

OPTISCAN IMAGING LIMITED

ABN 81 077 771 987

ANNOUNCEMENT OF RESULTS AND PRELIMINARY FINAL REPORT FOR YEAR ENDED 30 JUNE 2004

Key features

- 4 of 7 key milestones now achieved
- Efficacy of technology confirmed through clinical trials
- Company poised to commence first shipments to Pentax
- Time estimates to complete transfer to Pentax production proved to be ambitious
- Net loss after tax \$3.36M, in line with expectations
- Cash on hand at 30 June 2004 \$9.71M
- Operating expenses \$7.76M, down 29% following the business restructure in 2003

Commercialisation of Optiscan's unique technology was the predominant focus of our activities throughout 2003/2004. We achieved significant progress in all key aspects of the business, most notably in the critical area of demonstrating clinical efficacy. However by year end, our expectations of completing full technology transfer to Pentax manufacture, and of achieving a significant new licensing deal, had not been realised.

Pentax Flexible Endo-Microscope

Significant progress has been achieved with the Pentax collaboration on flexible endo-microscopes in the past year. The key achievements during 2003/2004 were:

- Expansion of the clinical trial program with very impressive early results
- Extensive technology transfer
- Quality accreditation achieved, and regulatory approval underway
- Product release near completion
- Arrangements for outsourced manufacture implemented

We have continued to work closely with Pentax, primarily through the Project Management Committee, which meets every 6 to 8 weeks to monitor progress and chart future activities.

The timelines set to complete full technology transfer into production have proved overly ambitious, largely due to a decision by Pentax to expand the testing protocols, which in turn led to the requirement for minor design modifications. In addition, an extensive process of quality accreditation had to be completed by Pentax, Optiscan and companies sub-contracted by Optiscan to manufacture key sub assemblies. These factors required more input and time from Optiscan's development engineers than was anticipated, and also held up completion of the regulatory approval processes.

During the year, Pentax placed an initial \$1.4M order for 20 control boxes and 25 scanners. The company will make the first commercial shipments of product against this order in coming months.

Clinical Trials

The clinical trial program has been a major feature of the Pentax project over the past year. In particular the excellent results obtained have significantly increased the confidence of Pentax and the doctors undertaking clinical trials in the ultimate commercial success of the flexible endo-microscope product.

Clinical trials play a critical role in the introduction of a new technology such as the endo-microscope. They serve to:

- Provide clinician feedback on use and ergonomics*
- Identify and validate high potential clinical applications*
- Provide a useful independent assessment through ethics approvals*
- Capture data for analysis of clinical efficacy*
- Provide material for publication which is critical for raising doctor awareness and interest*

The clinical trial program spans four continents through leading teaching hospitals in Australia, Germany, France, Japan and USA.

In data made public during the year, clinical investigators reported extremely high sensitivity, specificity and accuracy outcomes for detecting neoplasias (very early cancers) in two clinical studies. Key trial results obtained from two separate patient groups were:

- Detection sensitivities of 94.4% and 97.4%*
- Diagnostic specificities of 95.6% and 99.4%*
- Overall accuracies of 99.3% and 99.2%*

The results from these studies were accepted for oral presentation at the Digestive Diseases Week (DDW) Congress 2004 held in New Orleans, USA in May. DDW is the world's largest and most prestigious annual global meeting of gastroenterologists and flexible endoscope users.

The trial results have subsequently been accepted for publication in "Gastroenterology", the leading international peer-reviewed journal in the field of gastrointestinal medicine.

Business Development

The achievement of a second commercial partnership was the key business development objective that was pursued during 2003/2004. As has been previously communicated, this new partnership is most likely to come from fields of rigid endoscopy or laboratory research where our technology has the potential to provide significant advances over existing products.

Potential Rigid Endoscope Partnership

We identified that development of opportunities in rigid endoscopy requires a robust understanding of the ultimate clinical applications. Significant investigation of potentially attractive medical applications was pursued during the year.

Applications attracting the highest levels of interest have involved intra-operative diagnosis where real-time diagnosis is of significant medical benefit. Analysis of the economics of potential applications has been a priority and has acted to focus activity onto this group of high potential applications. The ability of our technology to collect digital images of cellular structures instantly upon contact with tissue is of interest to potential partners. By year-end significantly increased levels of response were evident from potential rigid endoscopy partners and planning for evaluation trials was underway.

We have also focussed considerable attention in the past year on diagnostic applications in ophthalmology, especially for Glaucoma management. The ability of our technology to obtain cellular level imaging non-invasively is attractive to ophthalmologists due to the inability to surgically biopsy the eye. Our activity in this application area has also attracted interest from some leading international firms with established market positions in ophthalmology instruments. We are planning to conduct some pilot studies to establish the efficacy of our technology in imaging tissue at the front of the eye.

Business development activities with potential rigid endoscope partners were accelerated towards the end of the year as outcomes from the Pentax clinical trial program were used to gain the attention of potential partners and the doctors they collaborate with to develop new products.

Potential Laboratory Research Partnership

In the market for research confocal microscopes, one of the leading industry players conducted an evaluation of our technology. This confirmed the existence of a range of laboratory research applications where our technology enables researchers to do new and innovative research. However, after careful analysis and negotiation both companies were unable to agree upon a set of commercial arrangements that could result in a partnership being formed at that time.

Our efforts to find the right partner in the globally concentrated research microscope industry are continuing, but it must be recognised that at present, these activities do not carry the same priority as delivering product to Pentax, or concluding a partnership in rigid endoscopy.

Financials

The net loss after tax for the year ended 30 June 2004 was \$3.363 million. This compares to a loss on \$3.426 million in the previous corresponding period, a reduction of \$0.063 million or 1.8%.

Overall, total expenses were reduced from \$10.85 million to \$7.76 million, showing the full year impact of the strategy review outcomes implemented late in 2003/2004. R&D expenses of \$3.820 million were reduced by 12% or \$0.535 million compared to last year, as all design work for Pentax was concluded. Marketing expenses were substantially reduced by \$1.23 million or 77%, reflecting termination of active marketing of the Stratum skin instrument.

As anticipated under the Pentax collaboration agreement, development cost contribution revenue from Pentax declined from \$6.128 million to \$2.350 million, as development of the Pentax product was completed and activities focused on technology transfer for production. Other revenue including royalties, grants and interest was up 10.4% on last year, from \$1.9 million to \$2.1 million, mainly due to new licensing of our optic fibre patents to a company producing confocal microscopes for laboratory research use.

Cash at bank at June 2004 is \$9.7M, compared to \$15.1M in 2003. Cash burn for the year of \$5.4M was in line with expectations set out at the beginning of the year.

Outlook

In 2004/2005 the final activities to complete the transfer to manufacture for the Pentax flexible endo-microscope will be completed. Regulatory approvals will be obtained and follow up orders will be received as Pentax product moves to market. Ongoing clinical trial activity will result in further publications of results and other Pentax market development activity will accelerate.

The realisation of a significant new licensing partnership on rigid endoscope and/or research applications will also remain a priority for 2005.

OPTISCAN IMAGING LIMITED

ABN : 81 077 771 987

APPENDIX 4E

Preliminary Final Report

Year ended 30 June 2004

Previous corresponding period: Year ended 30 June 2003

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1. Results for announcement to the market
2. Brief explanation of results
3. Commentary on results
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5. Financial data

1. Results for announcement to the market

The results of Optiscan Imaging Limited for the year ended 30 June 2004 are as follows:

Results

Operating revenue down 45% to \$4,449,340 (due to impact of one off Pentax agreement revenue in 2003; other operating revenues increased 10% in 2004)

Total expenses from ordinary activities down 29% to \$7,766,151

Loss from ordinary activities after tax attributable to members down 2% to \$3,362,577

Net loss after tax attributable to members down 2% to \$3,362,577

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

Operating revenue for the year was \$4,449,340, which was 45% lower than last year. This was made up of revenue from Pentax of \$2,349,511 (2003, \$6,127,739) and other revenue of \$2,099,829 (2003, \$1,901,864). Last year, total revenue included a one-off development contribution from Pentax. Setting aside the effect of this one-off payment in 2003, other operating revenue increased in 2004 by \$197,965 or 10%.

The other revenue in 2004 is comprised of service income (\$25,015), royalty revenue (\$1,247,160), interest and grants received (\$767,480) and sundry revenue (\$60,174).

Expenses for the year were reduced by \$3,143,998 (29%) over last year, to \$7,766,151. Total expenses in 2003 included once off restructuring costs of \$788,420 associated with the strategy review, which in turn enabled the company to achieve the following expense savings in 2004:

- Marketing expenses reduced by \$1,230,821
- Administration costs reduced by \$487,418
- R&D expenses reduced by \$535,203

The lower R&D cost reflects the progress being achieved with the Pentax project. As the product nears market release, the level of R&D activity has been slowly unwinding.

The net loss before tax was \$3,316,811. After allowing for income tax, (which represents the write off of withholding tax deductions amounting to \$45,766), the net loss for the year is \$3,362,577, which is 2% lower than the loss of \$3,426,015 in 2003.

3. Commentary on result

The commentary on results on pages 1 to 3 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 2004 amount to \$0.14 (2003, \$0.17).

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 are in the process of being 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 Tuesday 9 November 2004 at 2.00pm.

5. Financial information

Financial information is set out on pages 7 to 28 of this report.

A handwritten signature in blue ink, appearing to read "Bruce Andrew".

Bruce Andrew
Company Secretary

26 August 2004

Optiscan Imaging Limited and Controlled Entities

Statement of Financial Performance

for the year ended 30 June 2004

	Note	CONSOLIDATED		PARENT ENTITY	
		<u>2004</u> \$	<u>2003</u> \$	<u>2004</u> \$	<u>2003</u> \$
Sales revenue	2	25,015	104,195	-	-
Cost of sales		<u>(7,492)</u>	<u>(55,448)</u>	-	-
Gross profit		17,523	48,747	-	-
Other revenues from ordinary activities	2	4,424,325	7,925,408	186,134	9,599
Marketing expenses		(358,523)	(1,589,344)	-	-
Office and administration expenses		(2,653,657)	(3,141,075)	(192,690)	(212,603)
Research & development expenses		(3,820,657)	(4,355,860)	-	-
Investing expenses	2	(674,664)	(674,664)	(3,356,021)	(3,211,361)
Other expenses	2	<u>(251,158)</u>	<u>(1,093,758)</u>	-	-
Loss from ordinary activities before income tax expense		(3,316,811)	(2,880,546)	(3,362,577)	(3,414,365)
Income tax expense relating to ordinary activities	3	<u>(45,766)</u>	<u>(545,469)</u>	-	-
Loss from ordinary activities after related income tax expense		<u>(3,362,577)</u>	<u>(3,426,015)</u>	<u>(3,362,577)</u>	<u>(3,414,365)</u>
Net Loss		<u>(3,362,577)</u>	<u>(3,426,015)</u>	<u>(3,362,577)</u>	<u>(3,414,365)</u>
Decrease in accumulated losses on adoption of revised accounting standard: AASB 1028 "Employee Benefits"		-	11,650	-	-
Total revenues, expenses, and valuation adjustments attributable to members of Optiscan Imaging Limited and recognised directly in equity		-	11,650	-	-
Total changes in equity other than those resulting from transactions with owners as owners		<u>(3,362,577)</u>	<u>(3,414,365)</u>	<u>(3,362,577)</u>	<u>(3,414,365)</u>
Basic earnings (loss) per share (cents per share)	14	(4.20)	(4.29)		
Diluted earnings (loss) per share (cents per share)	14	(4.20)	(4.29)		

The accompanying notes form an integral part of this Statement of Financial Performance.

Optiscan Imaging Limited and Controlled Entities

Statement of Financial Position at 30 June 2004

	Note	CONSOLIDATED		PARENT ENTITY	
		<u>2004</u> \$	<u>2003</u> \$	<u>2004</u> \$	<u>2003</u> \$
CURRENT ASSETS					
Cash assets		9,705,699	15,120,571	7,858,922	71,084
Receivables	4	415,009	533,673	31,665	8
Inventories	5	803,326	343,557	-	-
Other	6	315,129	19,195	-	-
TOTAL CURRENT ASSETS		<u>11,239,163</u>	<u>16,016,996</u>	<u>7,890,587</u>	<u>71,092</u>
NON-CURRENT ASSETS					
Receivables	4	-	-	-	9,515,552
Other financial assets	7	-	-	5,009,329	6,607,171
Plant and equipment	8	494,831	644,507	-	-
Intangible assets	9	1,981,467	2,656,131	-	-
TOTAL NON-CURRENT ASSETS		<u>2,476,298</u>	<u>3,300,638</u>	<u>5,009,329</u>	<u>16,122,723</u>
TOTAL ASSETS		<u>13,715,461</u>	<u>19,317,634</u>	<u>12,899,916</u>	<u>16,193,815</u>
CURRENT LIABILITIES					
Payables	10	377,752	2,692,958	-	10,446
Provisions	11	252,331	285,186	-	-
TOTAL CURRENT LIABILITIES		<u>630,083</u>	<u>2,978,144</u>	<u>-</u>	<u>10,446</u>
NON-CURRENT LIABILITIES					
Provisions	11	185,462	156,121	-	-
TOTAL NON-CURRENT LIABILITIES		<u>185,462</u>	<u>156,121</u>	<u>-</u>	<u>-</u>
TOTAL LIABILITIES		<u>815,545</u>	<u>3,134,265</u>	<u>-</u>	<u>10,446</u>
NET ASSETS		<u>12,899,916</u>	<u>16,183,369</u>	<u>12,899,916</u>	<u>16,183,369</u>
EQUITY					
Contributed equity	12	32,824,959	32,745,835	32,824,959	32,745,835
Accumulated losses	13	(19,925,043)	(16,562,466)	(19,925,043)	(16,562,466)
TOTAL EQUITY		<u>12,899,916</u>	<u>16,183,369</u>	<u>12,899,916</u>	<u>16,183,369</u>

The accompanying notes form an integral part of this Statement of Financial Position.

Optiscan Imaging Limited and Controlled Entities

Statement of Cash Flows for the year ended 30 June 2004

	CONSOLIDATED		PARENT ENTITY	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
	\$	\$	\$	\$
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	85,929	230,517	-	10,448
Grant income received	179,426	311,641	-	-
Royalty income received	1,251,283	947,921	-	-
Development cost contribution received	482,813	6,434,752	-	-
Payments to suppliers and employees	(7,638,737)	(8,262,385)	(203,137)	(212,603)
Interest received	555,074	551,076	154,478	9,599
Withholding tax paid	(45,766)	(545,469)	-	-
NET CASH FLOWS USED IN OPERATING ACTIVITIES	<u>(5,129,978)</u>	<u>(331,947)</u>	<u>(48,659)</u>	<u>(192,556)</u>
(Note (b))				
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of plant and equipment	(365,804)	(214,915)	-	-
Loans to controlled entities	-	-	7,757,373	(96,614)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	<u>(365,804)</u>	<u>(214,915)</u>	<u>7,757,373</u>	<u>(96,614)</u>
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from issue of ordinary shares	79,124	668	79,124	668
NET CASH FLOWS FROM FINANCING ACTIVITIES	<u>79,124</u>	<u>668</u>	<u>79,124</u>	<u>668</u>
NET INCREASE (DECREASE) IN CASH HELD	(5,416,658)	(546,194)	7,787,838	(288,502)
Add opening cash brought forward	15,120,571	15,983,456	71,084	359,586
Effect of exchange rate changes on cash	1,786	(316,691)	-	-
CLOSING CASH CARRIED FORWARD	<u>9,705,699</u>	<u>15,120,571</u>	<u>7,858,922</u>	<u>71,084</u>
(Note (a))				

The accompanying notes form an integral part of this Statement of Cash Flows.

Optiscan Imaging Limited and Controlled Entities

Notes to the Statement of Cash Flows for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	<u>2004</u> \$	<u>2003</u> \$	<u>2004</u> \$	<u>2003</u> \$
(a) Reconciliation of cash				
For the purposes of the Statement of Cash Flows, cash includes cash on hand and in banks and term deposits				
Cash at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:				
Cash	438,000	10,500,166	199,110	71,084
Term deposit (i)	<u>9,267,699</u>	<u>4,620,405</u>	<u>7,659,812</u>	<u>-</u>
Closing cash balance	<u><u>9,705,699</u></u>	<u><u>15,120,571</u></u>	<u><u>7,858,922</u></u>	<u><u>71,084</u></u>
(i) Cash on term deposit includes amounts which are subject to charges from the company's bankers, which secure banking facilities. The term deposits mature within 23 days and the average interest rate at balance date is 5.42%.				
(b) Reconciliation of the net loss after tax to the net cash flows from operating activities				
Net loss	(3,362,577)	(3,426,015)	(3,362,577)	(3,414,365)
Non-Cash Items				
Net loss on sale of plant and equipment	11,340	24,069	-	-
Unrealised foreign exchange losses	(1,786)	316,691	-	-
Depreciation of non-current assets	504,140	663,769	-	-
Amortisation of goodwill	674,664	674,664	-	-
Amortisation of option premium	-	174,908	-	-
Diminution in value of investment in controlled entities	-	-	3,356,021	3,211,361
Changes in assets and liabilities				
(Increase) / decrease in trade receivables	274,237	(164,978)	-	-
(Increase) / decrease in royalties receivable	4,123	-	-	-
(Increase) / decrease in other debtors	(159,696)	122,264	(31,657)	2
(Increase) / decrease in prepayments	(295,934)	48,733	-	-
(Increase) / decrease in inventories	(459,769)	584,924	-	-
(Decrease) / increase in trade creditors and accrued expenses	(62,752)	29,287	-	-
(Decrease) / increase in sundry creditors	(109,369)	10,117	(10,446)	10,446
(Decrease) / increase in unearned income	(2,143,085)	582,273	-	-
(Decrease) / increase in employee entitlements	(3,514)	77,347	-	-
(Decrease) / increase inventory provision	-	(50,000)	-	-
NET CASH FLOW USED IN OPERATING ACTIVITIES	<u><u>(5,129,978)</u></u>	<u><u>(331,947)</u></u>	<u><u>(48,659)</u></u>	<u><u>(192,556)</u></u>

Optiscan Imaging Limited and Controlled Entities

Notes to the Statement of Cash Flows for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	<u>2004</u> \$	<u>2003</u> \$	<u>2004</u> \$	<u>2003</u> \$
(c) Financing facilities available at balance date				
The consolidated entity has the following financing facilities:				
Bank Guarantees	110,000	200,000	-	-
Credit Cards	140,000	100,000	-	-
Forward contracts	<u>1,300,000</u>	<u>1,300,000</u>	-	-
Total facilities	1,550,000	1,600,000	-	-
Amount drawn at balance date	<u>(49,114)</u>	<u>(53,111)</u>	-	-
Unused facilities at balance date	<u><u>1,500,886</u></u>	<u><u>1,546,889</u></u>	-	-

The facilities are secured by a charge over the term deposit (Refer (a) (i) above).

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004

Note 1: Statement of Significant Accounting Policies

Basis of accounting

The financial report is a general purpose financial report, which has been prepared in accordance with the requirements of the Corporations Act 2001, including applicable Accounting Standards. Other mandatory professional reporting requirements (Urgent Issues Group Consensus Views) have also been complied with.

The financial report has been prepared in accordance with the historical cost convention.

Changes in accounting policy

The accounting policies adopted are consistent with those of the previous year.

Principles of consolidation

The consolidated financial statements are those of the consolidated entity, comprising Optiscan Imaging Limited (the parent company) and all entities that Optiscan Imaging Limited controlled from time to time during the year and at balance date (Refer note 15).

Information from the financial statements of subsidiaries is included from the date the parent company obtains control until such times as control ceases. Should there be a loss of control of a subsidiary, the consolidated financial statements will include the results for the part of the reporting period during which the parent entity has control. Subsidiary acquisitions are accounted for using the purchase method of accounting.

The financial statements of subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All inter company balances and transactions, including unrealised profits arising from intra group transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

Income tax

Tax effect accounting is applied using the liability method whereby income tax is regarded as an expense and is calculated on the accounting result after allowing for permanent differences, which are income or expense items never to be assessed or allowed for taxation purposes. To the extent timing differences occur between the time items are recognised in the financial statements, and when items are taken into account in determining taxable income, the net related taxation benefit or liability, calculated at current rates, is disclosed as a future income tax benefit or a deferred tax liability. The net future income tax benefit relating to tax losses and timing differences is not carried forward as an asset unless the benefit is virtually certain of being realised.

The future benefit of tax losses and timing differences not brought to account will only be obtained if :

- 1 entities within the consolidated entity derive future assessable income of a nature and of an amount sufficient to enable the benefit of the taxation deductions to be realised;
- 2 entities within the consolidated entity continue to comply with the conditions for deductibility imposed by the law; and
- 3 no changes in tax legislation adversely affect the entities in realising the benefit.

Goods and Services Tax (GST)

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

The net amount of GST recoverable from or payable to the taxation authority is included as part of receivables or payables in the Statement of Financial Position.

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

Recoverable amount of non current assets

Non current assets measured using the cost basis are not carried at an amount above their recoverable amount, and where carrying values exceed this recoverable amount assets are written down. In determining recoverable amount, the expected net cash flows have been discounted to their present value using a market determined risk adjusted discount rate.

Plant, equipment and software

Plant, equipment and software are carried at cost. Assets are depreciated at rates based upon their expected useful economic lives, as follows:

	Life	Method
Plant and equipment	3 - 8 years	Straight Line
Software	2 - 3 years	Straight Line
Capitalised Instruments	2 - 3 years	Straight Line

Leasehold improvements included in Plant & Equipment may be depreciated over a period of less than 3 years if the lease term is less than 3 years.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements

for the year ended 30 June 2004 (continued)

Note 1: Statement of Significant Accounting Policies (continued)

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured.

Sale of goods

Revenue from the sale of goods is recognised at the point in time when products are delivered and installed and control of the goods has passed to the buyer.

Rendering of services

Revenue from rendering services is recognised when the entity controls a right to be compensated for the provision of such services, and the stage of completion can be reliably measured. Stage of completion is measured by reference to progress against predetermined milestones.

Interest, grants and royalties

Revenue from interest, grants and royalties is recognised when the entity controls a right relating to the consideration payable for the provision or investment of its assets.

Inventories

Inventories have been valued at the lower of cost and net realisable value. Cost, in relation to finished goods, is determined on the first in, first out basis.

Leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership. There are no finance leases at balance date. The minimum lease payments of operating leases, where the lessor effectively retains substantially all of the risks and benefits of ownership of the leased item are recognised as an expense on a straight line basis.

Foreign currencies

Translation of foreign currency transactions

Transactions in foreign currencies of entities within the consolidated entity are converted to local currency at the rate of exchange ruling at the date of the transaction.

Foreign currency monetary items that are outstanding at the reporting date (other than monetary items arising under foreign currency contracts where the exchange rate for that monetary item is fixed in the contract) are translated using the spot rate at the end of the financial year.

A monetary item arising under a foreign currency contract outstanding at the reporting date where the exchange rate for the monetary item is fixed in the contract is translated at the exchange rate fixed in the contract.

Except for certain specific hedges, all resulting exchange differences arising on settlement or re-settlement or re-statement are recognised as revenues and expenses for the financial year. Any gains or costs on entering a hedge are deferred and amortised over the life of the contract.

Specific hedges

Where a purchase or sale is specifically hedged, exchange gains or losses on the hedging transaction arising up to the date of purchase or sale and costs, premiums and discounts relative to the hedging transaction are deferred and included in the measurement of the purchase or sale. Exchange gains and losses on the hedge transaction after that date are brought to account in determining the net profit or loss for the financial year.

Translation of financial reports of overseas operations

The overseas operations are deemed integrated as they are financially and operationally dependent on the other entities in the consolidated entity. The financial reports of the overseas operations are translated using the temporal method and any exchange differences are brought to account in determining the net profit or loss for the financial year.

Derivative financial instruments

The consolidated entity enters into forward exchange contracts where it agrees to sell specified amounts of foreign currencies in the future at a predetermined exchange rate. The objective is to match the contract with anticipated future cash flows from sales and royalties in foreign currencies, to protect the consolidated entity against the possibility of loss from future exchange rate fluctuations. Exchange gains or losses from forward contracts are charged to the Statement of Financial Performance.

Earnings per share

Basic EPS is calculated as net loss attributable to members, adjusted to exclude costs of servicing equity divided by the weighted average number of ordinary shares.

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

- costs of servicing equity, if any
- the after tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and
- other non discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares, divided by the weighted average number of ordinary shares and dilutive potential ordinary shares.

Employee benefits

Provision is made for employee benefits accumulated as a result of employees rendering services up to the reporting date. The benefits include wages and salaries, annual leave, and long service leave.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements

for the year ended 30 June 2004 (continued)

Note 1: Statement of Significant Accounting Policies (continued)

Liabilities arising in respect of wages and salaries, annual leave, and other employee benefits expected to be settled within twelve months of the reporting date are measured at their nominal amounts based on remuneration rates which are expected to be paid when the liability is settled. All other employee benefit liabilities are measured at the present value of the estimated future cash outflow to be made in respect of the services provided by employees up to the reporting date. In determining the present value of future cash outflows, the market yield as at the reporting date on national government bonds, which have terms to maturity approximating the terms of the related liability, are used.

Employee benefit expenses and revenues arising in respect of wages and salaries, non monetary benefits, annual leave, long service leave, other leave benefits and other types of employee benefits are recognised against profits on a net basis in their respective categories. The value of the equity based compensation scheme described in Note 22 is not being recognised as an employee benefits expense.

All material on-costs, including payroll tax and workers' compensation are included in the determination of provisions for employee benefits.

Patent and licences

All patent and license costs are expensed as they are incurred.

Research and development costs

Research and development costs are expensed as incurred unless future benefits are expected, beyond any reasonable doubt, to exceed those costs. If research and development costs were to be deferred, such costs would be amortised over future periods on a basis related to expected future benefits. Unamortised costs would be reviewed at each balance date to determine the amount (if any) that is no longer recoverable and such amount would be written off. There are no capitalised research and development costs at balance date.

Cash and cash equivalents

Cash on hand and in banks and short term deposits are stated at nominal values.

Goodwill on acquisition

On acquisition of a controlled entity, the difference between the purchase consideration plus incidental expenses and the fair value of identifiable net assets acquired is initially brought to account as goodwill or discount on acquisition. Purchased goodwill is amortised on a straight line basis over the period during which the benefits are expected to arise, which is currently ten years. The unamortised balance of goodwill is reviewed at each balance date and charged to the Statement of Financial Performance to the extent that applicable future benefits are no longer probable. As discussed in the prospectus, goodwill acquired prior to the date of the float of Optiscan Imaging Limited is recoverable from future sales of microscopes and royalties earned from the related technologies which were developed or in development at the time of the float. The directors resolved to maintain the carrying value of goodwill at 30 June 2004.

Contributed equity

Issued and paid up capital is recognised at the fair value of the consideration received by the company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share issue proceeds received.

Financial instruments included in assets

Receivables

Trade receivables are initially recorded at the amount of contracted sales proceeds. They are non interest bearing and generally on 30 day terms. Other receivables and sundry debtors are non interest bearing and have repayment terms between 30 and 90 days. Receivables from controlled entities are carried at a value that reflects the underlying net assets of those companies. Where there has been a diminution in value, a provision for non recovery of the loan is made.

Credit risk exposures

The consolidated entity's maximum exposures to credit risk at reporting date in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the Statement of Financial Position.

Investments

Investments in subsidiaries are carried at the lower of cost or recoverable value.

The carrying value of financial instruments included in assets approximates their fair value.

Financial instruments included in liabilities

Payables

Liabilities for trade creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity. Payables to related parties are carried at the principal amount. Trade creditors are non-interest bearing and are normally settled on 30 day terms. Other creditors are non interest bearing and are usually settled on terms between 30 and 90 days.

The carrying value of financial instruments included in liabilities approximates their fair value.

Financial instruments included in equity

Ordinary share capital bears no special terms or conditions affecting income or capital entitlements of the shareholders.

Employee Share Option Plan

Employees are entitled to participate in an Employee Share Option Plan, details of which are set out in Note 22. No remuneration expense is recognised in respect of employee share options issued.

Comparatives

Where necessary, comparatives have been reclassified and repositioned for consistency with current year disclosures.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	<u>2004</u> \$	<u>2003</u> \$	<u>2004</u> \$	<u>2003</u> \$
Note 2: Revenue and Expenses				
Loss from ordinary activities is after crediting the following revenues:				
Sales revenues:				
Product sales	-	87,883	-	-
Service income	25,015	16,312	-	-
Total sales revenues	<u>25,015</u>	<u>104,195</u>	<u>-</u>	<u>-</u>
Other revenues from ordinary activities				
Interest revenue - unrelated parties	590,034	526,952	186,134	9,599
Grant revenue	177,446	303,662	-	-
Revenue derived from Pentax agreement				
- Development cost contribution recognised as revenue	2,349,511	6,127,739	-	-
Royalty revenue - licensees other than Pentax	1,247,160	954,655	-	-
Other revenue	60,174	12,400	-	-
Total other revenues from ordinary activities	<u>4,424,325</u>	<u>7,925,408</u>	<u>186,134</u>	<u>9,599</u>
Total revenues from ordinary activities	<u><u>4,449,340</u></u>	<u><u>8,029,603</u></u>	<u><u>186,134</u></u>	<u><u>9,599</u></u>

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	2004 \$	2003 \$	2004 \$	2003 \$
Note 2: Revenue and Expenses (continued)				
Expenses				
(a) Loss from ordinary activities is after charging the following expenses:				
Depreciation and amortisation				
Depreciation of non-current assets				
Depreciation of plant & equipment	461,927	598,649	-	-
Depreciation of software	42,213	65,120	-	-
Total depreciation of non-current assets	<u>504,140</u>	<u>663,769</u>	<u>-</u>	<u>-</u>
Amortisation of non-current assets				
Amortisation of goodwill (b)	674,664	674,664	-	-
Amortisation of option premium	-	174,908	-	-
Total amortisation of non-current assets	<u>674,664</u>	<u>849,572</u>	<u>-</u>	<u>-</u>
Total depreciation and amortisation expenses	<u>1,178,804</u>	<u>1,513,341</u>	<u>-</u>	<u>-</u>
Inventory written off	85,000	593,785	-	-
Provision for doubtful debts on loans to controlled entities (e)	-	-	1,758,179	3,211,361
Provision for diminution of investment in controlled entities (e)	-	-	1,597,842	-
Operating lease rentals - minimum lease payments	187,386	357,110	-	-
Provision for employee benefits	(3,514)	77,347	-	-
Net foreign exchange losses	21,860	204,841	-	-
(b) Investing expenses comprise:				
Diminution of amount receivable from controlled entities	-	-	1,758,179	3,211,361
Diminution in value if investment in controlled entities	-	-	1,597,842	-
Amortisation of goodwill	674,664	674,664	-	-
Total investing expenses	<u>674,664</u>	<u>674,664</u>	<u>3,356,021</u>	<u>3,211,361</u>
(c) Other expenses comprise:				
Inventory written off	85,000	593,785	-	-
Amortisation of option premium	-	174,908	-	-
Foreign exchange losses	21,860	204,841	-	-
Other expenses	144,298	120,225	-	-
Total other expenses	<u>251,158</u>	<u>1,093,759</u>	<u>-</u>	<u>-</u>
(d) Gain (loss) on sale of plant & equipment				
Revenue from sale of plant & equipment	-	-	-	-
Expense from sale of plant & equipment	(11,340)	(24,069)	-	-
Net gain (loss) on sale of plant & equipment	<u>(11,340)</u>	<u>(24,069)</u>	<u>-</u>	<u>-</u>
(e) Specific items				
Loss from ordinary activities before income tax expense includes the following material expenses whose disclosure is relevant in explaining the financial performance of the entity:				
Obsolete inventory written off	85,000	593,785	-	-
Redundancy costs	-	85,006	-	-
Surplus lease space provided for	-	109,629	-	-
The parent entity has made provision for non recovery of loans to, and investment in controlled entities in order to reflect the underlying net assets of those entities.	-	-	3,356,021	3,211,361

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	2004 \$	2003 \$	2004 \$	2003 \$
Note 3: Income Tax				
The difference between the income tax expense provided in the financial statements and the prima facie income tax expense is reconciled as follows :				
Net Loss	3,316,811	2,880,546	3,362,577	3,414,365
Prima facie income tax benefit on net loss from ordinary activities calculated at 30%	995,043	864,164	1,008,773	1,024,309
Tax effect of permanent differences:				
Non-deductible expenses	(2,915)	(3,425)	-	-
Amortisation of goodwill	(202,399)	(202,399)	-	-
R&D Tax Concession deductions	652,827	-	-	-
Foreign exchange adjustments not subject to tax	1,196	7,017	-	-
Diminution of amount receivable from controlled entities	-	-	(1,006,806)	(963,408)
Tax benefit of losses transferred out (in)	-	-	-	-
Income tax adjusted for permanent differences	1,443,752	665,357	1,967	60,901
Tax losses not brought to account	(1,443,752)	(665,357)	(1,967)	(60,901)
Foreign withholding tax deducted from royalty income (a)	45,766	545,469	-	-
Income tax attributable to ordinary activities	45,766	545,469	-	-
The tax effect at 30% of future income tax benefits not brought to account :				
Tax losses	5,654,780	2,787,136	62,868	60,901
Timing differences	421,185	779,807	-	-
The tax effect at 10% of future income tax benefits not brought to account :				
Withholding tax (a)	1,348,109	1,341,595	-	-

As at 30 June 2004, the company has unconfirmed unrecouped income tax losses of \$18,849,268 (2003, \$9,264,052) available to offset against future taxable income. The benefit of these losses has not been brought to account as their realisation is not virtually certain (Refer Note 1).

(a) Withholding Tax

A cumulative total of \$1,348,109 (2003, \$1,341,595) has been deducted from remittances of royalties to the consolidated entity in accordance with the withholding tax obligations of the payers. These deductions represent foreign tax credits which may be available to reduce the Australian income tax payable by the consolidated entity in future years. The benefit of these tax credits has not been brought to account as their realisation is not virtually certain (Refer Note 1).

Tax Consolidation

Effective 1 July, 2004, for the purposes of Australian income tax, Optiscan Imaging Limited and its 100% owned Australian subsidiary, Optiscan Pty Ltd, formed a tax consolidated group. The head entity is Optiscan Imaging Limited. In the past, the group has not adopted tax effect accounting (refer Note 1), and as a consequence there are no adjustments required to the financial statements to reflect the formation of a tax consolidated group.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	2004 \$	2003 \$	2004 \$	2003 \$
Note 4: Receivables				
CURRENT				
Trade debtors	1,024	275,261	-	-
Royalties receivable	210,733	214,856	-	-
Other receivables	203,252	43,556	31,665	8
Total current receivables, net	<u>415,009</u>	<u>533,673</u>	<u>31,665</u>	<u>8</u>
NON-CURRENT				
Non-trade amounts owing by:				
Related parties - wholly owned group	-	-	18,543,395	26,300,768
Provision for diminution of amount receivable from controlled entities (i)	-	-	(18,543,395)	(16,785,216)
Total non current receivables	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,515,552</u>

(i) The parent entity has made provision for non recovery of loans to controlled entities in order to reflect the underlying net assets of those entities.

There is no interest rate exposure on these financial assets.

Note 5: Inventories

Raw materials at cost	738,108	262,253	-	-
Work in progress at cost	-	37,086	-	-
Finished goods	65,218	44,218	-	-
Total current inventories	<u>803,326</u>	<u>343,557</u>	<u>-</u>	<u>-</u>

Note 6: Other Current Assets

Prepayments - General	315,129	19,195	-	-
Total Other Current Assets	<u>315,129</u>	<u>19,195</u>	<u>-</u>	<u>-</u>

Note 7: Other Financial Assets (non-current)

Investment at cost comprises:				
Shares in controlled entities at cost	-	-	6,607,171	6,607,171
Provision for diminution on unlisted shares (i)	-	-	(1,597,842)	-
Total Shares in Controlled Entities - Unlisted (Note 15)	<u>-</u>	<u>-</u>	<u>5,009,329</u>	<u>6,607,171</u>

(i) The parent entity has made provision for non recovery of loans to controlled entities in order to reflect the underlying net assets of those entities.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

	CONSOLIDATED		PARENT ENTITY	
	2004 \$	2003 \$	2004 \$	2003 \$
Note 8: Plant and Equipment and Software				
Plant, equipment and software at cost				
Opening balance	1,667,703	1,854,023	-	-
Additions	365,804	214,915	-	-
Write off of assets fully written down	(897,504)	(357,378)	-	-
Disposals	(13,316)	(43,857)	-	-
Closing balance	<u>1,122,687</u>	<u>1,667,703</u>	-	-
Accumulated depreciation				
Opening balance	(1,023,196)	(736,593)	-	-
Depreciation for the year	(504,140)	(663,769)	-	-
Write off of assets fully written down	897,504	357,378	-	-
Disposals	1,976	19,788	-	-
Closing balance	<u>(627,856)</u>	<u>(1,023,196)</u>	-	-
Net book value	<u>494,831</u>	<u>644,507</u>	-	-

There would be no capital gains tax if these assets were sold at the current carrying amount.

Note 9: Intangible Assets (non-current)

Goodwill	6,746,613	6,746,613	-	-
Accumulated amortisation	<u>(4,765,146)</u>	<u>(4,090,482)</u>	-	-
Total intangible assets	<u>1,981,467</u>	<u>2,656,131</u>	-	-

Note 10: Payables (current)

Trade creditors - unsecured	112,076	173,266	-	-
Sundry creditors - unsecured	38,314	147,683	-	10,446
Accrued expenses	227,362	228,924	-	-
Unearned income - unsecured	-	2,143,085	-	-
Total current accounts payable	<u>377,752</u>	<u>2,692,958</u>	-	<u>10,446</u>

There is no interest rate exposure on these liabilities.

Note 11: Provisions

EMPLOYEE BENEFITS				
Current	252,331	285,186	-	-
Non current	<u>185,462</u>	<u>156,121</u>	-	-
Total employee benefits	<u>437,793</u>	<u>441,307</u>	-	-

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

CONSOLIDATED		PARENT ENTITY	
2004	2003	2004	2003
\$	\$	\$	\$

Note 12: Contributed Equity

Ordinary shares	<u>32,824,959</u>	<u>32,745,835</u>	<u>32,824,959</u>	<u>32,745,835</u>
Movements in contributed equity during the year				
Opening balance	32,745,835	32,745,167	32,745,835	32,745,167
Issued pursuant to exercise of options (a)	79,124	668	79,124	668
Closing Balance	<u>32,824,959</u>	<u>32,745,835</u>	<u>32,824,959</u>	<u>32,745,835</u>
	Number	Number	Number	Number
Movements in number of issued shares during the year				
Opening balance	79,825,102	79,821,762	79,825,102	79,821,762
Issued pursuant to exercise of options (a)	395,621	3,340	395,621	3,340
Closing Balance	<u>80,220,723</u>	<u>79,825,102</u>	<u>80,220,723</u>	<u>79,825,102</u>
Options over unissued shares				
Employee Options outstanding at year end :	<u>4,467,170</u>	<u>3,872,504</u>	<u>4,467,170</u>	<u>3,872,504</u>
Movements in number of options during the year				
Opening balance	3,872,504	2,547,434	3,872,504	2,547,434
Options issued to employees and directors	1,819,900	1,790,250	1,819,900	1,790,250
Options Lapsed	(829,613)	(461,840)	(829,613)	(461,840)
Options exercised	(395,621)	(3,340)	(395,621)	(3,340)
Closing Balance	<u>4,467,170</u>	<u>3,872,504</u>	<u>4,467,170</u>	<u>3,872,504</u>

(a) In 2004 each share was issued as fully paid in consideration for the option exercise prices set out in the table of options set out below.

Terms and conditions of contributed equity

Ordinary shares

Ordinary shares have the right to receive dividends as declared and, in the event of winding up the company, to participate in the proceeds of sale of all surplus assets in proportion to the number of, and amounts paid up, on shares held.

Ordinary shares entitle their holder to one vote, either in person or by proxy, at a meeting of the company.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 12: Contributed Equity (continued)

Details of Options

Option Class / Type	Issue Date	Price	Expiry Date	Opening Balance	Movement this year		Closing Balance
					New Issues	Exercised	
					(Lapses)		
		\$		Number	Number	Number	Number
<u>Employee Options (Unlisted)</u>							
Issue to existing employees (1999/2000)	08.12.99	0.20	08.12.03	422,354	(26,733)	(395,621)	-
Issue to directors (1999/2000)	08.12.99	0.55	08.12.03	300,000	(300,000)	-	-
Issue to new employees (1999/2000)	13.12.99	2.00	13.12.04	25,000	-	-	25,000
Issue to new employees (1999/2000)	22.12.99	2.00	22.12.04	8,000	(8,000)	-	-
Issue to new employees (1999/2000)	28.02.00	2.00	28.02.05	236,000	(84,000)	-	152,000
Issue to employees (2000/2001)	22.12.00	1.94	22.12.05	350,400	(77,380)	-	273,020
Issue to new employees (2000/01)	30.06.00	1.55	01.06.05	5,000	-	-	5,000
Issue to new employees (2000/01)	09.10.00	2.10	09.10.05	2,000	-	-	2,000
Issue to new employees (2000/01)	30.01.01	1.74	30.01.06	45,000	-	-	45,000
Issue to new employees (2000/01)	19.02.01	1.85	19.02.06	66,000	-	-	66,000
Issue to employees (2001/02)	11.01.02	1.08	11.01.07	410,000	(91,000)	-	319,000
Issue to new employees (2001/02)	02.07.01	1.33	02.07.06	30,000	-	-	30,000
Issue to new employees (2001/02)	01.08.01	1.05	01.08.06	20,000	-	-	20,000
Issue to director (2001/02)	13.08.01	0.72	13.08.06	100,000	-	-	100,000
Issue to director (2001/02)	13.08.01	0.90	13.08.06	100,000	-	-	100,000
Issue to new employees (2001/02)	27.08.01	0.80	27.08.06	20,000	-	-	20,000
Issue to new employees (2002/03)	01.07.02	1.30	01.07.07	43,000	-	-	43,000
Issue to new employees (2002/03)	17.07.02	0.80	17.07.07	120,000	(40,000)	-	80,000
Issue to director (2002/03)	05.08.02	0.62	05.08.07	166,666	-	-	166,666
Issue to director (2002/03)	05.08.02	0.70	05.08.07	166,667	-	-	166,667
Issue to director (2002/03)	05.08.02	0.80	05.08.07	166,667	-	-	166,667
Issue to director (2002/03)	29.08.02	0.62	29.08.07	66,666	-	-	66,666
Issue to director (2002/03)	29.08.02	0.70	29.08.07	66,667	-	-	66,667
Issue to director (2002/03)	29.08.02	0.80	29.08.07	66,667	-	-	66,667
Issue to new employees (2002/03)	08.09.02	0.71	08.09.07	20,000	-	-	20,000
Issue to new employees (2002/03)	08.09.02	0.90	08.09.07	20,000	-	-	20,000
Issue to new employees (2002/03)	08.09.02	1.10	08.09.07	20,000	-	-	20,000
Issue to new employees (2002/03)	31.12.02	0.39	31.12.07	809,750	(162,500)	-	647,250
Issue to director (2003/04)	09.12.03	0.48	04.12.04	-	333,333	-	333,333
Issue to director (2003/04)	09.12.03	0.58	04.12.05	-	333,333	-	333,333
Issue to director (2003/04)	09.12.03	0.70	04.12.06	-	333,334	-	333,334
Issue to new employees (2003/04)	09.12.03	0.45	09.12.08	-	819,900	^	-
Issue to new employees (2003/04)	09.12.03	0.45	09.12.08	-	(40,000)	^	779,900
TOTALS AT BALANCE DATE				3,872,504	990,287	(395,621)	4,467,170
Exercised subsequent to balance date							-
Outstanding at date of directors' report							4,467,170

(Refer Note 22 for further information on employee options)

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

CONSOLIDATED		PARENT ENTITY	
2004	2003	2004	2003
\$	\$	\$	\$

Note 13 : Accumulated Losses

Accumulated losses at beginning of year	(16,562,466)	(13,148,101)	(16,562,466)	(13,148,101)
Adjustment arising from the adoption of revised accounting standard: AASB 1028 "Employee Benefits"	-	11,650	-	-
Net loss for year	<u>(3,362,577)</u>	<u>(3,426,015)</u>	<u>(3,362,577)</u>	<u>(3,414,365)</u>
Accumulated losses at end of year	<u>(19,925,043)</u>	<u>(16,562,466)</u>	<u>(19,925,043)</u>	<u>(16,562,466)</u>

Note 14: Earnings Per Share

Basic earnings per share (cents per share)	(4.20)	(4.29)
Diluted earnings per share (cents per share)	(4.20)	(4.29)

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

Earnings used in calculating basic and diluted earnings per share	(3,362,577)	(3,426,015)
Weighted average number of ordinary shares on issue used in the calculation of basic earnings per share	<u>79,972,991</u>	<u>79,821,890</u>

All potential ordinary shares, being options to acquire ordinary shares, are not considered dilutive for the year ended 30 June 2004

Note 15: Controlled Entities

Name of company	Country of incorporation	Book value of parent entity investment and % of each class of shares held			
		2004	%	2003	%
		\$		\$	
Optiscan Pty Ltd	Australia	5,004,776	100%	6,605,396	100%
Optiscan Inc.	USA	1,775	100%	1,775	100%
		<u>5,006,551</u>		<u>6,607,171</u>	

All controlled entities have the same financial year as Optiscan Imaging Limited.

The ultimate holding company is Optiscan Imaging Limited.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

CONSOLIDATED		PARENT ENTITY	
2004	2003	2004	2003
\$	\$	\$	\$

Note 16: Expenditure Commitments

LEASES

Operating leases (non cancellable)

Minimum lease payments

- Not later than one year

- Later than one year and not later than five years

51,855	243,727	-	-
-	54,101	-	-
<u>51,855</u>	<u>297,828</u>	<u>-</u>	<u>-</u>

Surplus lease space provided for

Aggregate lease expenditure contracted for at balance date not provided in accounts

25,526	109,629	-	-
<u>26,329</u>	<u>188,199</u>	<u>-</u>	<u>-</u>

Operating leases are entered into as a means of acquiring access to rental property. Rental payments are generally fixed, subject to inflation escalation clauses on which contingent rentals are determined. Renewal options exist, being one further term of three years, and a second further term of three years.

OTHER EXPENDITURE COMMITMENTS

Engineering and development expenditure to be incurred over the next year in discharging the obligations of the consolidated entity under the agreement with Pentax entered into in February 2002.

(Refer also Note 2 and Note 10)

- Not later than one year

-	2,141,420	-	-
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Commitments to provide research funding:

- Not later than one year

48,157	57,953	-	-
<u>48,157</u>	<u>2,199,373</u>	<u>-</u>	<u>-</u>

Note 17: Contingent Liabilities

Bank guarantees - property lease rental bond

45,500	45,500	-	-
<u>45,500</u>	<u>45,500</u>	<u>-</u>	<u>-</u>

Note 18: Subsequent Events

The directors are not aware of any subsequent events that would have a material impact on the financial statements at 30 June 2004.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 19: Director and Executive Disclosures

(a) Details of Specified Directors and Specified Executives

(i) Specified Directors

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

(ii) Specified Executives

B R Andrew	Chief Financial Officer and Company Secretary
J D Allen	IP and Licensing Manager
R Law AM	R&D Manager

(b) Remuneration of Specified Directors and Specified Executives

(i) Remuneration Policy

The Remuneration Committee of the Board of Directors of Optiscan Imaging Limited is responsible for determining and reviewing remuneration of directors and senior executives of the company. The Remuneration Committee assesses the appropriateness of the nature and amount of emoluments of such officers on an annual basis, having regard to market factors and a review of performance. The Remuneration Committee may seek independent remuneration advice. For executive directors and officers, remuneration packages generally comprise salary and superannuation. Executives are also provided with longer-term incentives through the employee share option scheme, which acts to align the executives' actions with the interests of shareholders.

The Board meets annually to review its own performance. The Chairman also holds individual discussions with each director to discuss their performance. The non-executive directors are responsible for evaluating the performance of the Chief Executive Officer who, in turn, evaluates the performance of all other senior executives. These evaluations are based on specific criteria, including the company's business performance, whether long-term strategic objectives are being achieved and the achievement of individual performance objectives.

It is the Remuneration Committee's policy that employment agreements shall only be entered into with the Chief Executive Officer and with no other executives. The current employment agreement with the Chief Executive Officer has a six month notice period. It also provides for the payment of an annual bonus subject to achievement of key objectives and milestones determined by the board.

(ii) Remuneration of Specified Directors and Specified Executives

		Primary	Post Employment		Equity	Total
		Salary & Fees	Cash Bonus	Superannuation	Options	
Specified Directors						
G F Latta	Chairman (non-executive)					
2004		80,000	-	-	22,525	102,525
2003		73,333	-	-	43,660	116,993
M H Barnett	Director and Chief Executive Officer					
2004		240,450	22,936	23,705	29,465	316,556
2003	(Part year)	125,641	-	11,308	-	136,949
K P Daniel	Director (non-executive)					
2004		40,000	-	3,600	2,340	45,940
2003		38,333	-	3,450	4,830	46,613
P M Delaney	Director of Technology					
2004		150,000	-	13,500	-	163,500
2003		150,071	-	13,506	-	163,577
A W Rogers	Director (non-executive)					
2004		40,000	-	3,600	14,352	57,952
2003		33,333	-	3,000	23,216	59,549
Total Remuneration: Specified Directors						
2004		550,450	22,936	44,405	68,682	686,473
2003*		560,877	-	42,454	71,706	675,037
Specified Executives						
B R Andrew	Chief Financial Officer and Company Secretary					
2004		150,000	-	13,500	7,885	171,385
2003		150,000	-	13,500	6,904	170,404
J D Allen	IP and Licensing Manager					
2004		135,000	-	12,150	9,193	156,343
2003		120,000	-	10,800	10,811	141,611
R Law AM	R&D Manager					
2004		135,000	-	12,150	3,591	150,741
2003	(Part year)	105,515	-	9,496	1,803	116,814
Total Remuneration: Specified Executives						
2004		420,000	-	37,800	20,669	478,469
2003*		938,105	-	84,429	36,793	1,059,327

* Group totals in respect of the financial year ended 2004 do not necessarily equal to the sums of amounts disclosed for 2003 for individuals specified in 2004, as different individuals were specified in 2003.

Details of bonus payment

On 17 September 2003, the Remuneration Committee determined that the Chief Executive Officer was entitled to a cash bonus of \$25,000, inclusive of superannuation, in respect of service and performance during the period to 30 June, 2003. The performance criteria used to determine the amount of the remuneration related to achievement of critical milestones under the Pentax agreement, including completion of a functional prototype and receipt of the third tranche development payment.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 19: Director and Executive Disclosures (continued)

(c) Remuneration options: Granted and vested during the year

During the financial year options were granted as equity compensation benefits to certain specified directors and specified executives as disclosed below. The options were issued free of charge. The terms and conditions for each grant are as specified below.

	Granted		Terms & Conditions for Each Grant			
	Number	Grant date	Value per option at grant date (\$)	Exercise Price per share (\$)	First Exercise Date	Last Exercise Date
Specified Directors						
M H Barnett	333,333	9 December 2003	0.1057	0.48	4 December 2004	15 January 2008
M H Barnett	333,333	9 December 2003	0.0718	0.58	4 December 2005	15 January 2008
M H Barnett	333,334	9 December 2003	0.0454	0.70	4 December 2006	15 January 2008
B R Andrew	41,250	9 December 2003	0.1177	0.45	9 December 2005	9 December 2008
J D Allen	55,000	9 December 2003	0.1177	0.45	9 December 2005	9 December 2008
R Law AM	41,250	9 December 2003	0.1177	0.45	9 December 2005	9 December 2008
Total	1,137,500					

(d) Shares issued on exercise of remuneration options

	Shares issued Number	Paid \$ per share	Unpaid \$ per share
Specified Executives			
B R Andrew	13,350	0.20	
Total	13,350		

(e) Option holding of specified directors and specified executives

	Balance at beginning of period	Granted as Remuneration	Options Exercised	Net Change Other (Lapse)	Balance at end of period	Vested at 30 June 2004		
						1 July 2003	30 June 2004	Total
Specified Directors								
G F Latta	500,000	-	-	-	500,000	166,666	-	166,666
M H Barnett	-	1,000,000	-	-	1,000,000	-	-	-
K P Daniel	200,000	-	-	-	200,000	100,000	-	100,000
P M Delaney	100,000	-	-	(100,000)	-	-	-	-
A W Rogers	200,000	-	-	-	200,000	66,667	-	66,667
Specified Executives								
B R Andrew	150,850	41,250	(13,350)	-	178,750	27,500	-	27,500
J D Allen	150,000	55,000	-	-	205,000	18,333	-	18,333
R Law AM	80,000	41,250	-	-	121,250	-	-	-
Total	1,380,850	1,137,500	(13,350)	(100,000)	2,405,000	379,166	-	379,166

(f) Shareholdings of Specified Directors and Specified Executives

<i>Shares held in Optiscan Imaging Ltd (number)</i>	Balance 1 July 03	Granted as Remuneration	On Exercise of Options	Net Change Other	Balance 30 June 04
Specified Directors					
G F Latta	-	-	-	-	-
M H Barnett	50,000	-	-	-	50,000
K P Daniel	10,000	-	-	-	10,000
P M Delaney	3,520,259	-	-	(1,000)	3,519,259
A W Rogers	-	-	-	-	-
Specified Executives					
B R Andrew	26,650	-	13,350	-	40,000
J D Allen	-	-	-	-	-
R Law AM	-	-	-	-	-
Total	3,606,909	-	13,350	(1,000)	3,619,259

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

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 20: Remuneration of Auditors

Amounts received or due and receivable by

Ernst & Young for:

- an audit or review of the financial report of the entity and any other entity in the consolidated entity
- taxation services in relation to the entity and any other entity in the consolidated entity

CONSOLIDATED		PARENT ENTITY	
2004	2003	2004	2003
\$	\$	\$	\$
25,300	29,715	2,000	2,000
<u>31,663</u>	<u>10,700</u>	-	-
<u>56,963</u>	<u>40,415</u>	<u>2,000</u>	<u>2,000</u>

Note 21: Related Party Disclosures

Transactions between related parties are on normal commercial terms and conditions.

(a) Transactions in the wholly owned group

Amounts loaned to (repaid by) Optiscan Pty Ltd - (7,757,373) 96,614

Amount owing at year end to parent entity (interest free, at call) by

- Optiscan Pty Ltd - 18,543,395 26,300,768
 - Optiscan Inc - - -

(b) Directors

The directors of the consolidated entity during the financial year were :

M H Barnett
 K P Daniel
 P M Delaney
 G F Latta
 A W Rogers

Information on the remuneration of directors is set out in Note 19.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 22: Employee Entitlements

	CONSOLIDATED		PARENT ENTITY	
	2004 Number	2003 Number	2004 Number	2003 Number
The number of full-time equivalents employed as at 30 June 2004 are:	29	32	-	-

Employee Share Option Plan

Optiscan Imaging Limited has an Employee Share Option Plan which was approved by shareholders in 1999. The exercise price of options issued under the plan is calculated as the weighted average share price over the fortnight immediately prior to the issue date, increased by a minimum of 10%. No options may be exercised within the first two years from date of issue. Thereafter options may be exercised in gradual portions over a further three year period. The directors have the right to vary certain terms and conditions as required.

Details of option issues

Details of the option issues under this plan are as follows:

	\$/No.	\$/No.
Total number issued to employees (including directors) during the year	1,819,900	1,790,250
Total number lapsed during the year	829,613	461,840
Total number issued to employees since commencement of the scheme	6,954,020	5,134,120
Total number that have become available for purchase since commencement of the scheme	2,343,831	1,132,821
Total number of employees eligible to participate in this scheme	36	38
Proceeds received and receivable from issues of options during the year	-	-

Details of options exercised

(i) Details of the options exercised during the year ended 30 June 2004 are as follows:

Options exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	Proceeds from shares issued	Shares issued	Issue Date	Fair Value of shares issued
Number				\$	\$	Number		\$
33,400	08.12.99	22.10.03	08.12.03	0.20	6,680	33,400	22.10.03	0.51
362,221	08.12.99	09.12.03	08.12.03	0.20	72,444	362,221	09.12.03	0.41

(ii) Details of the options exercised during the year ended 30 June 2003 are as follows:

Options exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	Proceeds from shares issued	Shares issued	Issue Date	Fair Value of shares issued
Number				\$	\$	Number		\$
3,340	08.12.99	22.10.03	08.12.03	0.20	668	3,340	28.05.03	0.35

Fair value of shares issued during the reporting period is estimated to be the market price of shares of Optiscan Imaging Limited on the ASX as at close of trading on their respective issue dates.

Details of options granted, lapsed and exercised during the reporting period, including date of grant, expiry date and exercise price are included in Note 12.

Note 23: Segment Information

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

Note 24: Impact of Adopting AASB Equivalents to IASB Standards

Optiscan Imaging Ltd has commenced transitioning its accounting policies and financial reporting from current Australian Standards to Australian equivalents of International Financial Reporting Standards (IFRS). The company has allocated internal resources and engaged expert consultants to perform diagnostics and conduct impact assessments to isolate key areas that will be impacted by the transition to IFRS. As a result of these procedures, Optiscan has graded impact areas as either high, medium or low. As Optiscan has a 30 June year end, priority has been given to considering the preparation of an opening balance sheet in accordance with AASB equivalents to IFRS as at 1 July 2004. This will form the basis of accounting for Australian equivalents of IFRS in the future, and is required when Optiscan prepares its first fully IFRS compliant financial reports for the year ended 30 June 2006. Set out below are the key areas where accounting policies will change and may have an impact on the financial report of Optiscan. At this stage the company has not been able to reliably quantify the impacts on the financial reports.

Classification of Financial Instruments

Under AASB 139 *Financial Instruments: Recognition and Measurement*, financial instruments will be required to be classified into one of five categories which will, in turn, determine the accounting treatment of the item. The classifications are loans and receivables - measured at amortised cost, held to maturity - measured at amortised cost, held for trading - measured at fair value with fair value changes charged to net profit or loss, available for sale - measured at fair value changes taken to equity and non-trading liabilities - measured at amortised cost. This will result in a change in the current accounting policy that does not classify financial instruments. Current measurement is at amortised cost, with certain derivative financial instruments not recognised on balance sheet. The future financial effect of this change in accounting policy is not yet known as the classification and measurement process has not yet been fully completed.

Optiscan Imaging Limited and Controlled Entities

Notes to the Financial Statements for the year ended 30 June 2004 (continued)

Note 24: Impact of Adopting AASB Equivalents to IASB Standards (continued)

Hedge Accounting

Under AASB 139 *Financial Instruments: Recognition and Measurement* in order to achieve a qualifying hedge, the entity is required to meet the following criteria:

- Identify the type of hedge - fair value or cash flow;
- Identify the hedged item or transaction;
- Identify the nature of the risk being hedged;
- Identify the hedging instrument;
- Demonstrate that the hedge has and will continue to be highly effective; and
- Document the hedging relationship, including the risk management objectives and strategy for undertaking the hedge and how effectiveness will be tested.

This may result in a change in the entity's current accounting policy which revalues hedge contracts to market values at balance date, with gains or losses being charged to the profit and loss account. Under the new policy, if a hedge is assessed to meet certain criteria, gains or losses may, in the case of an effective hedge, be charged to equity and not the profit and loss account. An estimation of the future financial effect of this change in accounting policy has not been measured, as it will depend on the type of hedges in existence, if any, at the balance date.

Goodwill

Under the Australian equivalent to IFRS 3 *Business Combinations* goodwill will no longer be able to be amortised but instead will be subject to annual impairment testing. This will result in a change in the current accounting policy which amortises goodwill over its useful life but not exceeding 10 years. Under the new policy, amortisation will no longer be able to be charged, but goodwill will be written down to the extent it is impaired. Reliable estimation of the future financial effects of this change in accounting policy is impracticable because the conditions under which impairment will be assessed are not yet known. The annual amortisation amount in the past has been \$674,661. If there is no further goodwill amortisation charge, there will be an increase in the reported profit or a decrease in the reported loss.

Impairment of Assets

Under the Australian equivalent to IAS 36 *Impairment of Assets* recoverable amount of an asset is determined as the higher of net selling price and value in use. This will result in a change in the current accounting policy which determines the recoverable amount of an asset on the basis of discounted cash flows. Under the new policy it is likely that impairment of assets will be recognised sooner and that the amount of write-downs will be greater. Reliable estimation of the future financial effects of this change in accounting policy is impracticable because the conditions under which impairment will be assessed are not yet known.

Share based payments

Under AASB 2 *Share based Payments*, the company will be required to determine the fair value of options issued to employees as remuneration and recognise an expense in the Statement of Financial Performance. This standard is not limited to options and also extends to other forms of equity based remuneration. It applies to all share-based payments issued after 7 November 2002 which have not vested as at 1 January 2005. Reliable estimation of the future financial effects of this change in accounting policy is impracticable as the details of future equity based remuneration plans are unknown. When implemented, this policy will result in higher expenses and lower reported profits or higher reported losses.

Income taxes

Under the Australian equivalents to IAS 12 *Income Taxes*, the company will be required to use a balance sheet liability method which focuses on the tax effects of transactions and other events that affect amounts recognised in either the Statement of Financial Position or a tax-based balance sheet. Previously, as disclosed in the Statement of Accounting Policy, the company has not adopted tax effect accounting, and has not brought to account deferred tax assets or liabilities. The new standard adopts a different threshold test for the recognition of deferred tax assets in respect of carry forward tax losses, whereby the utilisation of losses needs to be probable rather than virtually certain. In this regard, the new standard may result in a material change in the recognition of deferred tax assets if there is a change in accounting policy to recognise deferred tax balances.