2006 (number)

30 June 2006	<i>Balance at beginning of period 01-Jul-05</i>	<i>Granted as Remuneration</i>	<i>Options Exercised</i>	<i>Purchased on market</i>	<i>Balance at end of period 30-Jun-06</i>
<b>Directors</b>					
G. Latta	100,000	-	-	30,000	130,000
M. Barnett	50,000	-	-	50,000	100,000
P. Delaney	3,476,349	-	-	-	3,476,349
K. Daniel	10,000	-	-	150,000	160,000
A. Rogers	100,000	-	-	100,000	200,000
<b>Executives</b>					
J. Allen	-	-	-	-	-
B. Andrew	40,000	-	-	-	40,000
R. Pattie	-	-	-	-	-
<b>Total</b>	<b>3,776,349</b>	<b>-</b>	<b>-</b>	<b>330,000</b>	<b>4,106,349</b>

Shares held in Optiscan Imaging Limited for the year ended 30 June 2005 (number)

30 June 2005	<i>Balance at beginning of period 01-Jul-04</i>	<i>Granted as Remuneration</i>	<i>Options Exercised</i>	<i>Purchased on market</i>	<i>Balance at end of period 30-Jun-05</i>
<b>Directors</b>					
G. Latta	-	-	-	100,000	100,000
M. Barnett	50,000	-	-	-	50,000
P. Delaney	3,459,259	-	-	17,090	3,476,349
K. Daniel	10,000	-	-	-	10,000
A. Rogers	-	-	-	100,000	100,000
<b>Executives</b>					
J. Allen	-	-	-	-	-
B. Andrew	40,000	-	-	-	40,000
R. Pattie	-	-	-	-	-
<b>Total</b>	<b>3,559,259</b>	<b>-</b>	<b>-</b>	<b>217,090</b>	<b>3,776,349</b>

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

#### Other transactions and balances with Key Management Personnel

##### *Purchases*

During the year, purchases amounting to \$920 (2005: \$292) at normal market prices have been made from CBC Consolidated Bearings Pty Ltd, a subsidiary of Inenco Pty Ltd, a company of which Matthew Barnett is a director. The amounts are included in R&D expenses and cost of sales. There is no balance outstanding at reporting date.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

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#### 27 TRANSITION TO AIFRS

For all periods up to and including the year ended 30 June 2005, the Group prepared its financial statements in accordance with Australian generally accepted accounting practice (AGAAP). These financial statements for the year ended 30 June 2006 are the first the Group is required to prepare in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS).

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

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

#### *Exemptions applied*

AASB 1 allows first-time adopters certain exemptions from the general requirement to apply AIFRS retrospectively.

The Group has taken the following exemptions:

Comparative information for financial instruments is prepared in accordance with AGAAP and the company and group have adopted AASB 132: Financial Instruments: Disclosure and Presentation and AASB 139 Financial Instruments: Recognition and Measurement from 1 July 2005.

AASB 3 *Business Combinations* has not been applied to acquisitions of subsidiaries or of interests in associates and joint ventures that occurred before 1 July 2004.

Cumulative currency translation differences for all foreign operations are deemed to be zero as at 1 July 2004.

AASB 2 *Share-based Payment* has not been applied to any equity instruments that were granted on or before 7 November 2002, nor has it been applied to equity instruments granted after 7 November 2002 that vested before 1 January 2005.

#### *Explanation of material adjustments to the cash flow statement*

There are no material differences between the cash flow statement presented under AIFRS and the cash flow statement presented under previous AGAAP.

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 27 TRANSITION TO AIFRS (continued)

Abbreviated Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 1 July 2004

	AGAAP \$	CONSOLIDATED AIFRS Impact \$	AIFRS \$	AGAAP \$	PARENT AIFRS Impact \$	AIFRS \$
<b>ASSETS</b>						
<b>Current Assets</b>	11,239,163	-	11,239,163	7,890,587	-	7,890,587
<b>Non-current Assets</b>						
Other financial assets	-	-	-	5,009,329	-	5,009,329
Plant and equipment	494,831	(26,741)	468,090	-	-	-
Intangible asset - Software		26,741	26,741			
Goodwill	1,981,467	-	1,981,467	-	-	-
<b>Total Non-current Assets</b>	2,476,298	-	2,476,298	5,009,329	-	5,009,329
<b>TOTAL ASSETS</b>	13,715,461	-	13,715,461	12,899,916	-	12,899,916
<b>LIABILITIES</b>						
Derivatives	-	-	-	-	-	-
Other Liabilities	815,545	-	815,545	-	-	-
<b>TOTAL LIABILITIES</b>	815,545	-	815,545	-	-	-
<b>NET ASSETS</b>	12,899,916	-	12,899,916	12,899,916	-	12,899,916
<b>EQUITY</b>						
Contributed equity	32,824,959	-	32,824,959	32,824,959	-	32,824,959
Retained earnings	(19,925,043)	(90,901)	(20,015,944)	(19,925,043)	(90,901)	(20,015,944)
Reserves						
<i>Breakdown of impact on retained earnings:</i>						
Share-based payments		(90,901)	(90,901)		(90,901)	(90,901)
Goodwill amortisation		-	-		-	-
<i>Breakdown of impact on other reserves:</i>						
Employee equity reserve		90,901	90,901		90,901	90,901
<b>TOTAL EQUITY</b>	12,899,916	-	12,899,916	12,899,916	-	12,899,916

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 27 TRANSITION TO AIFRS (continued)

Abbreviated Balance Sheet reflecting reconciliation of adjustments to AIFRS as at 1 July 2005

	CONSOLIDATED			PARENT		
	AGAAP \$	AIFRS Impact \$	AIFRS \$	AGAAP \$	AIFRS Impact \$	AIFRS \$
<b>ASSETS</b>						
<b>Current Assets</b>	12,658,348	-	12,658,348	7,890,587	-	7,890,587
<b>Non-current Assets</b>						
Other financial assets	-	-	-	5,009,329	-	5,009,329
Plant and equipment	i 453,860	(25,222)	428,638	-	-	-
Intangible asset - Software	i	25,222	25,222	-	-	-
Goodwill	ii 1,306,803	674,664	1,981,467	-	-	-
<b>Total Non-current Assets</b>	1,760,663	-	2,435,327	5,009,329	-	5,009,329
<b>TOTAL ASSETS</b>	14,419,011	-	15,093,675	12,899,916	-	12,899,916
<b>LIABILITIES</b>						
Derivatives	-	-	-	-	-	-
Other Liabilities	-	-	-	-	-	-
<b>TOTAL LIABILITIES</b>	1,037,688	-	1,037,688	-	-	-
<b>NET ASSETS</b>	13,381,323	-	14,055,987	12,899,916	-	12,899,916
<b>EQUITY</b>						
Contributed equity	39,136,800	-	39,136,800	39,136,800	-	39,136,800
Retained earnings	(25,755,477)	475,001	(25,280,476)	(25,080,813)	(199,663)	(25,280,476)
Reserves		-			-	
<i>Breakdown of impact on retained earnings:</i>						
Share-based payments	iii	(199,663)			(199,663)	(199,663)
Goodwill amortisation	ii	674,664				
<i>Breakdown of impact on other reserves:</i>						
Employee equity reserve		199,663	199,663		199,663	199,663
<b>TOTAL EQUITY</b>	13,381,323	674,664	14,055,987	14,055,987	-	14,055,987

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 27 TRANSITION TO AIFRS (continued)

#### Income Statement FOR THE YEAR ENDED 30 JUNE 2005

Abbreviated Income statement reflecting reconciliation of adjustments to AIFRS for the year ended 30 June, 2005

	CONSOLIDATED			PARENT		
	AGAAP \$	AIFRS Impact \$	AIFRS \$	AGAAP \$	AIFRS Impact \$	AIFRS \$
<b>Revenue</b>	2,290,180		2,290,180			
Cost of sales	(789,005)	-	(789,005)	-	-	-
<b>Gross Profit</b>	1,501,175	-	1,501,175	-	-	-
Other income	561,921	-	561,921	343,359	-	343,359
Marketing expenses	(173,873)	-	(173,873)	-	-	-
Administrative expenses	ii (3,257,304)	(59,892)	(3,317,196)	(281,958)	(108,762)	(390,720)
R&D expenses	ii (3,258,749)	(48,870)	(3,307,619)	-	-	-
Investing expenses	ii (674,664)	674,664	-	(5,217,171)	-	(5,217,171)
Other expenses	(450,347)	-	(450,347)	-	-	-
<b>Loss before income tax</b>	(5,751,841)	565,902	(5,185,939)	(5,155,770)	-	(5,264,532)
Income tax expense	(78,593)	-	(78,593)	-	-	-
<b>Net loss for the year</b>	(5,830,434)	565,902	(5,264,532)	(5,155,770)	(108,762)	(5,264,532)

#### (i) Intangible assets

AGAAP	AIFRS	Impact	
		CONSOLIDATED	PARENT
Computer software was classified as Property, Plant & Equipment	Under AASB 138 <i>Intangible Assets</i> computer software is classified as an intangible asset. Therefore, computer software has been reclassified from Property, plant and equipment to Intangible assets.	<p><i>Equity at transition:</i> Decrease to plant &amp; equipment, increase to intangible assets of \$26,741. Net effect is zero.</p> <p><i>Equity at 30 June 2005:</i> Decrease to plant &amp; equipment and increase to intangible assets of \$26,741. Net effect is zero.</p> <p><i>Loss for 30 June 2005:</i> No effect</p>	No impact, no software assets

## Notes to the Financial Statements (continued)

### FOR THE YEAR ENDED 30 JUNE 2006

#### 27 TRANSITION TO AIFRS (continued)

##### (ii) Share Based Payments

AGAAP	AIFRS	Impact	
		CONSOLIDATED	PARENT
Share-based payments were not required to be expensed.	<p>AASB 2 <i>Share Based Payments</i> requires entities to recognise an expense in relation to shares, options, and other equity instruments provided to employees.</p> <p>The share based payment transactions must be fair valued at grant date and recognised as an expense in profit or loss evenly over the vesting period.</p> <p>An adjustment was required to recognise share based payments granted after 7 November 2002 and vesting after 1 January 2005.</p>	<p><i>Equity at transition:</i> Decrease to retained earnings and increase to employee equity benefits reserve of \$90,901. Net effect is zero.</p> <p><i>Equity at 30 June 2005:</i> Decrease to retained earnings and increase to employee equity benefits reserve of \$199,663. Net effect is zero.</p> <p><i>Loss for 30 June 2005:</i> Increase to loss of \$108,762.</p>	<p><i>Equity at transition:</i> Decrease to retained earnings and increase to employee equity benefits reserve of \$90,901. Net effect is zero.</p> <p><i>Equity at 30 June 2005:</i> Decrease to retained earnings and increase to employee equity benefits reserve of \$199,663. Net effect is zero.</p> <p><i>Loss for 30 June 2005:</i> Increase to loss of \$108,762.</p>

##### (iii) Business Combinations and Goodwill

AGAAP	AIFRS	Impact	
		CONSOLIDATED	PARENT
Goodwill was amortised over 10 years	The Group has chosen to adopt the exemption available under AASB 1 of not retrospectively applying AASB 3 <i>Business Combinations</i> to its business combinations occurring before transition date. Under AASB 3 goodwill is subject to annual impairment testing and amortisation of goodwill is strictly prohibited. An Adjustment is thus required to reverse the amortisation charge for 30 June 2005.	<p><i>Equity at transition:</i> No effect.</p> <p><i>Equity at 30 June 2005:</i> Decrease to accumulated losses and increase to goodwill of \$674,664.</p> <p><i>Loss for 30 June 2005:</i> Decrease to loss of \$674,664.</p>	<p><i>Equity at transition:</i> No effect</p> <p><i>Equity at 30 June 2005:</i> Decrease to accumulated losses and decrease to accumulated impairment on investment in subsidiaries \$674,664</p> <p><i>Loss for 30 June 2005:</i> Decrease to loss of \$674,664</p>

##### (iv) Derivatives

AGAAP	AIFRS	Impact	
		CONSOLIDATED	PARENT
Foreign exchange contracts that were not classified as hedges were recognised at the date the contract was entered into (at cost), and exchange gains or losses were recognised in net profit.	Under AASB 139, Foreign exchange contracts are measured at fair value, with any gains or losses recognised in profit or loss	Reclassification of non-hedging foreign currency payable from other creditors to derivatives. Increase in derivatives of \$2,325 on remeasurement to fair value, with the difference recognised in profit & loss.	No impact on parent.