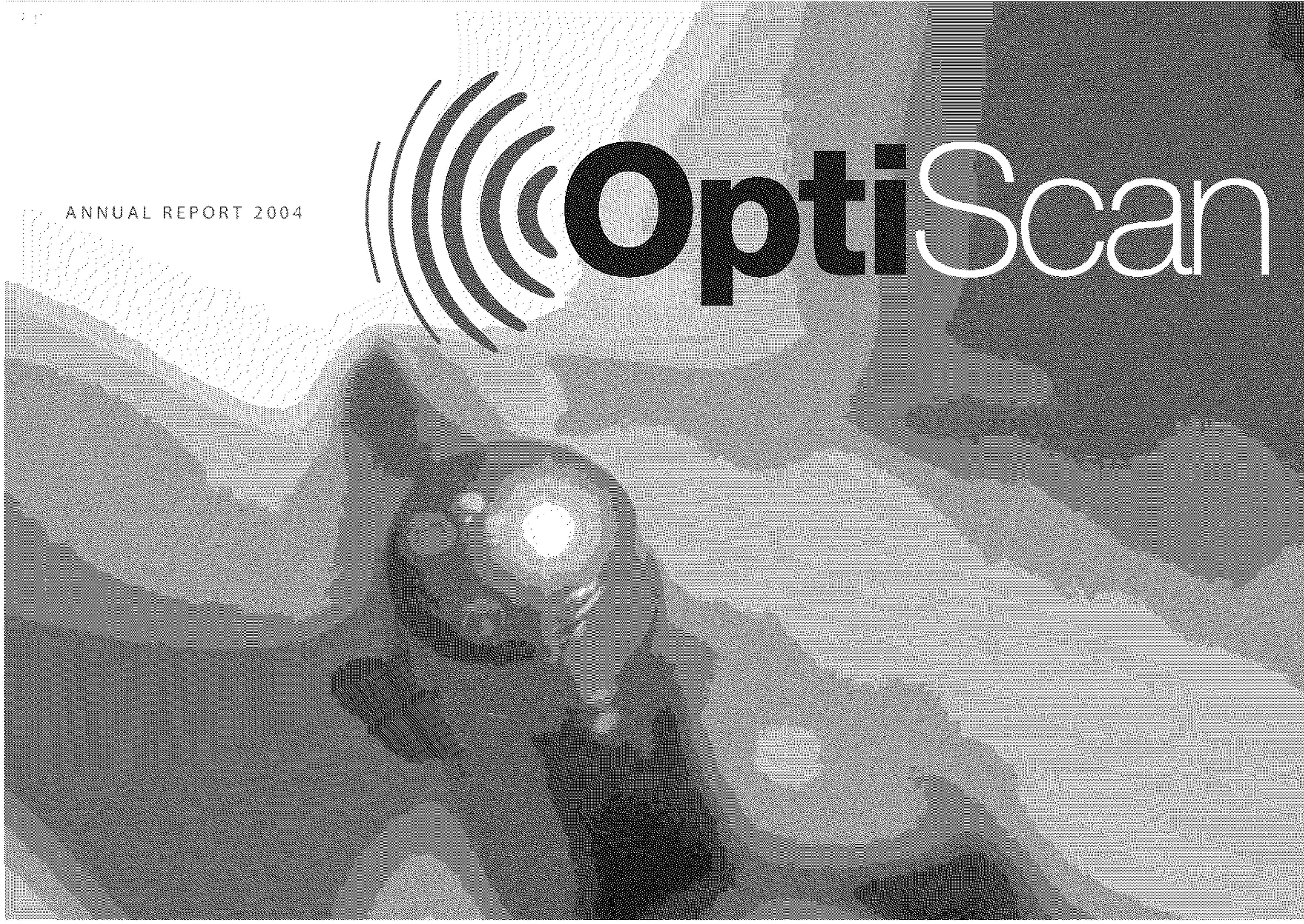
OptiScan

ANNUAL REPORT 2004



Key features

- Efficacy of technology confirmed through clinical trials
- Company poised to commence first shipments to Pentax
- Significant progress with transfer of technology to Pentax and subcontract manufacturers
- 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 percent following the business restructure in 2003
- Four of seven key milestones now achieved.

Commercialisation Continues

Commercialisation of Optiscan's unique technology was the predominant focus of our activities throughout the 2003/2004 year.

We achieved significant progress in all aspects of the business, including completion of two strategically important key milestones. The most notable outcome was in the critical area of demonstrating clinical efficacy of our technology. The other was receipt of initial orders from Pentax.

Significant activity and progress was made during the year on technology transfer to Pentax production and achieving a new licensing deal in rigid endoscopy or research. Our strategies and actions to bring these matters to conclusion are high priorities with management and the board.

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 results
- Extensive transfer of technology into production
- Quality accreditation achieved, and regulatory approval well advanced
- Arrangements for outsourced manufacture implemented.

Timelines

Early in the year, after the prototype version of the endo-microscope had been exhibited at the annual Digestive Diseases Week (DDW) Congress in May 2003, the primary task for Optiscan and Pentax R&D and engineering staff was to expedite the process of finalising and documenting designs and transferring to production. This was expected to be a significant task, challenging in terms of workload and timing, but carrying comparatively low technical risk, as most of this had dissipated during the prototype development phase.

The product testing process proved to be very thorough with Pentax requesting that it be expanded prior to transfer to manufacturing. This decision enhanced the level of confidence in product design and specification, but it extended the timeline for transfer to manufacture by several months.

For example, the product was subjected to temperature extremes, being cycled repeatedly through a temperature range from sub-zero lows to 60°C+ highs, well beyond those that would ever exist in the expected operating environment. Minor design changes affecting the way optical alignment is achieved during assembly were required to fully satisfy these tests.

> "The product testing process proved to be very thorough with Pentax requesting that it be expanded prior to transfer to manufacturing. This decision enhanced the level of confidence in product design and specification..."

Quality Accreditation for Production

Another essential area of pre-market activity completed during the year was quality accreditation. The business model in the Pentax collaboration involves Optiscan being an original equipment manufacturer (OEM) supplier to Pentax for the endo-microscope. This required Pentax to extend its quality accreditation procedures and Optiscan to achieve ISO accreditation in respect of its part in the supply chain.

We achieved medical quality accreditation certification ISO13485:2003 in May 2004, ensuring that our systems and procedures were world class.

To achieve the certification required for product sales in Europe, both Pentax and Optiscan's quality management systems needed to be audited by Pentax's German based quality auditors. For Optiscan, this medical device certification was additional to the external quality audit conducted by our independent auditor, and required further time to complete. The Medical Device Directive (MDD) comprises a series of provisions that manufacturers must comply with in order to obtain a CE Mark for sale of medical equipment in Europe. This required the submission of detailed design documentation that was also subjected to assessment by Pentax's German based quality auditors. The necessary certification was granted in June 2004.

By year end, all of the required quality certifications had been achieved, with the authorities granting the appropriate certifications for electrical safety and electrical emissions.

Regulatory Approvals

The pressure on timelines from both testing and quality perspectives was further compounded by the impact of regulatory approvals. The minor design changes brought about by the expanded testing regime meant that regulatory application could not be made until all modifications had been completed and designs for production finalised.

As a consequence, we have only recently been in a position to finalise the Food and Drug Administration requirements for regulatory approval for the USA market. Our expectation is to achieve FDA approval by November, allowing product release in USA.

For regulatory approval for Europe and other international markets, we have completed all requirements with the issue of the required CE Mark now being essentially a procedural issue. We expect the CE Mark regulatory approval to be received in October.

Sub-Contract Production

Arrangements for the sub contract manufacture of the product that Optiscan will supply to Pentax are now largely complete. This has been another significant project undertaken over the past year, involving the transfer of our technology to subcontract manufacturers. All design and technology transfer has been completed, production lines are established, staff training has been completed, inventory has been transferred, and the first shipments of completed product have now been supplied to Optiscan.

Final system integration and testing is conducted at our premises before shipment of the completed units to Pentax.

These arrangements reflect the decision reached in last year's strategy review to cease in-house manufacture in favour of sub contract manufacture.

Initial Order

As noted above, Optiscan, as supplier of the confocal scanner and control box, forms part of the supply chain for the Pentax endo-microscope. This means we will recognise sales to Pentax earlier than sales of endo-microscopes to end customers. During the year, Pentax placed an initial $1.4M order for 20 control boxes and 25 scanners.

The first shipments of product against this order are scheduled for October 2004.

Pentax Clinical Trials and Medical Education Program

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 application
- 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.

In planning this trial program, Optiscan and Pentax, in consultation with leading gastroenterologists, identified the following key areas of medical need where the flexible endo-microscope has high potential to improve outcomes and lead to substantial uptake of the technology:

- Colon cancer surveillance
- Monitoring of inflammatory bowel disease (IBD) including ulcerative colitis
- Surveillance for esophageal cancer in patients with Barrett's oesophagus
- Diagnosis and surgical management of gastric cancer
- Diagnosis and monitoring of gastritis and intestinal metaplasia
- Surveillance for signs of organ rejection in small bowel transplant patients.

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 percent and 97.4 percent
- Diagnostic specificities of 95.6 percent and 99.4 percent
- Overall accuracies of 99.3 percent and 99.2 percent

The results from these studies were accepted for oral presentation at DDW 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 and was the ideal high profile congress to release these extremely impressive trial results.

Subsequently, results were accepted for publication in 'Gastroenterology', the leading international peer-reviewed journal in the field of gastrointestinal medicine. Flexible endo-microscope images were featured on the cover and very positive editorial comment was also included, thus ensuring maximum exposure to the target market of Pentax's flexible endo-microscope.

Further results have either been submitted, or are being prepared, for submission to peer reviewed journals.

The trial program commenced in 2003 at the Cabrini hospital in Melbourne, and throughout the period has been expanded by Pentax. It now spans four continents through leading teaching hospitals:

- Cabrini Hospital, Melbourne, Australia
- University Hospital, Mainz, Germany
- C.H.U. Poitiers – La Miletrie, France
- University Hospital, Kyushu, Japan
- University Hospital, Jikei, Japan
- University Hospital, Nagoya, Japan
- University of Pittsburgh Medical Centre, Pittsburgh, USA
- Massachusetts General Hospital, Boston, USA.

Pentax plans to extend the program during the current year, with additional sites planned for Singapore, USA and Europe.

The initial trial outcomes are extremely encouraging and have exceeded the expectations of Optiscan and Pentax, prompting Pentax to accelerate confirmatory multi-centre studies, as well as initiating medical education and training activities.

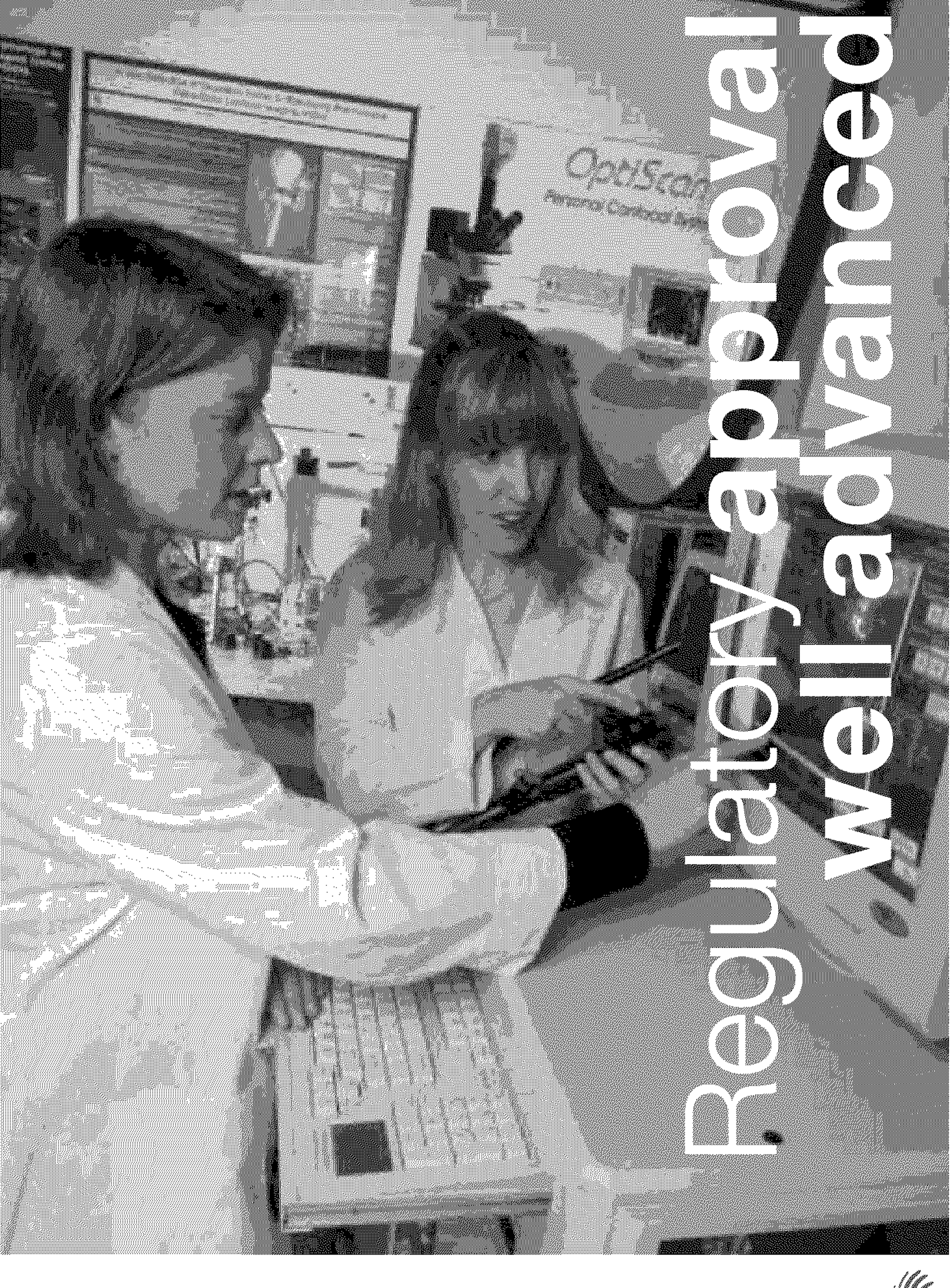
Demonstration Days

Pentax has run a series of live procedure demonstrations to groups of gastroenterologists. These involve live audio-visual broadcast from the procedure room to doctors in a nearby lecture theatre, with two way communication between the audience and the endoscopist. This approach has allowed the technique to be interactively showcased to either small groups (40-50) of opinion leading doctors, or to larger groups (300-400) of interested gastroenterologists.

Two demonstrations have been held in Germany for general endoscopists and one in Thailand at which Dr Ralf Kiesslich from University Hospital, Mainz, performed the procedures, introducing the technique to invited doctors from Thailand, Singapore, India, South Africa, Malaysia and USA.

These demonstrations have been an important part of Pentax's early engagement of the market for the new technology. They represent a key transition from evaluation of potential applications toward medical education and training of viable medical procedures, targeted at the broader endoscopy community.

Regulatory approval well advanced



"We achieved medical quality accreditation certification ISO13485:2003 in May 2004, ensuring that our systems and procedures were world class."

Business Development

The establishment of new partnerships in rigid endoscopy and the research market remains a key milestone.

During the year there have been extensive and on-going discussions and negotiations with a range of potential partners based in Europe and the USA.

The parties to these discussions are invariably attracted by the potential of our technology, but as a general rule have sought to reduce the risk level associated with early stage partnering by allowing us to further develop applications with Pentax. In this regard, the strong clinical trial results obtained with Pentax have the effect of reducing risk and hence increasing net value for potential rigid endoscopy partners.

We have attracted the interest of several potential partners by developing an overall understanding of rigid endoscopy applications, considering such factors as:

- Strength of medical need
- Size of market
- Care pathway to be used by the doctor using the instrument
- Procedure economics
- End user buyer behaviour
  - Location of equipment (hospital, day procedure centre or rooms)
  - Capitalisation of buying entity
- Competitor technologies or techniques.

This has involved us actively talking to leading doctors and conducting background research on the economics associated with potential applications.

Invariably the high potential opportunities identified by this research utilise at least one of the following key clinical benefits of endo-microscopes:

- Non-invasive
- Real time
- Lower cost than biopsy

This applications research, combined with the progress achieved in the Pentax project, and in particular the excellent results from the clinical trial program, is generating more engagement in our discussions with participants in the rigid endoscope market than ever before.

The discussions have enabled potential partners to better understand our technology and its applications, and they have also enabled us to define the key attributes we should be seeking in a partner, such as:

- Market position and presence
- A business model capable of leveraging our technology
- A strategy and track record of exploiting new technologies

Furthermore, the miniaturised scanner insert incorporated into the Pentax product is expected to require comparatively little additional technical development and re-engineering to be adapted to a range of rigid endoscope applications.

We are currently in the process of providing evaluation units to well-credentialed participants in the rigid endoscope market, and there are strong levels of interest being shown by a number of the industry's leading participants.

Our experience now allows us to better estimate the timeline required for a potential partner to conduct a thorough evaluation of our technology as well as the time required to negotiate and settle a licensing or collaboration agreement.

Our extensive efforts during the year have put us in a much better position to successfully conclude a partnership in this field.

Clinical trials expand with impressive results

Research

The market for research confocal microscopes is well established, and the main participants include companies to whom Optiscan has already licensed its benchtop (non-miniaturised) fibre confocal technology.

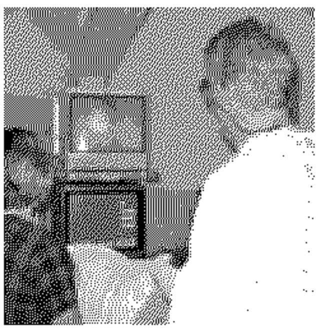
The research confocal market is significant. Systems typically cost several hundred thousand dollars each to buy, are funded through research grants and are only sold when their features enable scientists to do new research that attracts grant funding. Hence, there is a real opportunity to open up new prospects for sales growth by introducing Optiscan's miniaturised confocal technology to this market, and enabling scientists to conduct new types of research and experiments.

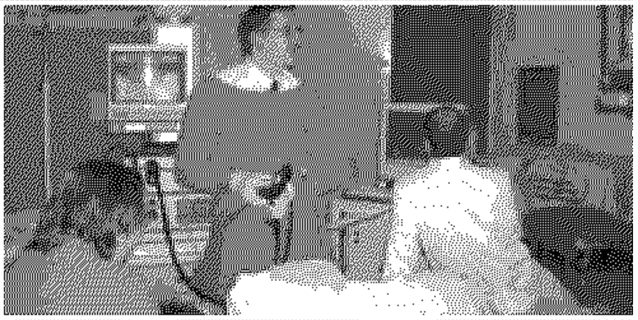
During the year, one of the leading industry players conducted an evaluation of our technology for this market. This confirmed the existence of a range of laboratory research applications where our technology enables researchers to do new and innovative research. However, after careful analysis and negotiation,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

During negotiations with this potential partner and others, it was indicated that there would be substantially increased interest if we were able to adapt our scanning technology to the new generation of research oriented multi-photon microscopy systems. While we believe this to be feasible, there is considerable technical risk to be navigated before we could commit to such product.

Our efforts to find the right partner for miniaturised research applications 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 for rigid endoscopy.





Milestone Status

The strategy review carried out in 2003 identified seven key milestones that the company must deliver to realise the full potential value of its technologies. The current status and achievements during the past year are shown in the adjacent table.

As the key deliverables on the Pentax project all near completion the final Pentax related milestone is expected to be achieved over the coming months.

Finalising a new licensing partnership on either or both rigid and research applications will then become the top priority for 2005.

We do believe however, that we should not be entering into two new partnerships at the same time. Hence with the current interest being received from rigid endoscope companies concluding such a partnership milestone will, for the moment, take priority over a research partnership.

Milestone	Activity to date	Status Now
Successful exhibition at Digestive Diseases Week	Achieved in 2003	
Receipt of final payment from Pentax	Achieved in 2003	
Completion of engineering for Pentax sales release	Extensive testing completed, quality certification achieved	Completion imminent
Pentax initial order received	Achieved	
Partnership for rigid endoscope	Extensive discussions, supported by progress with Pentax, especially clinical trial results	Continuing discussions and evaluations
Partnership for research instrument	Extensive evaluation completed; no licensing agreement	Continuing lower priority partner search
Publication of clinical trial results that have a major bearing on commercialisation	Achieved at DDW, and subsequent publications in "Gastroenterology"	

"All design and technology transfer has been completed, production lines are established, staff training has been completed, inventory has been transferred..."

Intellectual Property

The company continues to carefully manage and extend its intellectual property portfolio.

Over the past year there has been a great deal of activity in filing joint patents with Pentax for a number of new inventive features that have resulted from our flexible endo-microscope designs. This has increased the number of families of patents and patent applications from 17 to 38.

We were also able to conclude a further case of infringement of our base patents used in benchtop applications. The infringement was recognised some years ago, and it has taken considerable effort in the interim to finalise agreement on licensing. This resulted in an initial royalty of US$0.25 million, payable in two annual instalments, with unit sales royalties to follow thereafter.

Management of the IP portfolio during the year has also involved continuing legal appeals in both the Japanese and European patent offices. This is a long, slow and at times uncertain process.

Since the year end, we have been successful in Japan with the granting of our optical fibre confocal patent. This will enable us to extend existing research instrument (non-miniaturised) agreements to cover sales and production in Japan. The global sales and manufacturing breakdown for these products should result in our existing royalty revenue of almost A$1 million per year increasing by up to 40 percent.

The equivalent patent is still under appeal in the European Patent Office.

As the legal process continues, we will regularly review our position and form judgements on the cost of the proceedings and the potential upsides from successful outcomes.

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 percent.

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 percent 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 percent, 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 percent on last year, from $1.9 million to $2.1 million, mainly due to the new licensing of our optic fibre confocal patents as noted in the Intellectual Property section above.

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

Income tax expense was $0.046 million, representing the write off of withholding tax deductions made from royalty remittances to the company.

Outlook

The company is poised at an exciting position in its evolution.

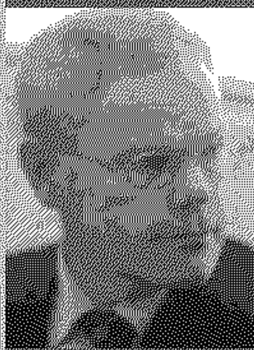
The current financial year will see the international release of the Pentax flexible endo-microscope product. The Pentax sales regions in USA, Europe, Japan, and South East Asia are already actively engaged in market development and the identification of likely early customers. However at this stage it is too early to provide a meaningful forecast of sales. Nevertheless, everyone associated with the product, at Pentax, in the clinical trials, and within Optiscan, have an increasing confidence in the prospects for this exciting new product.

If this predicted product success with Pentax can be matched with an outcome from our business development activities with rigid endoscopes, we will be well on the way to unlocking the true value inherent in our company.

Given the revised timing of the Pentax product release and subject to the structure of a second partnership, it is unlikely that the business will report a profit in the coming year, but it will set the scene for trading profits thereafter.

BOARD OF DIRECTORS AND MANAGEMENT

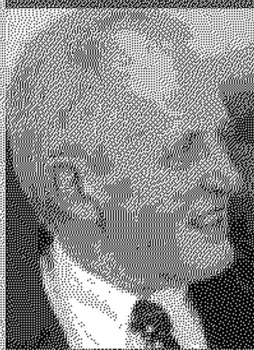
Grant Latta
Chairman



Matthew Barnett
Chief Executive Officer

Peter Delaney
Director of Technology

Tony Rogers
Non-Executive Director



Keith Daniel
Non-Executive Director

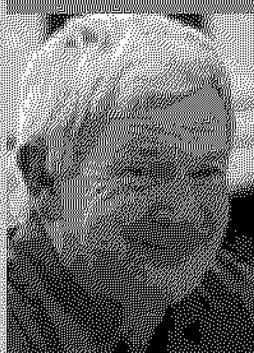
EXECUTIVE MANAGEMENT TEAM

Matthew Barnett
Chief Executive Officer

Bruce Andrew
CFO

John Allen
Licensing and IP

Peter Delaney
Director of Technology



Robert Law AM
R&D Manager

The Board of Directors of Optiscan Imaging Limited has pleasure in submitting its report for the financial year ended 30 June 2004.

Directors

The names of the directors in office during or since the end of the financial year are:

Mr Grant Latta, Chairman
Mr Matthew Barnett, Chief Executive Officer
Mr Keith Daniel, Non-executive Director
Mr Peter Delaney, Director of Technology
Mr Antony Rogers, Non-executive Director

Details of the qualifications and experience of the directors in office at the date of this report are as follows:

Grant F. Latta AM
CPA, FAICD, B Bus, MBA, FAIM, AAMI

Grant Latta is Executive Chairman of GCMCorp Pty Ltd, Deputy Chairman of Vision Systems Limited, Director of Ricegrowers' Co-operative Limited, Chairman of Kailis and France Foods Pty Ltd, Chairman of Australian Convenience Foods Pty Ltd and Director of Venture Capital Partners Trustee Board. In 1998 Mr Latta was appointed to the Federal Court as a Member of the Australian Competition Tribunal.

From 1985 -1991 Mr Latta was employed by Pacific Dunlop Limited as Managing Director of their Industrial Foam & Fibre Group and from 1991 – 1995 as Managing Director of their Food Operations. He was Chief Executive of the Camerlin Consortium from 1995 – 1998, Deputy Chairman of the Export Finance & Insurance Corporation (EFIC) 1995 – 2002, Director of Austrade 1994 – 2000, Past President of the Australian Chamber of Manufactures 1994 – 1996, Chairman of the Grains Research and Development Corporation (GRDC) from 1999 – 2002, Deputy Chairman of the National Dryland Salinity Program from 1999 – 2002, and Deputy Chairman of Food Science Australia 1996 – 2004.

Mr Latta was appointed a non-executive Director and Chairman of Optiscan in August 2002.

Matthew H. Barnett
MBA, B Eng (Hons), GAICD

Matthew Barnett joined Optiscan as Chief Executive Officer in December 2002 and was appointed to the Board of Directors in the same month.

Matthew has a technical engineering background and substantial general management experience gained from several business leadership roles with Amcor Limited and the Boston Consulting Group. Matthew's general management experience includes the development and implementation of commercialisation strategies for several business units within Amcor. Matthew's engineering experience includes high technology design applications work gained with bearing manufacturer Timken Pty Ltd.

Matthew has an Honours Engineering degree from the University of Melbourne, with prizes for mechanical engineering design and creative design, and an MBA from the Australian Graduate School of Management at the University of NSW, with prizes for corporate strategy, corporate policy and overall aggregate performance

Keith P. Daniel
FTSE, FIEAust, CPEng

Keith Daniel is a non-executive director with extensive experience in the commercialisation of medical instruments. He has spent the last 35 years in the medical device industry largely taking innovative Australian technology to world markets. During most of that time he has held senior general management and technology management roles in various global subsidiaries of Nucleus Ltd. including the role of CEO and Chairman of Nucleus before his retirement in 1999. Nucleus has been the nurturer of many of Australia's leading health care companies including Cochlear Limited, the world's leading manufacturer of implantable prosthetic devices for the hearing impaired, the Telectronics group, developing and marketing implantable cardiac pacemakers and defibrillators, and AMBRI Pty Ltd, the developer of a breakthrough technology in the field of membrane biosensors.

Mr Daniel is a founder and director of Milvella Pty Ltd, a start up company that since 1999 has developed and is marketing devices worldwide for use in the field of cataract and refractive surgery.

Peter M. Delaney
BSc(Pharm) (Hons.)

Peter Delaney, Director of Technology, completed a science degree with honours in Pharmacology at Monash University in 1989. He has played a major role in the refinement of the fibre optic approach to produce a commercial instrument which received an R&D 100 Award in 1991. In 1993, Mr Delaney received the Victorian Young Achiever Award (Science and Technology) for his development of the company strategy and infrastructure. Mr Delaney was appointed a director of Optiscan Pty Ltd in March 1994, and was Managing Director until December 2002, at which time he assumed the role of Director of Technology.

Antony (Tony) Rogers
CPA, MAICD

Tony Rogers is Deputy Chairman of Monash Institute of Reproduction & Development, and a director of Copy Rat Pty Ltd, and Ingenko Pty Ltd (Monash start up companies). He is also a director of Australian Securities Limited, Leigh Mardon Pty Ltd and Monash Commercial Pty. Ltd.

From 1963 to 1993, Mr Rogers was employed by I.C.I. Australia Limited holding a variety of management roles. In 1987, he was appointed General Manager, Industrial Chemicals Group; in 1989 he became General Manager of Plastics Group, and in 1991, General Manager, Chemicals & Plastics Group. During this period he also served as a director of I.C.I. Finance, Vinidex/Tubemakers, I.A.C.C. Thailand and was National President of the Plastics Institute of Australia for 4 years. He also served on the Federal Government's Waterfront Commission.

From 1993 to 1997, Mr Rogers was CEO of Smorgon ARC and served on the Smorgon Steel board and Smorgon Group Operations Executive.

Mr Rogers was appointed a non-executive director of Optiscan in August 2002.

All directors held their position as director throughout the entire financial year and up to the date of this report.

Company Secretary, B R Andrew
B Bus CPA

Bruce Andrew has been Company Secretary since Optiscan listed on the ASX in 1997. He is an accountant with extensive experience in accounting and reporting for both public and private companies.

Directors' Interests

Relevant interests of the directors in the shares, options or other instruments of the company and related bodies corporate are:

Holder	Ordinary Shares	Employee Options
Grant Latta	-	500,000
Matthew Barnett	50,000	1,000,000
Keith Daniel	10,000	200,000
Peter Delaney	3,206,259	-
Antony Rogers	-	200,000

Other interests of Directors

Peter Delaney
Related parties to Peter Delaney hold a combined total of 253,000 ordinary shares.

Directors' Meetings

The company held fourteen (14) Directors' meetings during the year. The attendances of the directors at meetings of the Board were:

Director	Attended	Maximum possible attended
Grant Latta	14	14
Matthew Barnett	14	14
Keith Daniel	14	14
Peter Delaney	14	14
Antony Rogers	14	14

As at the date of this report, the company had an Audit Committee, a Nomination Committee and a Remuneration Committee of Directors. The members of the Audit Committee during the year were and Tony Rogers (Chairman), Grant Latta and Keith Daniel. The members of the Remuneration Committee during the year were Grant Latta (Chairman), Keith Daniel and Tony Rogers. The attendances of the directors at meetings of the Board Committees were:

	Grant Latta	Keith Daniel	Tony Rogers
Audit Committee Meetings Held	5	5	5
Audit Committee Meetings Attended	5	5	5
Remuneration Committee Meetings Held	2	2	2
Remuneration Committee Meetings Attended	2	2	2
Nomination Committee Meetings Held	1	1	1
Nomination Committee Meetings Attended	1	1	1

Principal Activities

The principal activity of the consolidated entity during the year was the development and commercialisation of confocal microscopes. There was no change in the nature of this activity during the year.

Corporate Structure

Optiscan Imaging Limited is a company limited by shares that is incorporated and domiciled in Australia.

Trading Results

The consolidated loss of the consolidated entity for the financial year was $3,362,577 after income tax. This represents a 2 percent decrease on the 2003 consolidated loss of $3,426,015.

Review of Operations

Operational factors contributing to the result are described in the Review of Operations section of this report.

Dividends

No dividends have been paid or declared since the beginning of the financial year by the Company.

Significant Changes in the State of Affairs

There have been no significant changes to the state of affairs of the consolidated entity during the year.

Significant Events After Balance Date

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

Likely Developments and Future Results

The Directors have excluded from this report any information on likely developments in the operations of the consolidated entity and the expected results of those operations in future financial years, since, in the opinion of the directors, it may prejudice the interests of the company if this information were included.

Environmental Regulations

The Company is not subject to significant environmental regulations.

Share Options

Details of movements in share options are set out in Note 12 in the financial statements.

Since the end of the financial year, and up to the date of this report, no new shares have been issued as a consequence of the exercise of options which were on issue at year end. No new options have been issued, and the total number of options outstanding at the date of this report is 4,467,170.

Directors' and Officers' Remuneration

Remuneration of directors and senior executives of the company is established by the Remuneration Committee. 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. Details of the issue of options under this plan are set out in Note 12 and Note 22.

The Nomination Committee of the Board meets annually to review the performance of the board. 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 Managing Director, 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.

Details of remuneration provided to directors and officers of the company during the year are shown below.

	Base Salary	Super-annuation	Value of Options	No of Options Issued this year	Options % of Total Remuneration
Directors	$	$	$	Number	%
Grant Latta	80,000	-	22,525	-	22.0%
Matthew Barnett	263,386	23,705	29,465	1,000,000	9.3%
Keith Daniel	40,000	3,600	2,340	-	5.1%
Peter Delaney	150,000	13,500	-	-	-
Tony Rogers	40,000	3,600	14,352	-	24.8%
Officers					
Bruce Andrew	150,000	13,500	7,885	41,250	4.6%
John Allen	135,000	12,150	9,193	55,000	5.9%
Robert Law	135,000	12,150	3,591	41,250	2.4%

Options granted as part of remuneration have been valued using the Black Scholes option pricing formula which values options taking into account such variables as exercise price, time to expiry, share price at date of grant, and share price volatility. Under this valuation model, options with an exercise price which is well above current share prices will have little value. In assessing the value of options included in the table above, the company assumed a volatility factor of 22 percent, and a long term rate of return of 6.0 percent. Other details of options are disclosed in Note 12 of the financial statements, and details of remuneration are set out in Note 19 of the financial statements.

Indemnification and Insurance

During the financial year ended 30 June 2004, the company indemnified its directors, the company secretary and executive officers in respect of any acts or omissions giving rise to a liability to another person (other than the company or a related party) unless the liability arose out of conduct involving a lack of good faith. In addition, the company indemnified the directors, the company secretary and executive officers against any liability incurred by them in their capacity as directors, company secretary or executive officers in successfully defending civil or criminal proceedings in relation to the company. No monetary restriction was placed on this indemnity.

The Company has insured its directors, the company secretary and executive officers for the financial year ended 30 June 2004. Under the company's Directors' and Officers' Liabilities Insurance Policy, the Company shall not release to any third party or otherwise publish details of the nature of the liabilities insured by the policy or the amount of the premium. Accordingly, the company relies on section 300(9) of the Corporations Act 2001 to exempt it from the requirement to disclose the nature of the liability insured against and the premium amount of the relevant policy.

This report has been made in accordance with a resolution of directors.

GRANT LATTA
Chairman

MATTHEW BARNETT
Director

Melbourne
21 September, 2004

CORPORATE GOVERNANCE

The Board of Directors of Optiscan Imaging Limited is responsible for the corporate governance of the consolidated entity. The Board guides and monitors the business and affairs of Optiscan Imaging Limited on behalf of the shareholders by whom they are elected and to whom they are accountable.

The format of the Corporate Governance Statement has changed in comparison to the previous year due to the introduction of the Australian Stock Exchange Corporate Governance Council's "Principles of Good Corporate Governance and Best Practice Recommendations". In accordance with the Council's recommendations, the Corporate Governance Statement must now contain certain specific information and must disclose the extent to which the company has followed the guidelines during the period. Where a recommendation has not been followed, that fact must be disclosed, together with the reasons for the departure.

Optiscan Imaging Limited's Corporate Governance Statement is now structured with reference to the Corporate Governance Council's principles and recommendations, which are as follows:

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

For further information and full details on corporate governance policies adopted by Optiscan Imaging Limited, please refer to our website at www.optiscan.com

Optiscan Imaging Limited's corporate governance practices were in place throughout the year ended 30 June 2004 and were subject to ongoing refinement and modification. They were fully compliant with the Council's best practice recommendations, other than in respect of the structure of non executive directors' remuneration. Best practice guideline 9.3 requires that the structure of non-executive directors' remuneration should be clearly distinguished from that of executives. In particular, the guidelines state that non-executive directors should not receive options as part of their remuneration. Optiscan is a small entity with simple and transparent remuneration policies, comprising essentially base salary and an Employee Share Option Plan. The option plan has been the only mechanism within the remuneration policy for the provision of incentives, either short or long term, to staff. In 2001 and 2002, prior to the promulgation of the ASX code of best practice, the company appointed new non-executive directors, with remuneration comprised of both salary and options, in accordance with remuneration policy. There is no intention at this time to make further issues of options to existing or new non-executive directors.

Structure of the Board

Details of the current directors and their term in office are:

Director	Status	Term in office
Grant F Latta (Chairman)	Independent, Non-executive	2 years
Matthew H Barnett	Executive,Managing Director	2 years
Keith P Daniel	Independent, Non-executive	3 years
Peter M Delaney	Executive	7 years
Tony W Rogers	Independent, Non-executive	2 years

The skills, experience and expertise of each director is included in the Directors' Report.

Directors of Optiscan Imaging Limited are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their independent judgement. In the context of director independence, "materiality" is considered from both the company and individual director perspective. In accordance with the definition of independence, and the materiality thresholds set, all non executive directors of Optiscan Imaging Limited are considered to be independent.

Members of the board or any committee are entitled to obtain such independent advice as is deemed necessary at the expense of the company, subject to the prior consent of the Chairman.

Nomination Committee

The board has established a Nomination Committee, the members of which are Grant Latta (Chairman), Keith Daniel and Tony Rogers, all non-executive directors. It is responsible for policy, appointment criteria and recommendations for appointment to the board. It is also responsible for performance appraisal of the board.

Performance

During the year ended 30 June 2004, and up to the date of this report, one meeting of the Nomination Committee was convened for the purpose of evaluating the performance of the board. The review was conducted by the Chairman and involved an exchange of views with all members of the board, including executive directors.

Audit Committee

The Board has established an audit committee, which operates under a charter approved by the Board. It is the Board's responsibility to ensure that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators. The Board has delegated the responsibility for the establishment and maintenance of a framework of internal control and ethical standards for the management of the consolidated entity to the audit committee.

The committee also provides the board with additional assurance regarding the reliability of financial information for inclusion in the financial reports. The members of the audit committee during the year were Tony Rogers (Chairman), Keith Daniel and Grant Latta. Details of the experience and qualifications of the members of the audit committee are set in the Directors' report, as are details on the number of meetings of the audit committee held during the year and the attendees at those meetings.

Remuneration

The Board is responsible for determining and reviewing compensation arrangements for the directors themselves and the chief executive officer and the executive team. The Board has established a remuneration committee, comprising three non-executive directors. Members of the remuneration committee are Grant Latta (Chairman), Keith Daniel and Tony Rogers. Details of meetings of the remuneration committee held during the year and the attendees at those meetings are set out in the Directors' Report.

The objective of the company's remuneration policy is to provide maximum stakeholder benefit from the retention of a high quality board and executive team. This is achieved by remunerating directors and key executives fairly and appropriately with reference to relevant employment market conditions. The Remuneration Committee links the nature and amount of executive directors' and officers' emoluments to the company's financial and operational performance. This is intended to achieve the retention and motivation of management and key staff. Similarly, in relation to the payment of bonuses and the issue of options, discretion is exercised by the board, having regard to the overall performance of the company and the performance of the individual during the period.

There is no scheme to provide retirement benefits, other than statutory superannuation, to non-executive directors.

Full details of the remuneration of specified executives, and all directors is included in the Directors' Report.

STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2004

	Note	Consolidated		Parent Entity	
		2004	2003	2004	2003
		$	$	$	$
Sales revenue	2	25,015	104,195	-	-
Cost of sales		(7,492)	(55,448)	-	-
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	(251,158)	(1,093,758)	-	-
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	(45,766)	(545,469)	-	-
Loss from ordinary activities after related income tax expense		(3,362,577)	(3,426,015)	(3,362,577)	(3,414,365)
Net Loss		(3,362,577)	(3,426,015)	(3,362,577)	(3,414,365)
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		(3,362,577)	(3,414,365)	(3,362,577)	(3,414,365)
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.

STATEMENT OF FINANCIAL POSITION

at 30 June 2004

	Note	Consolidated		Parent Entity	
		2004	2003	2004	2003
		$	$	$	$
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		11,239,163	16,016,996	7,890,587	71,092
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		2,476,298	3,300,638	5,009,329	16,122,723
Total Assets		13,715,461	19,317,634	12,899,916	16,193,815
Current Liabilities					
Payables	10	377,752	2,692,958	-	10,446
Provisions	11	252,331	285,186	-	-
Total Current Liabilities		630,083	2,978,144	-	10,446
Non-Current Liabilities					
Provisions	11	185,462	156,121	-	-
Total Non-Current Liabilities		185,462	156,121	-	-
Total Liabilities		815,545	3,134,265	-	10,446
Net Assets		12,899,916	16,183,369	12,899,916	16,183,369
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		12,899,916	16,183,369	12,899,916	16,183,369

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

STATEMENT OF CASH FLOWS

for the year ended 30 June 2004

	Note	Consolidated		Parent Entity	
		2004	2003	2004	2003
		$	$	$	$
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	Note (b))	(5,129,978)	(331,947)	(48,659)	(192,556)
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		(365,804)	(214,915)	7,757,373	(96,614)
Cash flows from financing activities					
Proceeds from issue of ordinary shares		79,124	668	79,124	668
Net cash flows from financing activities		79,124	668	79,124	668
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	(Note (a))	9,705,699	15,120,571	7,858,922	71,084

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

NOTES TO THE STATEMENT OF CASH FLOWS

for the year ended 30 June 2004

		Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
(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)	9,267,699	4,620,405	7,659,812	-
	Closing cash balance	9,705,699	15,120,571	7,858,922	71,084
	(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	(5,129,978)	(331,947)	(48,659)	(192,556)
(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	1,300,000	1,300,000	-	-
	Total facilities	1,550,000	1,600,000	-	-
	Amount drawn at balance date	(49,114)	(53,111)	-	-
	Unused facilities at balance date	1,500,886	1,546,889	-	-

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

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.

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.

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

1 Statement of Significant Accounting Policies (continued)

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.

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $

2 Revenue and Expenses

Loss from ordinary activities is after crediting the following revenues:

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
Sales revenues:				
Product sales	-	87,883	-	-
Service income	25,015	16,312	-	-
Total sales revenues	25,015	104,195	-	-
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	4,424,325	7,925,408	186,134	9,599
Total revenues from ordinary activities	4,449,340	8,029,603	186,134	9,599

Expenses

(a) Loss from ordinary activities is after charging the following expenses:

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	504,140	663,769	-	-
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	674,664	849,572	-	-
Total depreciation and amortisation expenses	1,178,804	1,513,341	-	-

	Consolidated		Parent Entity	
	2004	2003	2004	2003
	$	$	$	$
2 Revenue and Expenses (continued)				
Expenses				
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	674,664	674,664	3,356,021	3,211,361
(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	251,158	1,093,759	-	-
(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	(11,340)	(24,069)	-	-
(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

	Consolidated		Parent Entity	
	2004	2003	2004	2003
	$	$	$	$

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.

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	415,009	533,673	31,665	8
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	-	-	-	9,515,552

(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.

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	803,326	343,557	-	-
6 Other Current Assets				
Prepayments – General	315,129	19,195	-	-
Total other current assets	315,129	19,195	-	-
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)	-	-	5,009,329	6,607,171

(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.

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	1,122,687	1,667,703	-	-
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	(627,856)	(1,023,196)	-	-
Net book value	494,831	644,507	-	-

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

9 Intangible Assets (non-current)

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

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	377,752	2,692,958	-	10,446

There is no interest rate exposure on these liabilities.

11 Provisions

Employee Benefits

Current	252,331	285,186	-	-
Non-current	185,462	156,121	-	-
Total employee benefits	437,793	441,307	-	-

	Consolidated		Parent Entity	
	2004	2003	2004	2003
	$	$	$	$
12 Contributed Equity				
Ordinary Shares	32,824,959	32,745,835	32,824,959	32,745,835
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	32,824,959	32,745,835	32,824,959	32,745,835
	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	80,220,723	79,825,102	80,220,723	79,825,102
Options Over Unissued Shares				
Employee Options outstanding at year end :	4,467,170	3,872,504	4,467,170	3,872,504
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	4,467,170	3,872,504	4,467,170	3,872,504

(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.

12 Contributed Equity (continued)

Details of Options — **Movement this year**

Option Class / Type	Issue Date	Price	Expiry Date	Opening Balance	New Issues (Lapses)	Exercised	Closing Balance
Employee Options (Unlisted)		$		Number	Number	Number	Number
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)

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	(3,362,577)	(3,426,015)	(3,362,577)	(3,414,365)
Accumulated losses at end of year	(19,925,043)	(16,562,466)	(19,925,043)	(16,562,466)

14 Earnings Per Share

	2004	2003
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:

	2004	2003
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	79,972,991	79,821,890

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

15 Controlled Entities

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

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

The ultimate holding company is Optiscan Imaging Limited.

	Consolidated		Parent Entity	
	2004	2003	2004	2003
	$	$	$	$

16 Expenditure Commitments

Leases

Operating leases (non-cancellable)				
Minimum lease payments				
- Not later than one year	51,855	243,727	-	-
- Later than one year and not later than five years	-	54,101	-	-
	51,855	297,828	-	-
Surplus lease space provided for	25,526	109,629	-	-
Aggregate lease expenditure contracted for at balance date not provided in accounts	26,329	188,199	-	-

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	-	-
Commitments to provide research funding:				
- Not later than one year	48,157	57,953	-	-
	48,157	2,199,373	-	-

17 Contingent Liabilities

Bank guarantees - property lease rental bond	45,500	45,500	-	-
	45,500	45,500	-	-

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.

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 turns 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.

19 Director and Executive Disclosures (continued)

(ii) Remuneration of Specified Directors and Specified Executives

		Primary	Post Employment		Equity	Total
		Salary & Fees	Cash Bonus	Super-annuation	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.

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.

			Terms & Conditions for Each Grant			
	Number Granted	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	0.106	0.48	4 December 2004	15 January 2008
M H Barnett	333,333	9 December 2003	0.072	0.58	4 December 2005	15 January 2008
M H Barnett	333,334	9 December 2003	0.045	0.70	4 December 2006	15 January 2008
B R Andrew	41,250	9 December 2003	0.118	0.45	9 December 2005	9 December 2008
J D Allen	55,000	9 December 2003	0.118	0.45	9 December 2005	9 December 2008
R Law AM	41,250	9 December 2003	0.118	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	Not exercisable	Exercisable
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

19 Director and Executive Disclosures (continued)

(f) Shareholdings of Specified Directors and Specified Executives

Shares held in Optiscan Imaging Ltd (number)	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.

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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	25,300	29,715	2,000	2,000
- taxation services in relation to the entity and any other entity in the consolidated entity	31,663	10,700	-	-
	56,963	40,415	2,000	2,000

21 Related Party Disclosures

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

(a) Transactions in the wholly owned group

	Consolidated 2004 $	Consolidated 2003 $	Parent Entity 2004 $	Parent Entity 2003 $
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 G F Latta
K P Daniel A W Rogers
P M Delaney

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

	Consolidated		Parent Entity	
	2004 Number	2003 Number	2004 Number	2003 Number

22 Employee Entitlements

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:

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.

23 Segment Information

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

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.

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.

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

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 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 liabilties. The new standard adopts a different threshhold 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.

DIRECTORS' DECLARATION

for the year ended 30 June 2004

In accordance with a resolution of directors, we state that:

In the opinion of the directors:

(a) the financial statements and notes of the company and of the consolidated entity are in accordance with the Corporations Act 2001 including:

   (i) giving a true and fair view of the company's and the consolidated entity's financial position as at 30 June 2004 and of their performance for the year ended on that date; and

   (ii) complying with accounting standards and Corporations Regulations 2001, and;

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

For and on behalf of the board

GRANT LATTA
Chairman

MATTHEW BARNETT
Director

Melbourne
21 September, 2004

ERNST & YOUNG
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Melbourne VIC 3000
Australia
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Melbourne VIC 3001
Tel 61 3 9288 8000
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DX 293 Melbourne

Independent audit report to members of Optiscan Imaging Limited

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, 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 2004. The consolidated entity comprises both the company and the entities it controlled during that year.

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.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion on it 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. 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.

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
- 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. 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.

ERNST & YOUNG

Independence

We are independent of the company, and have met the independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*. In addition to our audit of the financial report, 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, 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 2004 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.

Ernst & Young

Ernst & Young

Denis Thorn

Denis Thorn

Partner

Melbourne

21 September 2004

SHAREHOLDER INFORMATION

Substantial Shareholders as at 31 August 2004

The following information is extracted from the Company's Register of Substantial Shareholders

Name	Number of ordinary shares
Fibre Optics (Aust) Pty Ltd	6,370,001
J P Morgan Chase & Co and its Affiliates	6,070,596
Ixohoxi Pty Ltd	5,746,248

Distribution of Shareholdings as at 31 August 2004

Size of holding	Ordinary Shareholders
1 to 1,000	1,190
1,001 to 5,000	2,197
5,001 to 10,000	750
10,001 to 100,000	901
100,001 and over	70
Total shareholders	5,108
Number of ordinary shareholders with less than a marketable parcel	1,615

Voting Rights

Articles 42 to 51 (incl.) of the Company's Constitution stipulate the voting rights of members. In summary, but without prejudice to the provisions of the Constitution, every member present in person or by representative, proxy or attorney shall have one vote on a show of hands, and on a poll have one vote for each share held.

Twenty Largest Shareholders as at 31 August 2004

Name	Ordinary Number	Shares %
Fibre Optics (Aust) Pty Ltd	6,370,001	7.94
Ixohoxi Pty Ltd	5,746,248	7.16
Asahi Optical Company Limited	3,330,000	4.15
Mr Peter Maxwell Delaney	3,206,259	4.00
S W R Harris Holdings Pty Ltd	2,036,095	2.54
Westpac Custodian Nominees Limited	1,663,250	2.07
ANZ Nominees Limited	1,616,400	2.01
HSBC Custody Nominees (Australia) Limited	1,327,039	1.65
J P Morgan Nominees Australia Limited	1,319,000	1.64
Microcaps Limited	1,000,000	1.25
Bow Lane Nominees Pty Ltd	800,003	1.00
Citicorp Nominees Pty Limited	759,000	0.95
Cullyamurra Pty Ltd	712,482	0.89
Sash Pty Ltd <Knezevic Super Fund A/C>	550,000	0.69
Eryri Pty Ltd	540,000	0.67
Mr Roger Harold Wallis	525,000	0.65
S W R Harris Pty Ltd <Superannuation Fund A/C>	509,071	0.63
Mr Brian Catley & Mrs Julia Catley <B N Catley Super Fund A/C>	503,000	0.63
Mr David Ian Mitchell	450,863	0.56
Peters Investments Pty Ltd	300,000	0.37
Total	**33,263,711**	**41.45**

CORPORATE DIRECTORY

Directors

Grant F Latta (Chairman)
Matthew H Barnett (CEO)
Peter M Delaney (Director of Technology)
Keith P Daniel
Antony W Rogers

Secretary

Bruce R Andrew

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F: +61 3 9562 7742
www.optiscan.com

Solicitors

Lander & Rogers
Minter Ellison

Auditors

Ernst & Young

Share Registry

Computershare Investor Services Pty Ltd
Yarra Falls 452 Johnston Street
Abbotsford Victoria 3067 Australia
T: +61 3 9415 5000

Stock Exchange Listing

Optiscan Imaging Limited shares are quoted
on the Australian Stock Exhange (OIL)

ABN 81 077 771 987