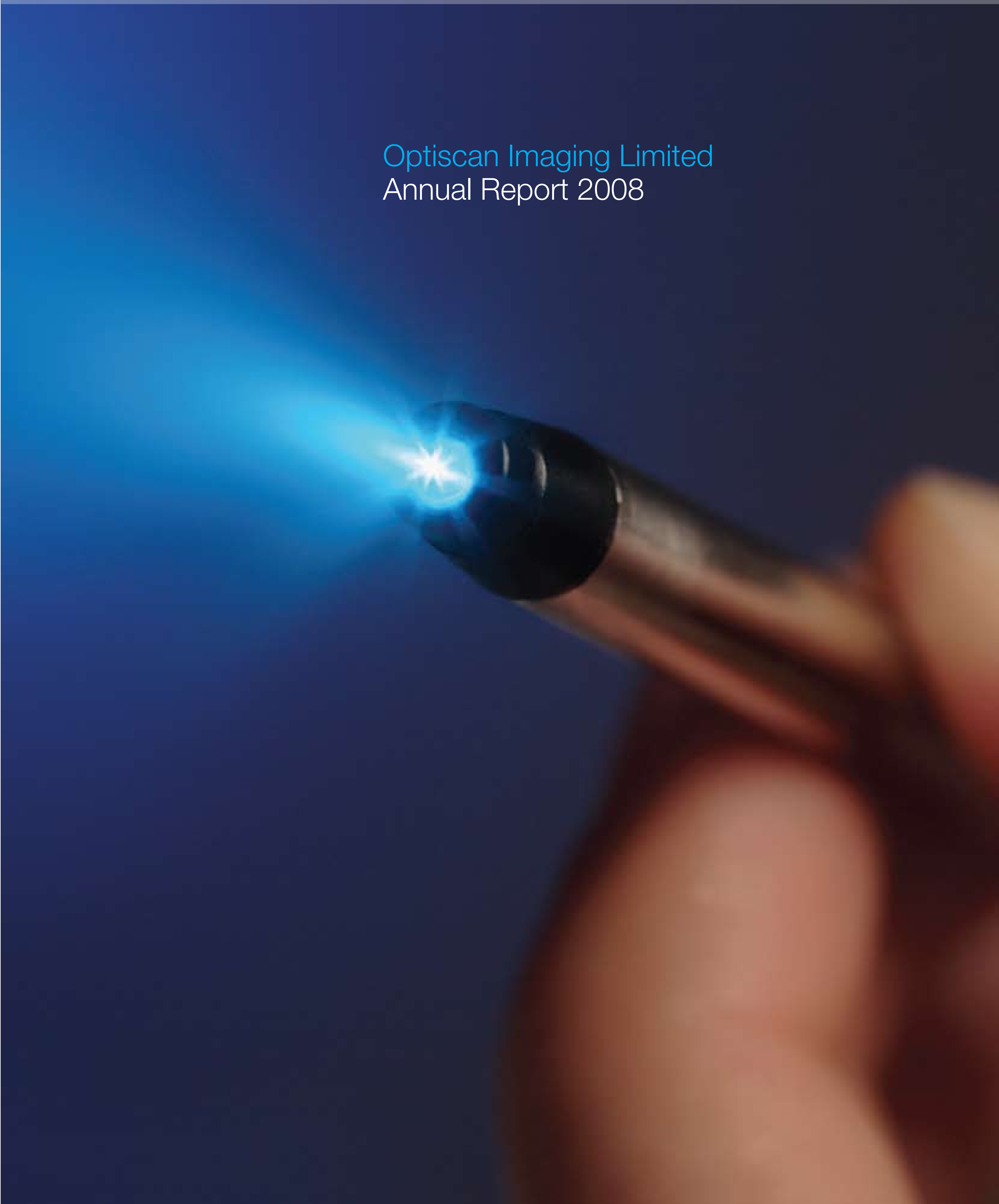
Optiscan Imaging Limited
Annual Report 2008



Optiscan Imaging Limited
Annual Report 2008

Contents

Corporate Information

Optiscan Imaging Limited
ABN 81 077 771 987

This annual report covers both Optiscan Imaging Limited as an individual entity and the consolidated entity comprising Optiscan Imaging Limited and its subsidiaries. The Group's functional and presentation currency is Australian Dollars AUD ($).

A description of the Group's operations and of its principal activities is included in the review of operations and activities in the directors' report on pages 9 to 28. The directors' report is not part of the financial report.

Directors

G. F. Latta (Chairman)
K.P. Daniel
P. M. Delaney
J. C. Fox
A. W. Rogers
V. L. Tutungi

Company Secretary
B.R. Andrew

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Australia

Principal place of business
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Share Register

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452 Johnston Street
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Solicitors
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Melbourne VIC 3000

Auditors
Ernst & Young
Australia

Bankers
ANZ Banking Group
National Australia Bank

Highlights

Optiscan has made significant progress in all core activities during 2007/2008.

The first deal in rigid endoscopy was concluded; sales of our first own brand instrument increased as marketing activity was stepped up; clinical trials continued to identify new opportunities; exciting new applications in women's health were identified and assessed; second generation platform development reached prototype stage, **and perhaps most importantly of all, our confocal technology was widely embraced and applauded by a growing legion of physicians around the globe.**

The major achievements for 2007/2008 include:

- Outstanding clinical results in the US
- Successful animal trials with Carl Zeiss
- Development of the Generation 2 smaller scanner to prototype stage
- Establishment of the global sales and distribution channels for the Optiscan FIVE 1
- Identification, quantification and analysis of the significant market opportunity in women's health.

Our Technology

Optiscan is a global leader in the development and application of fibre optics based microscopic imaging technologies.

The Company's technology platform is a unique and patented miniaturised confocal microscope that enables real-time imaging of internal body tissues. The technology is being successfully applied in several high need medical specialties and research applications with the opportunity for many more to be added within the medical domain but also in other markets. Currently, Optiscan's primary focus is in medical diagnostics, where the technology can provide a virtual biopsy, revolutionising the current practice of disease diagnosis through tissue specimen based histopathology.

Our technology incorporates complex electrical and mechanical engineering and design, with state of the art laser and optics technology and sophisticated software systems. A few of the simple features that characterise the key aspects of our endomicroscopes include:

- High magnification with high resolution imaging.
- Miniaturisation of the microscope device to unprecedented sizes without the loss of image quality.
- Revolutionary ability to image below the surface of the tissue and at different depths.

Miniaturisation of the microscope device has been achieved to unprecedented size without the loss of image quality.

Within the medical domain there are 2 core markets for Optiscan's platform technology:

Flexible endomicroscopy – Flexible Endomicroscope (Pentax ISC 1000)

The flexible endomicroscope integrates Optiscan's miniaturised confocal microscope into a conventional flexible endoscope. Its miniaturised design allows it to be deployed inside the body for diagnosis and monitoring of diseases such as colon cancer or ulcerative colitis.

The ISC-1000 flexible endomicroscope was collaboratively developed with Pentax. It received FDA and CE Mark clearance in late 2004, and Pentax formally launched global marketing and sales of the Pentax ISC 1000 in March 2006.

Rigid endomicroscopy – Rigid Endomicroscopes for Medical Markets

Optiscan has assessed a large number of potential applications, and identified the use of endomicroscopes in intra-operative cancer margin determination (e.g. pancreas, prostate, breast cancers) and intra-operative disease diagnosis (e.g. endometriosis) as the most attractive for rigid applications of the technology. The product development leverages off the technology incorporated in the flexible scanner and uses a sheath design to achieve sterility. Only modest levels of engineering are required to modify the scanner form and function for a wide variety of potential new applications. Using prototype instruments, a range of applications have been evaluated in animal trials and are now being actively evaluated in humans.

Optiscan's first collaboration in this market space is with Carl Zeiss of Germany.

As well as the medical market Optiscan is active in the Pre-Clinical or Research Market for Endomicroscopy (Optiscan FIVE 1)

Optiscan's miniaturised rigid endomicroscopes can be applied to a broad range of laboratory research applications, for monitoring cellular and vascular changes in response to disease states or treatments as well as development of molecular imaging and biomarker applications. These represent very significant potential markets for Optiscan's technology as they create new opportunities to enhance the efficiency of research and drug development, as well as a window to future medical imaging paradigms.

In response to requests and demand from researchers, the FIVE 1 pre-clinical research microscope was released to the market in 2007. The instrument is a repackaging of the miniaturised scanner supplied to Pentax into a small rigid endoscope style probe requiring extremely modest technical variations and incurring limited development costs. With a sales price of around US$100K the instrument generates high margins and is sold into the research laboratory confocal microscope market.

Our Business

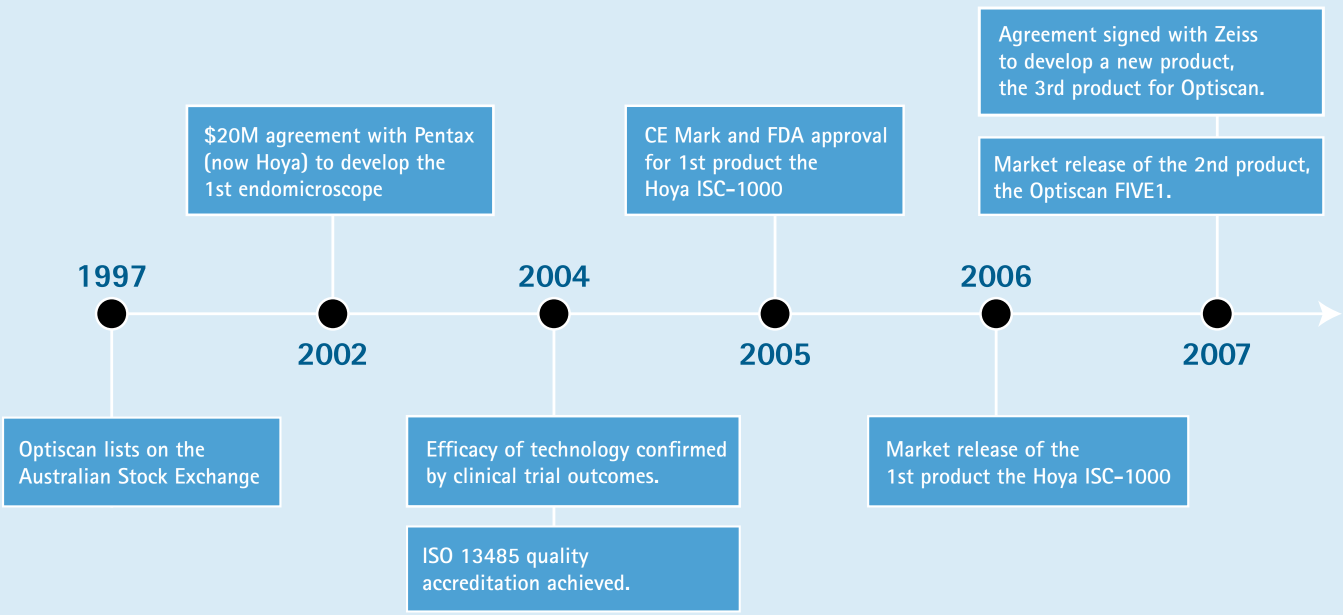
History

Since its public listing in 1997, Optiscan has pursued a strategy focused on developing increasingly miniaturised versions of its optical fibre based confocal microscopes. In 1999, this development work resulted in the production of a world first hand held confocal microscope in prototype form. In late 2001, Optiscan achieved further miniaturisation of its scanner technology, and developed a prototype so small it was capable of use in an endoscope, inside the body. This led to an agreement with Pentax in 2002 in field of flexible endoscopy, and the first commercialisation of a rigid endomicroscope in a collaboration with Carl Zeiss of Germany in 2007. A number of new rigid endomicroscope applications are now being developed by Optiscan, including the FIVE 1, an instrument designed for research applications.

Operations

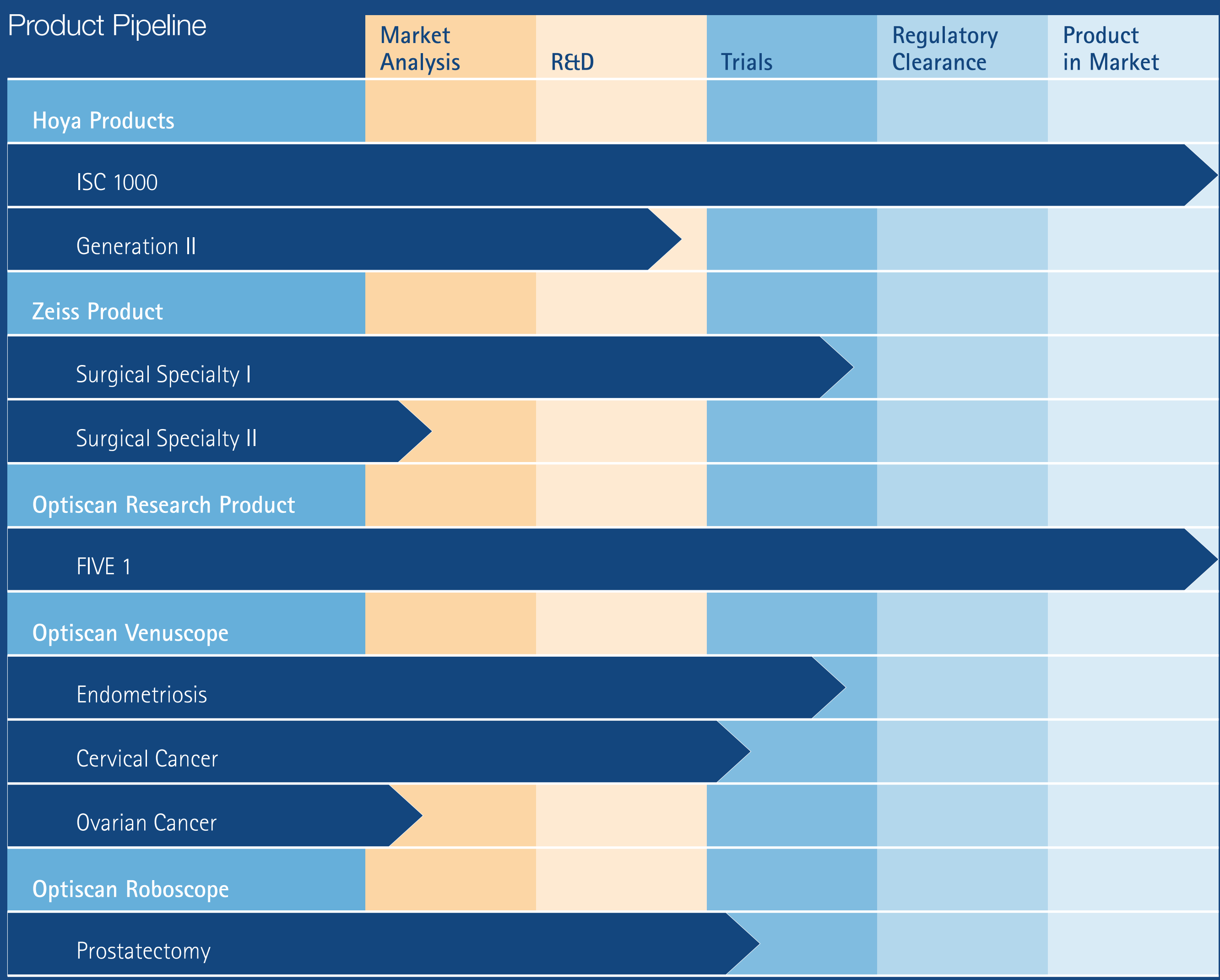
Optiscan is based in Melbourne, Australia where its administration, development and production activities are carried out. A small representative office has been established in California, USA.

Optiscan's production facilities include a state of the art clean room for high precision assembly of its miniaturised scanners, to prevent dust contamination of lenses.

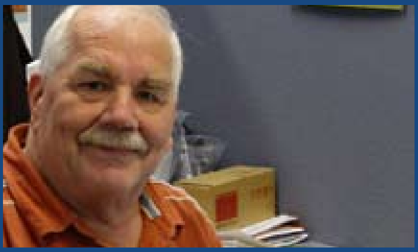


Our Products

The diagram below shows Optiscan has two products in market with a number of new product initiatives currently in progress. We expect to have five products in market within three years.



Our People






Executive Management Group (left to right)

Peter Delaney,
Director of Technology,

Bruce Andrew,
Chief Financial Officer and Company Secretary,

Vicki Tutungi,
Chief Executive Officer,

Robert Pattie,
R&D Manager,

John Allen,
Commercialisation and Business Development Manager.

Optiscan has an experienced team of 45 employees, engaged in four primary centres of activity:

The core competencies in administration include general management, finance, intellectual property and licensing, information systems and quality management.

The core competencies in R&D are mechanical, electrical and optical engineering, and software.

The core competencies in medical applications are in physiology and pre-clinical research.

In sales and service, there are two sales executives, one in Australia, one in USA, and two service and product support specialists.

In production, there are six highly skilled precision electronics technicians, supported by production management, stores and purchasing.

Optiscan personnel are highly trained, with more than 70% being degree qualified, including 45% with post graduate qualifications (Honours, Masters, PhD).

Directors and Management

There are currently six Directors on the board of Optiscan, two of whom are executive directors, and four who are non-executive directors. Personal details of the directors are set out on in the Directors Report on pages 20 to 21, and remuneration details are on pages 23 to 28.

The Executive Management group is:

Vicki Tutungi,
Chief Executive Officer

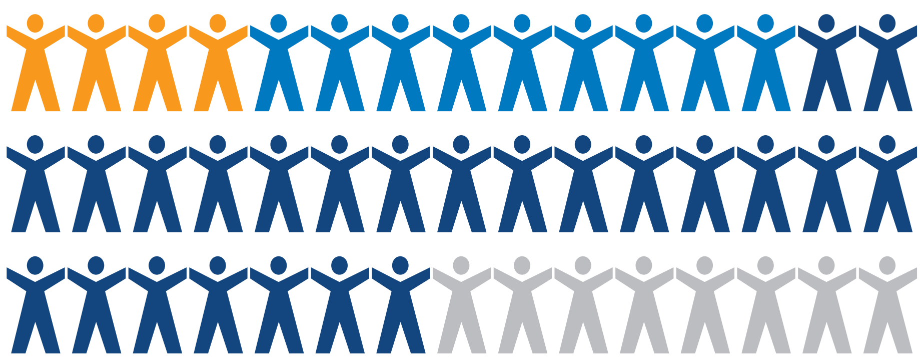
John Allen,
Commercialisation and Business Development Manager

Bruce Andrew,
Chief Financial Officer and Company Secretary

Peter Delaney,
Director of Technology

Robert Pattie,
R&D Manager

Details of the remuneration of executive managers are set out on page 26 of this report. Details of the personal background and experience of executives is available on the company's website at www.optiscan.com.



OUR TEAM
4 Sales & Service
9 Production
24 Research & Development
8 Administration

Our Strategy

Optiscan is passionate about improving the quality of patient care through the use of in-vivo confocal microscope technology. In the process of providing this technology to the global medical community Optiscan will become a profitable high growth medical device business.

Our vision is to have an Optiscan designed and developed endomicroscope in all major hospitals and leading day procedure centres in Europe, USA, Asia and Australia.

Our strategy to achieve this vision requires Optiscan to:

- Maintain global leadership in design and production of IP protected miniaturised endomicroscopes.
- Sell endomicroscopes into high utilisation segments of global medical markets by either:

  – working with market leading partners, or

  – taking Optiscan branded instruments to market through distributors

This process will facilitate the expanding market penetration in three phases:

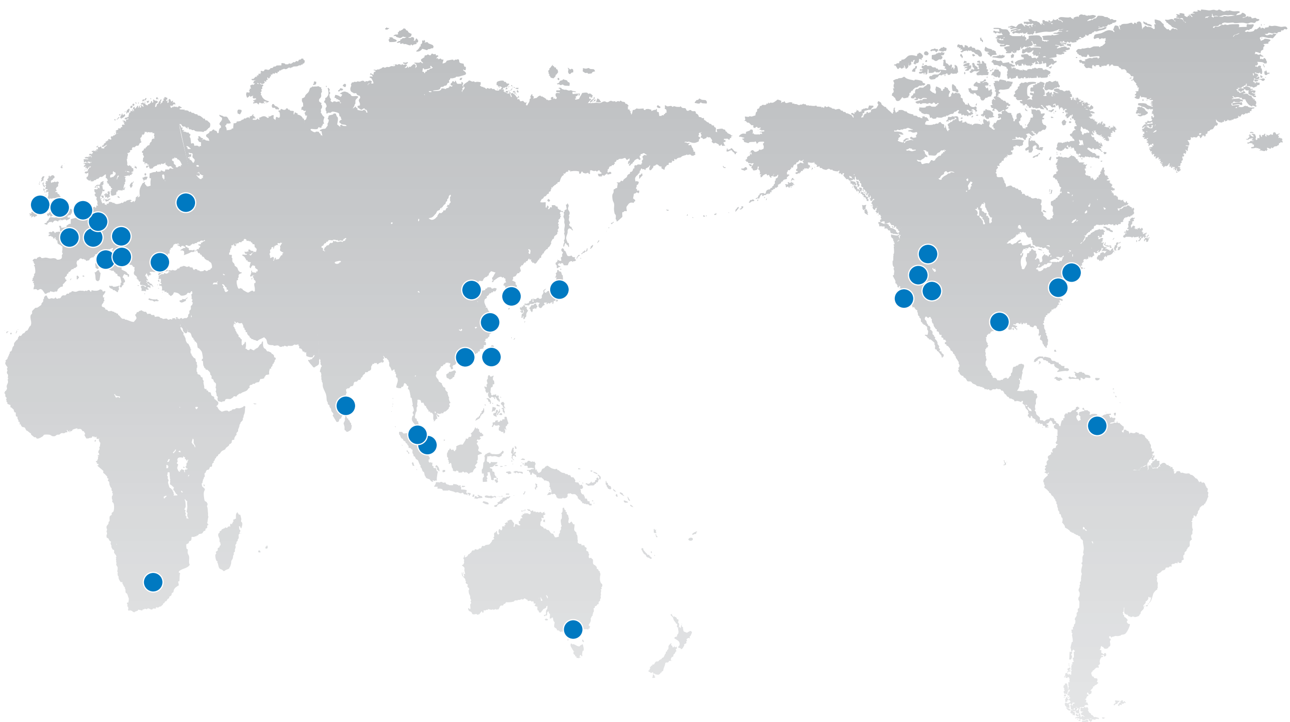
- From leading teaching and research hospitals,
- All major metropolitan hospitals
- Regional hospitals and day procedure centres

The specific milestones we are working toward to achieve this strategy are

- Support the uptake of endomicroscopy in flexible applications with Pentax/Hoya
- Complete development and market launch of the Zeiss rigid endomicroscope
- Expand sales of the FIVE 1 research instrument
- Establish the Roboscope as a small volume, high margin Optiscan branded instrument
- Establish a high utilisation product in the Women's Health sector
- Obtain regulatory approval in all key global markets to:

  – Provide proof of efficacy of the technology in all applications

  – Obtain reimbursement from medical insurers



Review of Operations

Optiscan has made significant progress in all core activities during 2007/2008. The first deal in rigid endoscopy was concluded; sales of our first own brand instrument increased as marketing activity was stepped up; clinical trials continued to identify new opportunities; exciting new applications in women's health were identified and assessed; second generation platform development reached prototype stage, and perhaps most importantly of all, our confocal technology was widely embraced and applauded by a growing legion of physicians around the globe. The only area of sub optimal performance was sales and market development activity with the Pentax ISC-1000, impeding our financial position for the year.

The major achievements for 2007/2008 include:

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Confocal on the Global Stage

The past twelve months has seen confocal microscopy widely adopted and accepted as a new generation medical imaging modality.

The applications for endomicroscopy now cover most major gastrointestinal disorders. This means that endomicroscopy can be effectively used in most endoscopy cases. It takes endomicroscopy out of being a niche technology for Tier one specialist endoscopists and into the hands of the general endoscopist. In turn, this means that an endomicroscope would be commonplace in the rooms of most, if not all endomicroscopy suites around the globe. Obviously, this has significant market implications.

As well as making considerable progress in terms of extending the value proposition for the technology to new gastrointestinal disorders, the number of sites using the technology has substantially increased to more than 50 hospitals globally. These users are not only seeing the benefits that flow from endomicroscopy but are becoming advocates for the technology and teachers of the procedures.

Such is the interest and enthusiasm of these opinion leaders that the first ever International Conference on Endomicroscopy was convened in Milan in April 2008. The event was attended by more than 150 endoscopists, which demonstrates that endomicroscopy is sufficiently important and relevant to the future of endoscopy to warrant a dedicated conference.

A key outcome of the conference was the consensus view that endomicroscopy should be combined with high definition endoscopy in a single endoscope to provide for state of the art "see and confirm" imaging. This was very inspiring news from Optiscan's perspective because the Generation 2 smaller scanner, now in prototype, will enable this to be technically achieved. As part of our ongoing discussions and review of arrangements with Hoya we will be looking at this clear market opportunity.

It has also been very pleasing to see significant progress in activity in the US. In March, Johns Hopkins, the number 1 hospital in the US, ran its Eighth Annual Gastroenterology and Hepatology Conference in Puerto Rico. During the conference a number of technologies (including Optiscan's nearest competitor's offerings) were demonstrated. However, only the Optiscan technology delivered on the promise to see diagnostic cellular detail, as Dr Marcia Canto performed live procedures that were transmitted from the endoscopy room at Johns Hopkins Hospital in Baltimore, USA. Professor Ralf Kiesslich from Johannes Gutenberg-Universitat (Mainz, Germany) moderated at the conference venue and commented on the Optiscan technology "...now we see the actual cellular detail and there is no doubt that this is dysplastic tissue and Dr Canto can now proceed directly to resect it…". The US gastroenterology community were also well represented at the Milan conference and they were very enthusiastic about the technology and what it offers. One of the leading US

"I once asked if I would trust these images, but after a few rounds of checking with my pathologist, I now know that if I see significant disease, it is real and it is there – if I don't act on that information, I am not doing the best for my patient."

Optiscan is confident that this breakthrough in the advocacy based on local experience within the US market will lead to increased sales in the near term.

endoscopists said "I once asked if I would trust these images, but after a few rounds of checking with my pathologist, I now know that if I see significant disease, it is real and it is there – if I don't act on that information, I am not doing the best for my patient." Optiscan is confident that this breakthrough in the advocacy based on local experience within the US market will lead to increased sales in the near term.

Equally pleasing was the outcome of the annual Digestive Diseases Week Conference in the US which was held in May. This is the single largest conference of its kind and more than 10,000 endoscopists from around the world attended. Our technology featured in 19 sessions, whereas the competition only featured in five. Consistent with what was said in Milan, the US contingent were effusive about the value that endomicroscopy provides. Key US trial data was released for the first time and it went beyond all expectations in advocating "see and treat" procedures based on endomicroscopy images rather than just recommending the technology to take directed biopsies.

With all of this activity amongst endoscopists around the world it is not surprising that we have also seen a significant number of publications during the past 12 months. These include over 26 peer reviewed journal articles, 16 review articles and editorials, 4 book chapters, more than 150 conference presentations and the first dedicated book. The Atlas of Endomicroscopy which was published in January of this year is a valuable tool in introducing new endoscopists to the technique and also serves to reinforce the message that endomicroscopy is a key diagnostic step.

Pentax/Hoya

Progress with Pentax over the past twelve months has been frustrating.

In 2006/2007, the first full year of sales for the ISC-1000, Optiscan achieved revenues of more than $5 million, with 88 systems sold to Pentax. Optiscan looked forward to a further increase in 2007/2008, to take it toward the breakeven benchmark of 200 annual system sales. Unfortunately, in August 2007, Pentax advised that a stock build had occurred, and that forward orders would be suspended until the sales rate had improved sufficiently to clear the accumulated inventory.

In response to this advice, Optiscan sought further information from Pentax in order to understand what was occurring in market. Given that Pentax was now deep into a merger process with Hoya, this proved very difficult. Hoya completed its consolidation of the Pentax business on its balance sheet effective as of 1 April 2008.

Hoya is around ten times the size of Pentax and has annual profits in the order of US$1 billion, with interests in a range of businesses including optics and precision lenses. Hoya announced in December 2006 that it planned to acquire Pentax and merge the camera and life care businesses into the Hoya organization. At the time of the announcement, the process was expected to take some ten months.

There is no doubt that over the past 12 months the senior executives responsible for endomicroscopy within Pentax were distracted by the corporate activities in Japan, and this culminated in the departure of several of the most senior personnel. Whilst Pentax moved quickly to make new appointments the accumulated knowledge and experience of the senior management that had contributed to the critical decisions in the business collaboration over the previous three years was lost.

Optiscan has met with Hoya CEO, Hiroshi Suzuki, and the new team responsible for endomicroscopy and has shared detailed information about performance in market. It is clear from this information that penetration into the US market has lagged compared to the progress being made in Europe. The parties agreed that more would be done to address this issue.

Optiscan and Hoya are currently reviewing arrangements and in particular Optiscan has sought assurances from Hoya as to how it can improve in-market performance. Importantly, Hoya has stated its expectation to start re-ordering product this financial year.

As a direct consequence of these recent high level meetings with Hoya, Optiscan believes that the outlook for sales of the ISC-1000 is better than it has been in a long while.

Zeiss Collaboration

The collaboration with Carl Zeiss commenced early in the year, following announcement of the deal in July 2007.

The early stages of the collaboration involved considerable detailed planning and establishment of a Joint Project Committee. This was followed by engagement of the hospitals and physicians tasked with conducting trials and introducing endomicroscopy to the new Zeiss applications. Shortly after establishing this multi-faceted team, pre-clinical trials commenced in the USA. The trials were focused on obtaining a first pass proof of efficacy. The results were exceptionally good, and there was a level of excitement and anticipation amongst both the Project Committee and the doctors about the possibilities for this new application.

Zeiss moved forward to establish pilot human trials early in 2008, and at the same time, engaged their quality and regulatory staff and internal advisors to determine whether a product could be fast tracked to market. Unfortunately, the enthusiasm of the investigators was not enough to overcome the timelines associated with regulatory clearance. Our hopes of an early product release had to capitulate to the requirements of the regulatory process.

Nevertheless, human pilot trials commenced in the June quarter. We expect these trials to be completed during the December quarter, which will be followed by reports and publication of the outcomes that will secure the exclusive IP position of Zeiss in this important “first time in human” application. The project plan calls for further trials, and corresponding development of the regulatory applications that will enable final product release. This product will be based on the Optiscan second generation confocal platform and smaller scanner.

Zeiss has also secured rights to a second application for confocal endomicroscopy, and although its development is scheduled to follow the primary application, a considerable amount of preparatory planning work has already been completed. It is likely that the time to market for this second application will be comparatively short.

"It is expected that (FIVE 1) sales in the next year will exceed $1 million, with further growth to follow..."

FIVE 1

The Optiscan FIVE 1 research confocal microscope was developed in 2007. It is a handheld confocal microscope that enables in vivo tissue imaging at cellular level in real time. The FIVE 1 is particularly suitable for a range of pre-clinical applications in the important areas of stem cell research, tissue regeneration and development of cancer therapies.

The FIVE 1 has been the subject of considerable management attention and marketing resource during 2007/2008. This reflects both the strong interest that has been shown by the target market since its release last year, as well as the need for Optiscan to achieve additional sales in response to the drop in sales to Pentax.

The FIVE 1 was launched, with a modest sales target of 10-12 units per year. The product was to be supported from a limited, low cost marketing program that included attending a small number of key exhibitions and conventions in the target market. However, on entry into the market it became clear that the level of interest in the product was higher than anticipated and called for a re-think of this strategy.

In response to this early interest, Optiscan engaged a marketing support resource to manage the enquiries and leads generated during 2007. More analysis of the sectors of the research market most likely to have interest in, or benefit from, confocal microscopy was also conducted.

As these marketing support activities identified more opportunities, Optiscan recognised that the potential of the FIVE 1 would not be realised with the limited resourcing that was allocated. After a careful assessment of the opportunity and preparation of a detailed business plan, two full time sales representatives were engaged, one in USA and one in Australia to service Australian and the Asia Pacific region.

The network of global sales channels has also been expanded with the appointment of distributors in Europe, Japan, North China (Beijing), South China (Shanghai), Taiwan, India, South Korea and Malaysia.

A key marketing strategy for any research tool of this kind is to establish a level of awareness for the FIVE 1 through publication of research papers. Following some early sales to leading research institutes in Australia, USA, Singapore and Europe, several research papers have been published using the FIVE1 as the key tool for investigation. The two most recent publications were published in pre-eminent industry journals, "Gastroenterology" and the "Journal of Hepatology". One of the articles received front page exposure in the Gastroenterology journal for the achievement of world first imaging of the dislodgement of surface cells in the intestinal lining. This was only possible because of the very high sub-cellular resolution that the compact FIVE 1 probe provides.

The past year has been one of investment in the FIVE 1 product. The research market recognises the unique abilities of the confocal handheld microscope, and it recognises how its research horizons can be expanded with this new technology. However, it is often resource constrained, and funding for devices such as the FIVE 1 often requires a process of application, justification, and budget approval. As a consequence, enquiries and sales leads can take twelve months or more to convert to a sale. Returns from the efforts over the past year are yet to be realised, but all the seeding work has been done. It is expected that sales in the next year will exceed $1 million, with further growth to follow, as the effect of the long lead times converts into an increasing rate of sales.

New Product Initiatives

Optiscan's strategy of achieving growth through the identification of new applications for endomicroscopy has been significantly enhanced over the past twelve months. At the very beginning of the financial year, Optiscan signed its first commercialisation agreement in the field of rigid endoscopy with Carl Zeiss. In the research market, Optiscan expanded the sales and distribution channels for the FIVE1 product. However, in some ways even more exciting than these two opportunities are the new prospects that have been identified in women's health and men's health.

Optiscan has engaged in a detailed analysis of the market in women's health during the past year. Boston Healthcare, a US based specialist in medical and healthcare economic analysis, was engaged to conduct primary research into the application of endomicroscopy to two particular conditions, endometriosis and cervical cancer. Whilst Optiscan's own internal assessments indicated a strong potential for endomicroscopy, the research results have revealed that these applications represent substantial opportunities for the company. Boston estimates that there are around 2 million laparoscopies for endometriosis performed annually in the US alone, and a similar number of colposcopies for cervical cancer. Furthermore, there is widespread dissatisfaction amongst Obstetricians and Gynaecologists with the current procedure for diagnosing and treating endometriosis. The advice from Boston is that a technology such as endomicroscopy would be well received by practitioners.

Another opportunity identified by Optiscan for use of the endomicroscope is in minimally invasive robotic surgery. The initial application would be prostatectomy surgery, where there is a clear medical need to better differentiate between nerve tissue and connective tissue during the procedure. The new robotic endomicroscope, the "Roboscope" has the potential to differentiate the nerve tissue and therefore allow the surgeon to preserve greater function. Trials in the US are about to commence on this new application of the technology. Whilst this is a niche application for the technology, the market is attractive because customers are easily identified, they are typically early adopters of new technology and the capital budgets associated with robotic surgery facilities are large. This represents a near term opportunity for a high margin, Optiscan branded product.

Pre-Clinical and Clinical Trials

There were two significant preclinical trials conducted over the past year. In December a preclinical trial for the Zeiss application was successfully concluded, and in the robotic prostatectomy application a preclinical trial of the roboscope was completed.

The European multicentre trial for the Pentax ISC-1000 commenced in April. The trial, supported by Pentax Europe, will draw 200 cases from hospitals in Germany, Italy and England. It is scheduled for completion in early 2009. The trial is focused on Ulcerative Colitis. The study involves five hospitals, in three countries, each operating under the same tightly controlled protocol. The gold standard trial design allows robust measurement of both diagnostic yield and a measure of the consistency with which the technique can be replicated in different hospitals by different doctors. Details can be found at www.clinicaltrials.gov (trial identifier reference NCT00659867). Negotiations with hospitals in the US over the US multicentre trial are well advanced and discussions are now focused on the details of the protocols and how to maximize the value of the trial.

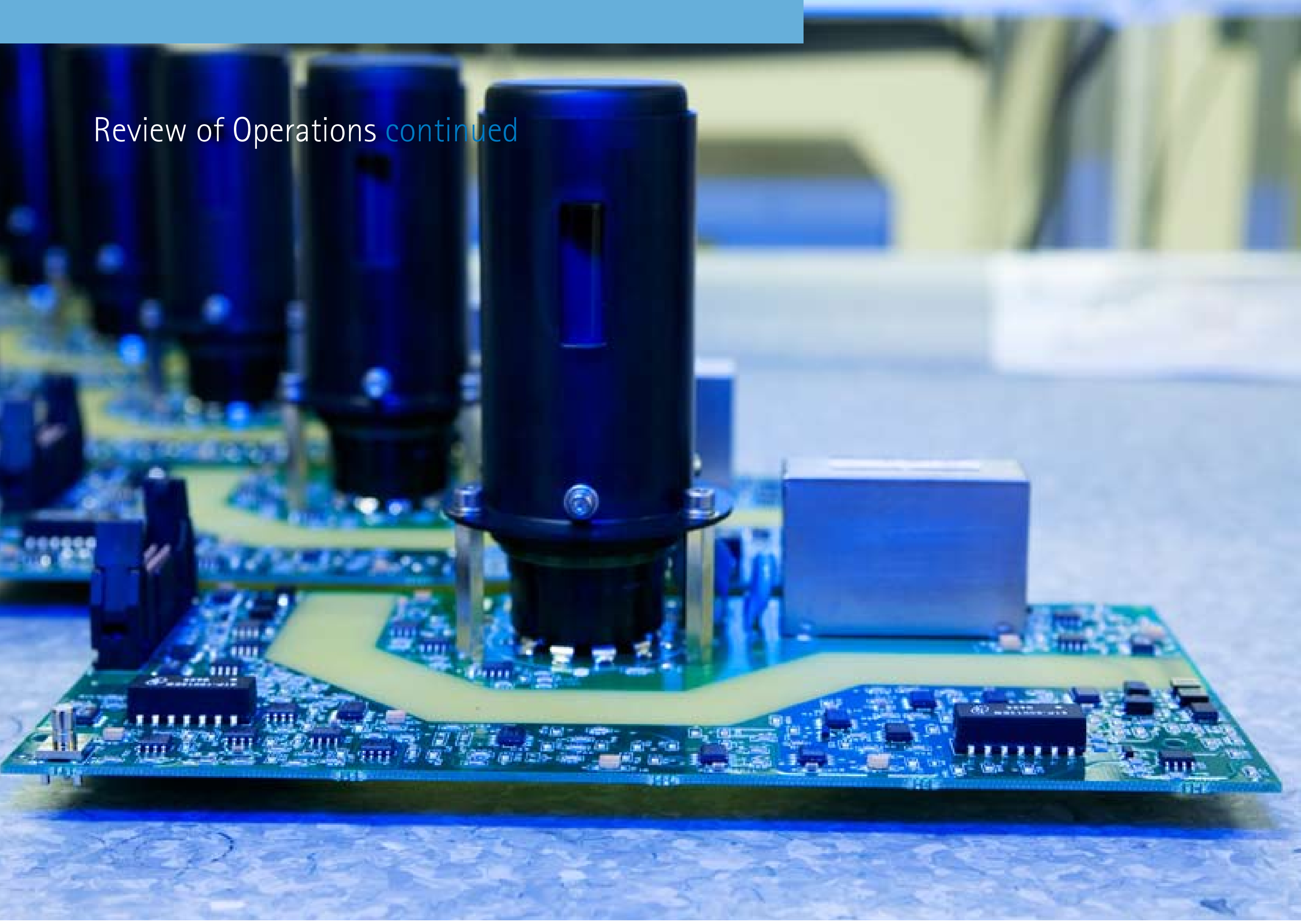
"There were two significant preclinical trials conducted over the past year. In December a preclinical trial for the Zeiss application was successfully concluded, and in the robotic prostatectomy application a preclinical trial of the roboscope was completed."

On the back of the success of the preclinical study for Zeiss, a clinical study of the Zeiss device involving around 30 patients has commenced. A further clinical study is planned to commence shortly and the studies will continue at least until the end of 2008.

Clinical trial activity in a range of new surgical applications also increased substantially during the period. Optiscan has made significant progress in development of clinical grade prototype instruments based on customisation of its existing scanner and processor technology to the form factors and sterilisation requirements of individual new clinical applications. Consequently, Optiscan has initiated a significant number of clinical trials with preliminary feasibility of imaging performed in patients in the following applications:

- Laparoscopy for endometriosis
- Laparoscopy for liver disease (including trial of a new near infrared prototype that sees deeper than the current blue system).
- Use during open surgery for examination of cancer resection margins

Trials are ongoing with results to emerge during the coming period.



Design and Development Activity

Optiscan made excellent progress on its new design and development projects during 2007/2008.

There are two primary development programs which underpin Optiscan's new product initiatives over the coming years. The first is the development of a new operating platform, referred to as "CIS2", being a confocal imaging system, second generation. The second project is the design of a new, smaller scanner.

The CIS2 platform has been designed on a modular basis, enabling a "plug and play" capability that provides a flexible design that can be economically tailored to the requirements of individual markets or users. Its design also takes account of the latest technological developments, and will be able to produce a faster more flexible platform at a lower cost, providing increased utility and functionality to Optiscan customers. This is a substantial engineering undertaking and Optiscan's collaboration partners, Zeiss and Pentax Hoya are both providing a level of financial support to the design process. It is anticipated that CIS2 will underpin many of Optiscan's future products.

During 2007/2008, this project has gained momentum, and Optiscan's software team achieved some very significant design milestones. Hardware development has also progressed with key module design advancing well. By year end, Optiscan had bench tested the first working prototype of the new platform, and produced first images on the new system. This was a major achievement as the process now becomes one of refinement rather than fundamental proof of concept. This position also enables Optiscan to plan the remainder of the project with greater certainty, and Optiscan is confident that the platform development will be largely completed within twelve months.

The other project is the design and development of a smaller scanner. Optiscan's core IP and engineering achievements lie in the miniaturisation of the scanner. This has been the cornerstone of the engineering achievements that created the endomicroscope. The continuing development and refinement of Optiscan's miniaturisation skills, to produce a smaller scanner, has been a key goal of our development activities. Smaller scanners will enable a wider variety of applications for endomicroscopy.

The dimensions of the first generation scanner, with a diameter of 5mm, make it too large for use in certain applications, for example vascular surgery or orthopaedics. However, if

"Overall, the Optiscan IP portfolio continued to grow in value through the filing of several new patent applications."

the scanner size can be reduced, these and a host of other medical applications come on to the horizon. Put simply, further miniaturisation will enable more applications for endomicroscopy, thus broadening the product range and spreading commercial and development risk for Optiscan. The new smaller scanner with a diameter of around 3.5 mm also allows it to be fitted into the end tip of a high definition flexible endoscope, which many endoscopists have described as a state of the art device to enable them to "see and confirm" in a simple and time saving work flow. Optiscan already has an extensive patent portfolio in this area of expertise, and more importantly, know-how and experience well in advance of all of Optiscan's competitors in the field.

There are some engineering and design issues that can be enhanced in a second generation scanner design, and these have been incorporated into the current development activity. Areas of critical design trade off in the miniaturisation process are "robustness" and image quality. A smaller design uses smaller parts and that often compromises the inherent strength of the device. Optiscan's second generation scanner has reduced the volume by about 70%, and at the same time the improved design has substantially strengthened the device. This has been achieved without compromising image quality and actually providing enhanced performance in some areas. Optiscan's timelines on this development project have been well managed, and it is expected that the new scanner will be introduced within the next year, or sooner.

Whilst these projects account for most of Optiscan's development activity, Optiscan always maintains a level of involvement on other projects. Work on the development of a multiphoton system has continued; assessment of alternative contrast agents has also continued as has the development of prototype probes for new applications. Optiscan has also developed a higher resolution scanner and evaluated it in a number of applications. As would be expected in a company based on technology, Optiscan has maintained a modest level of well targeted fundamental research that continues to feed into product development.

Intellectual Property Activities

In relation to new patent activity, Optiscan has for some years been developing designs and working prototypes for improved smaller scanners to enable them to fit into smaller endomicroscope probes to access a wider range of medical and research imaging applications. During the year both European and US patents were granted with claims covering these designs. Overall, the Optiscan IP portfolio continued to grow in value through the filing of several new patent applications. These included even smaller scanner systems and a patent covering combination-imaging involving fluorescent macroscopic imaging to identify cancer biomarkers, followed by confocal endomicroscopic imaging of the tagged cells to achieve a high sensitivity and specificity for early cancer detection.

Optiscan's patent family 1 will expire in June/July 2009 and patent family 2 will expire in August/November 2009 for Australia, Canada, Japan, USA and European designated countries. These patents contained claims over the use of optical fibres to create the confocal pinhole and over scanning the light at the tissue end of the fibre to effect a scan thereby building up a confocal image of the tissue. Optiscan has received annual and once–off royalties from these patents from a number of confocal microscope manufacturers. These royalties will no longer be paid once the patents expire in the respective countries.

The expiry of these patents potentially means that other parties could use an optical fibre to create a confocal endomicroscope. However, Optiscan has a large portfolio of patents and patent applications that include claims covering new miniaturised scanner technologies and associated small lens assemblies, end tip designs and connectorisation to enable the scope to be optically and electrically disconnected from the laser processor module. Optiscan considers that the expiry of these two core patents will not result in a competitor entering the field, as there are many other Optiscan patented technical issues to overcome. It would be both difficult and costly for another party to manufacture an equally high performing confocal endomicroscope.

Corporate Governance and Investor Relations Activity

As recently announced to the market Optiscan has appointed two new Board Members, Dr. Jim Fox and Mr. Paul Wright. Dr. Fox joined the Board on 1 July 2008 and Mr. Wright will be joining the Board in the fourth quarter of 2008 when he returns to Australia from Europe.

In May Optiscan brought Dr. Ralf Keisslich and Dr. Martin Goetz from Mainz University Hospital, Germany to Victoria to present on their experiences in using the technology. A small audience of shareholders, doctors and interested parties participated in the highly successful workshop. This exercise also coincided with Optiscan's efforts to locate a number of endomicroscopy units in Australia. Three units are in the process of being placed in Victoria and negotiations are underway regarding a system in Sydney and one in Adelaide.

Optiscan also successfully raised $3 million from a select group of existing investors in June.

Financial

Sales revenue was $1,427,035, compared to $5,707,536 in 2007, a decrease of 75%, and as a consequence, gross profit was down from $1,756,680 to $255,002.

Revenue from Pentax declined 84%, with the only sales being miniaturised scanners. There were no sales of ISC-1000 processors during the year. In August 2007, Pentax reported an overstock position that would impede sales. Optiscan advised the 2007 AGM that sales in 2007/2008 were expected to be at the lower end of the $1M to $2M range.

Total royalty revenue was down 56% to $1,105,002. There are a number of factors underlying this movement. In 2007, a substantial infringement settlement amounting to $2,076,957 was brought to account. Although another settlement was achieved in the current year, the amount was substantially less, at $419,465. As a result, infringement settlements declined year on year by $1,657,492. Offsetting this movement, a new licensing fee of $324,874 was recognised in 2007/2008. Recurring royalty receipts were steady, so the net decrease in royalty income amounted to $1,394,292.

Other income in 2008 is comprised of interest ($292,949), grants received ($643,090), lease income ($25,685) and development fees received ($413,614). In total, income from sources other than sales and royalties amounted to $1,375,338, up 11% on 2007.

The decline in the gross profit rate from 31% to 18% is a result of under absorbed indirect labour and factory overhead caused by the reduced orders from Pentax.

Total expenses, excluding the cost of goods sold, amounted to $7,667,394, an increase of $109,784 (1.4%) compared to last year. Most of the increase was in marketing expenditure, and in particular, the cost of market research and analysis of the Women's Health opportunity. Administration, R&D and other expenses were all reduced in 2008.

The net loss before tax for the year was $4,932,052. After allowing for income tax, (which represents the write off of withholding tax deductions amounting to $52,288), the net loss for the year is $4,984,340, which is 132% higher than the loss of $2,139,481 in 2007.

Investment in working capital declined with a reduction in trade receivables as a result of the fall in sales to Pentax.

Cash at bank at end June 2008 was $3,990,520, compared to $5,936,573 the year before. Cash consumed in operations was $4,650,662, an increase over the previous year of $2,205,421. A share placement in June 2008 raised $2,549,930, reducing the overall net cash usage for the year to $1,995,568.

"The medium term outlook remains very promising and has strengthened considerably over the past year. The prospect of a range of new products in the rigid endoscope market, based on the new generation platform and smaller scanner, could see a substantial improvement in trading results."

Outlook

The key to the short term outlook is the performance of Hoya and Pentax. If Hoya can leverage its highly respected marketing skills in the flexible endoscope market, it will recover the momentum lost in the past year. Inventories will be cleared, sales will regenerate, and confocal will resume its role as the critical point of differentiation for the Pentax flexible endoscope product offering. Recent high level meetings with Hoya have provided grounds for cautious optimism.

The next year should also see improved market penetration by the Optiscan FIVE 1, with a consequent improvement in overall margins as the sales mix reflects increased volumes of higher margin products.

From a new products perspective, the coming year will see significant progress with key milestones including the commencement of trials in the US of endomicroscopy in minimally invasive prostatectomy by end October, 2008, and completion by March 2009, the completion of human trials for Zeiss product by June 2009, the commencement of human trials of the Venuscope for endometriosis, in Australia by December 2008 and the completion of the first prototype of the second generation system and smaller scanner by March 2009.

Moving forward, much will depend on trading conditions and sales performance, and Optiscan will carefully monitor the capital and funding position of the group. It remains to be seen whether the current cash reserves will be adequate to fund the product developments envisaged.

The medium term outlook remains very promising and has strengthened considerably over the past year. The prospect of a range of new products in the rigid endoscope market, based on the new generation platform and smaller scanner, could see a substantial improvement in trading results. Contributions from the Zeiss collaboration, women's health, robotic applications and other custom designed devices will see a broadening revenue base that will consolidate the reputation of confocal and underwrite the viability and profitability of Optiscan.

Directors' Report

The Board of Directors of Optiscan Imaging Limited has pleasure in submitting its report in respect of the financial year ended 30 June 2008.

Directors

The names of the directors in office during or since the end of the financial year and up to the date of this report are:

Mr Grant Latta, Chairman

Mr Matthew Barnett, Chief Executive Officer
(resigned 31 December 2007)

Mr Keith Daniel, Non-executive Director

Mr Peter Delaney, Director of Technology

Mr James Fox, Non-executive Director (appointed 1 July 2008)

Mr Antony Rogers, Non-executive Director

Ms Vicki Tutungi, Chief Executive Officer
(appointed 4 February 2008)

Details of the qualifications and experience of the directors in office during the financial year and until the date of this report are as follows:

Grant F. Latta AM
CPA, FAICD, B.Bus, MBA, FAIM, AAMI
Age 58

Grant Latta is Executive Chairman of GCMCorp Pty Ltd, Director of Ricegrowers Limited, Biota Holdings Limited and 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. He is Chairman of the Remuneration Committee and the Nomination Committee.

During the past three years, Mr Latta has served as a director of the following listed companies;

- Biota Holdings Limited

- Ricegrowers Limited

- Vision Systems Limited

Matthew H Barnett,
B Eng (Hons), MBA, GAICD
Age 45

Matthew Barnett joined Optiscan as Chief Executive Officer in December 2002 and was appointed to the Board of Directors in the same month. He resigned on 31 December 2007.

Mr Barnett has a technical engineering background and substantial general management experience gained from several business leadership roles with Amcor Ltd and the Boston Consulting Group. His engineering experience includes high technology design applications work gained with bearing manufacturer Timken Pty Ltd.

Mr Barnett 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
Age 65

Keith Daniel is a Non-executive director with extensive experience in the commercialisation of medical instruments. He has spent the last 39 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 was a founder and director of Milvella Pty Ltd, a start up 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.)
Age 40

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. In April 2007, Peter Delaney was awarded a prestigious ATSE Clunies Ross award for excellence in the innovation and commercialisation of scientific endeavours.

James C. Fox
BE, M.Eng.Sci, PhD
Age 56

Dr Fox has more than 25 years experience as a public company director across a range of internationally based businesses. His particular track record is in the building of innovative, technology based companies in competitive international markets. After eight years working around the world with a large international management consulting company, he started his own technology based product and service company in 1987. Following the merger of Dr Fox's company with the then listed Vision Systems Limited in 1993, he took over as the CEO of the combined group. In December 2006, Dr Fox retired as the CEO of Vision Systems Limited following a heavily competed takeover of the company by a large USA based corporate which resulted in significant returns (close to $1 billion) to shareholders. Dr Fox is also a director of Air New Zealand Limited, Futuris Limited and TTP Group (UK).

Dr Fox was appointed a Non-executive director of Optiscan on 1 July, 2008.

Antony (Tony) Rogers
CPA, MAICD
Age 65

Tony Rogers is a director of Australian Securities Limited and Monash University Commercialisation and Intellectual Property Committee.

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 four 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, and is Chairman of the Audit Committee.

Vicki L. Tutungi
BSc, LLB, MBA, AICD
Age 40

Vicki Tutungi holds a Science Degree and Law Degree from Monash University, an MBA from Melbourne University and a Diploma from the Australian Institute of Company Directors.

Vicki joined Optiscan in February 2008 as Chief Executive Officer after a career with CSIRO, where she was the Director of the newly established Niche Manufacturing Flagship. In this role, Vicki was responsible for investing $36.2M in research directed to assist the Australian Manufacturing Industry.

Prior to taking up this role, Vicki was Chief of CSIRO's division of Manufacturing and Materials Technology and was responsible for running a $50 million business unit. During her 13 years at CSIRO, Vicki was involved in commercialising a number of manufacturing technologies, including establishing spin-off companies and negotiating multi-million dollar licensing and sale agreements. Vicki has also served on the board of a number of companies including CAST and VCAMM.

All directors held their position as director throughout the entire financial year and up to the date of this report, other than:

- Matthew Barnett, who resigned as CEO, and retired from the board on 31 December 2007,
- Vicki Tutungi, who commenced as CEO on 4 February 2008, and was appointed to the board on 12 February 2008, and
- James Fox, who was appointed to the board on 1 July, 2008

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' Report (continued)

Directors' Interests

Relevant interests of the directors in the shares, options or other instruments of the company at the reporting date and at the date of this report are:

Director	Ordinary Shares			Employee Options
	Holding as at 30 June 2008	Since Purchased [(1)]	Balance at date of this report	
Grant Latta	230,000	870,000	1,100,000	-
Keith Daniel	160,000	-	160,000	-
Peter Delaney	3,206,259	-	3,206,259	450,000
James Fox	-	434,783	434,783	-
Tony Rogers	275,000	434,783	709,783	-
Vicki Tutungi	-	217,400	217,400	-

[(1)] *Shares purchased by directors following shareholder approval at a General Meeting on 12 August, 2008.*

Other Interests of Directors

Peter Delaney

Related parties to Peter Delaney hold a combined total of 270,090 ordinary shares.

Directors' Meetings

The company held fifteen (15) Directors' meetings during the year. The attendances of the directors at meetings of the Board were:

	Board of Directors	
Director	Attended	Held
Grant Latta	15	15
Matthew Barnett	9	9
Keith Daniel	14	15
Peter Delaney	15	15
Tony Rogers	15	15
Vicki Tutungi	5	5

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 Tony Rogers (Chairman), Grant Latta and Keith Daniel. The members of the Remuneration Committee and Nomination 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	2	2	2
Audit Committee Meetings Attended	2	2	2
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 $4,984,340 after income tax. This represents a 132% increase on the 2007 consolidated loss of $2,139,481.

Dividends

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

Directors' Report (continued)

Review of Operations

The Review of Operations is set out on pages 9 to 19 of this report.

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

Subsequent to 30 June 2008, the company issued 1,956,966 fully paid ordinary shares at $0.23 each, raising $450,102. Apart from this event 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 group if this information were included.

Environmental Regulations

The Group is not subject to significant environmental regulations.

Share Options

Details of movements in share options are set out in Note 16 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 employee options which were on issue at year end. No new options have been issued, and no options have expired. The total number of options outstanding at the date of this report is 5,140,242.

Indemnification and Insurance

During the financial year ended 30 June 2008, 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 2008. 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.

Remuneration Report (Audited)

This remuneration report outlines the director and executive remuneration arrangements of the group in accordance with the requirements of the Corporations Act 2001 and its regulations. For the purposes of this report, Key Management Personnel (KMP) of the group are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the group, directly or indirectly, including any director (whether executive or otherwise) of the parent company and includes the five executives receiving the highest remuneration.

For the purposes of this report, "executive" encompasses the chief executive, the Director of Technology, and the senior executives noted below, who collectively comprise the Executive Management team.

Details of Key Management Personnel

(i) Directors

G. Latta	Chairman (Non-executive)
M. Barnett	Chief Executive Officer (resigned 31 December 2007)
P. Delaney	Director of Technology
K. Daniel	Director (Non-executive)
A. Rogers	Director (Non-executive)
V. Tutungi	Chief Executive Officer (appointed 4 February 2008)

(ii) Executives

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

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Remuneration Philosophy

The quality and performance of directors, executives and staff is critical to achieving business success. Optiscan must foster a remuneration policy that attracts, motivates and retains personnel of the highest calibre.

In formulating a framework for remuneration policies and practices, the board takes account of the following factors:

- Capacity to pay.
- Employment market conditions.
- Company performance.
- Identification of appropriate performance benchmarks.
- Individual performance levels.

Objective of Remuneration Policy

The overall objective of the remuneration policy is to ensure maximum stakeholder benefit from the retention of a high quality board, management and staff at a cost which is commercially realistic and acceptable to shareholders. This objective seeks to:

- Reward employees for individual performance against appropriate benchmarks.
- Align the interests of management and staff with those of shareholders.
- Provide a link between rewards and the achievement of strategic targets, performance outcomes and share price.
- Ensure remuneration is competitive by market standards.

Remuneration Committee

The board has established a Remuneration Committee to provide remuneration policies that will encourage enhanced performance and enable investors to understand the costs and benefits of those policies and the link between remuneration paid to directors and key executives and corporate performance.

Remuneration Structure

In accordance with best practice corporate governance, the structure of non-executive director and executive compensation is separate and distinct.

Non-executive Director Remuneration

The Constitution of the company and the ASX Listing Rules establish an aggregate or maximum level of remuneration available to non-executive directors, to be divided amongst the directors as agreed. The aggregate amount approved by shareholders to be available for remuneration of non-executive directors is $400,000 per annum. This amount was approved at a general meeting of the company held on 12 August 2008.

The Board has determined that non-executive directors shall receive only fixed remuneration by way of payment of fees. There is no variable, short term incentive remuneration for non-executive directors, nor is there any entitlement to retiring allowances or payments other than the statutory superannuation required by law.

Each non-executive director receives an annual fee for all services provided to the company, including being a director of the company and any of its subsidiaries, and for serving on board sub committees in accordance with the requirements of the Corporate Governance Policy.

The non-executive directors hold shares in the company which have been purchased on market or through placements where participation by the directors has been approved by shareholders in general meeting. It is considered good governance for the directors to have a personal financial stake in the company.

The remuneration of non-executive directors for the years ended 30 June 2008 and 30 June 2007 is detailed in Table 1 and Table 2 on pages 26 and 27 of this report.

Executive Remuneration

The Remuneration Committee is responsible for establishing the structure and amount of remuneration for executive management. The Committee is provided with independent, external data on market trends in comparable executive roles.

Remuneration consists of fixed and variable components, incorporating both short term incentives (STI) and long term incentives (LTI), as follows:

Remuneration Component	Form of Settlement
Fixed remuneration	Base salary and superannuation
Variable remuneration, (STI)	Performance bonus
Variable remuneration, (LTI)	Employee options

Fixed Remuneration

Objective

The level of fixed remuneration is set so as to provide a base level of remuneration, which is both appropriate to the position and competitive in the market.

Structure

Fixed remuneration is reviewed annually by the Remuneration Committee, and the process consists of a review of company and individual performance, and comparative remuneration in the market. All employees are provided with the opportunity to receive their fixed remuneration in both cash or benefits, subject to there being no change in overall cost to the company. Compulsory superannuation contributions are included in the determination of fixed remuneration.

The fixed remuneration component of executives for the years ended 30 June 2008 and 30 June 2007 is detailed in Table 1 and Table 2 on pages 26 and 27 of this report.

Remuneration Report (Audited) (continued)

Variable Remuneration - Short Term Incentive (STI)

Objective

The objective of the STI program is to link the achievement of the group's operational targets with the remuneration received by the executives with prime responsibility for meeting those targets. The total potential STI available is set at a level so as to provide sufficient incentive to the executive managers to achieve the operational targets and such that the cost to the company is reasonable in the circumstances.

Structure

Actual STI payments granted to each executive manager depend on the extent to which specific operating targets set at the beginning of the financial year are met. The operational targets consist of a number of Key Performance Indicators (KPI's) covering both financial and non-financial measures of performance. Typically included are such measures as achievement of budgeted financial outcomes and key milestones, for example, demonstrating clinical efficacy, achieving quality accreditation, obtaining regulatory clearance or measures such as control of expenditure or achievement of sales targets. The Remuneration Committee establishes clear performance benchmarks, which must be met in order to trigger payments under the short term incentive scheme.

The aggregate amount of annual STI payments available for executives is subject to the approval of the Remuneration Committee. Payments made are usually delivered as a cash bonus.

Variable Remuneration - Long Term Incentive (LTI)

Long term incentives are delivered to executives and employees by way of grant of options under the Employee Share Option Plan.

Objective

The objective of the long term incentive plan is to reward executives and employees in a manner which aligns this element of remuneration with the creation of shareholder wealth.

Structure

LTI grants to employees, including executives, are delivered in the form of options. The Remuneration Committee is responsible for the allocation of options, and determines the quantum of grants by reference to group and individual performance against targets.

Incentives and Company Performance

The link between incentive structure and company performance is an important aspect of remuneration philosophy.

The group is in the process of transition from a business that was predominantly engaged in research and development ("R&D") to one increasingly focussed on commercialisation of its technology. Whilst substantial progress has been made, the transition from loss making R&D activities to profit making trading has not yet been completed. As a consequence, performance to date cannot appropriately be determined with conventional financial measurement tools. As the group has expensed all R&D expenditure incurred to date, losses have been reported so conventional earnings measures such as profit growth, EPS or dividend yield and payout are not applicable.

In view of the limited relevance of financial measurement tools, the Remuneration Committee has determined that the performance of the group over the past five years is best reviewed in the context of achievement of the following key milestones:

2004	Efficacy of technology confirmed by clinical trial outcomes; ISO 13485 quality accreditation achieved
2005	Publication of outstanding clinical trial outcomes; CE Mark & FDA regulatory clearances received; first pre-production units sold; $5 million order from Pentax
2006	Market release of Pentax ISC-1000; product sales of $3 million Development of a second business stream with the Optiscan FIVE 1 Commencement of pilot clinical trials with prototype rigid endo-microscopes
2007	Sales of $5.7 million, including first sales of Optiscan FIVE 1 First agreement to open up commercialisation of the rigid endoscope market Successful settlement of patent entitlements
2008	Outstanding clinical results in the US Successful pre-clinical trials with Carl Zeiss Development of the Generation 2 smaller scanner to prototype stage Establishment of the global sales and distribution channels for the Optiscan FIVE 1 Identification, quantification and analysis of the significant market opportunity in women's health.

The group's performance, and that of its executive group, is predominantly assessed in the context of these milestone achievements.

Short term Incentive Payments and Performance Conditions

During the year ended 30 June 2008, a short term incentive payment amounting to $11,690 was earned by one senior manager, as set out in Table 1 on page 26. The performance conditions which were the subject of the bonus payment related to the achievement of product design and development targets. No other incentive payments were made, as performance targets relating to sales and earnings growth were not achieved due to the impact of the downturn in orders from Pentax during the year and the effect on the trading result for the year.

Long Term Incentives and Performance Conditions

The Remuneration Committee considers the granting of long term incentives, by way of issue of options, generally on an annual basis. The committee is provided with reports from management about the performance of individuals and recommendations on entitlement to incentives.

During the year ended 30 June, 2008, the Board resolved to grant a total of 865,000 with 120,000 being granted to executives (refer Table 3 for details) with the balance being granted to staff. The options were valued at $55,187. The performance criteria related predominantly to assessment of individual performance.

Details of these are set out in note 16 to the financial statements.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Employment Contracts

All executives are engaged under rolling employment agreements. The contracts continue indefinitely subject to satisfactory performance. The only variant in the employment contracts relates to the period of notice of termination. The contract for Ms Tutungi provides for six months notice to be provided by the company, and the contract for Mr Delaney provides for three months notice. All other contracts provide one months notice. Under the terms of the agreements:

- The company may terminate the employment agreement by providing the requisite period of written notice or by providing payment in lieu of notice, based on the fixed component of remuneration. Any unvested options at the expiry of the notice period will be forfeited.
- On resignation, all unvested options are forfeited.
- The company may terminate the agreement at any time without notice if serious misconduct has occurred, in which case the executive is only entitled to that portion of remuneration that is fixed, and only up to the date of termination.

The Board has implemented a Management Continuity Scheme to secure the services of Messrs Allen, Andrew, Delaney and Pattie in the event there is a change in control of the company. In consideration for contractually committing to continue their employment for a minimum of twelve months after a change in control, the executives will be entitled to a management continuity payment.

Matthew Barnett resigned on 31 December 2007. Vicki Tutungi was appointed CEO on 4 February 2008, and was appointed to the board on 12 February 2008.

Compensation Options Granted and Vested During the Year

During the financial year options were granted as equity compensation benefits under the long-term incentive plan to certain key management personnel as disclosed below. The options were issued free of charge.

The terms of options issued to staff, including key management personnel other than executive directors, entitle the holder to subscribe for one fully paid ordinary share in the entity at an exercise price equal to 110% of the market price of the shares on the date of grant. One third of the options vest after 24 months service, one third after 36 months service, and the balance after 48 months service. The contractual life of each option granted is five years. There are no cash settlement alternatives. For further details relating to the options, refer to note 16 in the financial statements.

Table 1: Compensation of Key Management Personnel for the year ended 30 June 2008

	Short Term			Post Employment	Long-Term		Total	Total Performance related
30 June 2008	Salary & Fees $	Cash Bonus $	Cash Bonus %[1]	Superannuation $	Long Service Leave $	Share based-Options $	$	%
Directors								
G. Latta	60,000	-	-	-	-	-	60,000	-
V Tutungi [2]	186,344	-	-	16,771	-	-	203,115	-
M. Barnett [3]	122,236	-	-	11,001	-	-	133,237	-
P. Delaney	193,000	-	-	17,370	5,012	2,723	218,105	1.25
K. Daniel	60,000	-	-	5,400	-	-	65,400	-
A.Rogers	60,000	-	-	5,400	-	-	65,400	-
Executives								
J. Allen	179,000	-	-	16,110	9,139	3,520	207,769	-
B. Andrew	179,000	-	-	16,110	3,955	4,685	203,750	-
R.Pattie	167,000	11,690	33%	16,082	-	5,233	200,005	5.84
Total	1,206,580	11,690	-	104,244	18,106	16,161	1,356,781	3.45

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

[2] V Tutungi commenced employment with the group as Chief Executive Officer on 4 February 2008. Therefore the remuneration disclosed here is only from this date until 30 June 2008. Her total annual base remuneration is $450,000.

[3] M Barnett resigned as Chief Executive Office on 31 December 2007. Therefore the remuneration disclosed is only from 1 July 2007 until this date.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Table 2: Compensation of Key Management Personnel for the year ended 30 June 2007

	Short Term			Post Employment	Long-Term		Total	Total Performance related
30 June 2007	Salary & Fees $	Cash Bonus $	Cash Bonus %1	Superannuation $	Long Service Leave $	Share based-Options $	$	%
Directors								
G. Latta	100,000	-	-	-	-	-	100,000	-
M. Barnett	279,816	91,743	100%	33,440	-	2,178	407,177	22.53
P. Delaney	185,000	25,000	64%	18,900	4,864	10,517	244,281	14.54
K. Daniel	60,000	-	-	5,400	-	-	65,400	-
A.Rogers	60,000	-	-	5,400	-	-	65,400	-
Executives								
J. Allen	171,000	25,000	69%	17,640	-	7,859	221,499	11.29
B. Andrew	171,000	25,000	69%	17,640	1,604	7,404	222,648	11.23
R.Pattie	158,000	25,000	75%	16,740	-	7,396	206,866	12.09
Total	1,184,816	191,743	-	114,890	6,468	35,354	1,533,271	13.19

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

Table 3: Options granted as part of remuneration during the year ended 30 June 2008

30 June 2008	Grant Date	Grant Number	Value of options granted during the year	% Remuneration consisting of options for the year	Value of options exercised during the year	Value of options lapsed during the year	Total value of options granted exercised and lapsed during the year
Director							
G. Latta	-	-	-	-	-	-	-
M. Barnett	-	-	-	-	-	-	-
V. Tutungi	-	-	-	-	-	-	-
P. Delaney	-	-	-	1.2	-	-	-
K. Daniel	-	-	-	-	-	-	-
A. Rogers	-	-	-	-	-	-	-
Executives							
J. Allen	22 Jan 2008	40,000	2,552	1.7	-	-	2,552
B. Andrew	22 Jan 2008	40,000	2,552	2.3	-	-	2,552
R. Pattie	22 Jan 2008	40,000	2,552	2.6	-	-	2,552
Total		120,000	7,656	1.9	-	-	7,656

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Table 4: Options issued to Key Management Personnel for the year ended 30 June 2008

30 June 2008	No. Granted	No. Vested	Grant Date	Fair Value per option at grant date ($) (note 16)	Exercise Price per option ($) (note 16)	Expiry Date	First Exercise Date	Last Exercise Date
Directors	-	-	-	-	-	-	-	-
Executives								
J. Allen	13,333	-	22 Jan 2008	0.05	0.31	22 Jan 2013	22 Jan 2010	22 Jan 2013
J. Allen	13,333	-	22 Jan 2008	0.06	0.31	22 Jan 2013	22 Jan 2011	22 Jan 2013
J. Allen	13,334	-	22 Jan 2008	0.08	0.31	22 Jan 2013	22 Jan 2012	22 Jan 2013
B. Andrew	13,333	-	22 Jan 2008	0.05	0.31	22 Jan 2013	22 Jan 2010	22 Jan 2013
B. Andrew	13,333	-	22 Jan 2008	0.06	0.31	22 Jan 2013	22 Jan 2011	22 Jan 2013
B. Andrew	13,334	-	22 Jan 2008	0.08	0.31	22 Jan 2013	22 Jan 2012	22 Jan 2013
R. Pattie	13,333	-	22 Jan 2008	0.05	0.31	22 Jan 2013	22 Jan 2010	22 Jan 2013
R. Pattie	13,333	-	22 Jan 2008	0.06	0.31	22 Jan 2013	22 Jan 2011	22 Jan 2013
R. Pattie	13,334	-	22 Jan 2008	0.08	0.31	22 Jan 2013	22 Jan 2012	22 Jan 2013
Total	120,000	-						

Table 5: Options issued to Key Management Personnel for the year ended 30 June 2007

30 June 2007	No. Granted	No. Vested	Grant Date	Fair Value per option at grant date ($) (note 16)	Exercise Price per option ($) (note 16)	Expiry Date	First Exercise Date	Last Exercise Date
Directors	-	-	-	-	-	-	-	-
Executives								
J. Allen	14,667	-	19 Jun 2007	0.12	0.50	23 Apr 2012	23 Apr 2009	23 Apr 2012
J. Allen	14,667	-	19 Jun 2007	0.15	0.50	23 Apr 2012	23 Apr 2010	23 Apr 2012
J. Allen	14,666	-	19 Jun 2007	0.17	0.50	23 Apr 2012	23 Apr 2011	23 Apr 2012
B. Andrew	14,667	-	19 Jun 2007	0.12	0.50	23 Apr 2012	23 Apr 2009	23 Apr 2012
B. Andrew	14,667	-	19 Jun 2007	0.15	0.50	23 Apr 2012	23 Apr 2010	23 Apr 2012
B. Andrew	14,666	-	19 Jun 2007	0.17	0.50	23 Apr 2012	23 Apr 2011	23 Apr 2012
R. Pattie	18,333	-	19 Jun 2007	0.12	0.50	23 Apr 2012	23 Apr 2009	23 Apr 2012
R. Pattie	18,333	-	19 Jun 2007	0.15	0.50	23 Apr 2012	23 Apr 2010	23 Apr 2012
R. Pattie	18,334	-	19 Jun 2007	0.17	0.50	23 Apr 2012	23 Apr 2011	23 Apr 2012
Total	143,000	-						

Shares Issued on Exercise of Compensation Options

No shares have been issued as a result of the exercise of options granted as compensation to key management personnel during the years ended 30 June 2008 and 30 June 2007.

Directors' Report (continued)

Auditor Independence and Non-Audit Services

The directors received the following declaration from the auditor of Optiscan Imaging Limited.

ERNST & YOUNG

Ernst & Young Building
8 Exhibition Street
Melbourne VIC 3000 Australia
GPO Box 67 Melbourne VIC 3001

Tel: +61 3 9288 8000
Fax: +61 3 8650 7777
www.ey.com/au

Auditor's Independence Declaration to the Directors of Optiscan Imaging Limited

In relation to our audit of the financial report of Optiscan Imaging Limited for the financial year ended 30 June 2008, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

Don Brumley
Partner
28 August 2008

Directors' Report (continued)

Non-Audit Services

The following non-audit services were provided by the entity's auditors, Ernst & Young. The directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

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

- Tax compliance services, $15,750
- Other assurance services, $2,884

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

Vicki Tutungi
Director

Melbourne
28 August, 2008

Corporate Governance Statement

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 reflects 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 contains certain specific information and discloses the extent to which the company has followed the guidelines during the reporting period. Where a recommendation has not been followed, the matter is disclosed, together with the reasons for the departure.

The Corporate Governance Statement of Optiscan Imaging Limited is 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 2008 and were subject to ongoing refinement and modification. They were fully compliant with the Council's best practice recommendations.

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	6 years
Vicki L Tutungi	Executive, Managing Director	0.4 years
Keith P Daniel	Independent, Non-executive	7 years
Peter M Delaney	Executive	11 years
James C. Fox	Independent, Non-executive	Appointed 1 July, 2008
Tony W Rogers	Independent, Non-executive	6 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. The directors have determined a materiality threshold, for these purposes, of $50,000, subject to the transaction being outside the ordinary terms of trade and ordinary course of business.

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.

Corporate Governance Statement (continued)

Performance of the Board

During the year ended 30 June 2007, the Nomination Committee was convened for the purpose of evaluating the performance of the board. A formal evaluation process involving an extensive questionnaire was conducted prior to convening the Nomination Committee to review the evaluation outcomes and identify areas of process and performance improvement. The board has determined that the evaluation process need not be conducted annually, given the size of the company, the composition of the board and the frequency of board and committee meetings. The next evaluation is therefore to be conducted during 2008/2009.

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 audit 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 remuneration committee, 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 key management personnel, and all directors are included in the Directors' Report.

Optiscan Imaging Limited
Financial Report 2008

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Income Statement
for the year ended 30 June 2008

		CONSOLIDATED		PARENT	
	Note	2008 $	2007 $	2008 $	2007 $
Revenue					
Sale of goods		1,384,622	5,648,375	-	-
Rendering of services		42,413	59,161	-	-
Other revenue	5(a)	1,397,951	2,837,058	47,771	27,334
Total revenue		2,824,986	8,544,594	47,771	27,334
Cost of sales		(1,172,033)	(3,950,856)	-	-
Gross Profit		1,652,953	4,593,738	-	-
Other income	5(b)	1,082,389	897,697	-	-
Marketing expenses		(808,232)	(398,912)	-	-
Research & development expenses		(3,621,848)	(3,677,808)	-	-
Administrative expenses		(3,146,611)	(3,303,797)	(422,906)	(498,977)
Other expenses		(90,703)	(179,967)	-	-
Investing expenses	5(g)	-	-	(4,610,137)	(1,667,838)
Fair value gain (loss) on derivatives		-	2,874	-	-
Loss before income tax		(4,932,052)	(2,066,175)	(4,985,272)	(2,139,481)
Income tax expense	6	(52,288)	(73,306)	-	-
Net loss for the year		(4,984,340)	(2,139,481)	(4,985,272)	(2,139,481)
Loss per share (cents per share)	7				
- basic loss per share for the year		(4.78)	(2.1)		
- diluted loss per share for the year		(4.78)	(2.1)		

Balance Sheet
as at 30 June 2008

	Note	CONSOLIDATED 2008 $	CONSOLIDATED 2007 $	PARENT 2008 $	PARENT 2007 $
ASSETS					
Current Assets					
Cash and cash equivalents	8	3,990,520	5,936,573	3,097,849	499,754
Trade and other receivables	9	482,491	1,588,094	6,967	2,826,015
Inventories	10	1,885,268	1,358,327	-	-
Prepayments		45,672	44,754	-	-
Derivatives	21	-	2,874	-	-
Total Current Assets		6,403,951	8,930,622	3,104,816	3,325,769
Non-current Assets					
Other financial assets	11	-	-	4,606,657	6,607,398
Other receivables	9	-	-	-	-
Plant and equipment	12	795,296	615,594	-	-
Intangible assets - Software	13	49,366	76,621	-	-
Goodwill	14	1,981,467	1,981,467	-	-
Total Non-current Assets		2,826,129	2,673,682	4,606,657	6,607,398
TOTAL ASSETS		9,230,080	11,604,304	7,711,473	9,933,167
LIABILITIES					
Current Liabilities					
Trade and other payables	17	608,190	758,108	7,959	-
Provisions	19	870,127	820,916	-	-
Total Current Liabilities		1,478,317	1,579,024	7,959	-
Non-current Liabilities					
Provisions	19	48,249	92,113	-	-
Total Non-current Liabilities		48,249	92,113	-	-
TOTAL LIABILITIES		1,526,566	1,671,137	7,959	-
NET ASSETS		7,703,514	9,933,167	7,703,514	9,933,167
EQUITY					
Contributed equity	20	43,428,415	40,773,321	43,428,415	40,773,321
Accumulated losses	20	(36,341,057)	(31,356,717)	(36,341,989)	(31,356,717)
Reserves	20	616,156	516,563	617,088	516,563
TOTAL EQUITY		7,703,514	9,933,167	7,703,514	9,933,167

Statement of Recognised Income and Expense

for the year ended 30 June 2008

	Note	CONSOLIDATED 2008 $	CONSOLIDATED 2007 $	PARENT 2008 $	PARENT 2007 $
Foreign exchange difference on translation of net investment in USA subsidiary		(932)	-	-	-
Loss for the period		(4,984,340)	(2,139,481)	(4,985,272)	(2,139,481)
Total recognised income and expense for the period		(4,985,272)	(2,139,481)	(4,985,272)	(2,139,481)

Cash Flow Statement

for the year ended 30 June 2008

	Note	CONSOLIDATED 2008 $	CONSOLIDATED 2007 $	PARENT 2008 $	PARENT 2007 $
Cash flows from operating activities					
Receipts from customers		2,596,568	5,480,487	-	-
Payments to suppliers and employees		(8,277,198)	(11,063,195)	(314,422)	(370,492)
Royalties received		706,648	2,460,832	-	-
Interest received		304,881	332,630	40,804	27,334
GST refund received		-	3,319	-	-
Income tax paid		(52,288)	(73,306)	-	-
Receipt of government grants		626,450	976,963	-	-
Net cash flows from/(used in) operating activities	8	(4,094,939)	(1,882,270)	(273,618)	(339,839)
Cash flows from investing activities					
Purchase of plant and equipment	12	(541,026)	(496,575)	-	-
Purchase of intangible assets - software	13	(14,697)	(66,396)	-	-
(Advances to) / Repayments from controlled entity	9	-	-	216,619	(1,106,025)
Net cash flows from/(used in) investing activities		(555,723)	(562,971)	216,619	(1,106,025)
Cash flows from financing activities					
Proceeds from issue of shares	20	2,663,053	1,699,315	2,663,053	1,699,315
Transaction costs relating to issue of shares	20	(7,959)	(68,644)	(7,959)	(68,644)
Net cash flows from/(used in) financing activities		2,655,094	1,630,671	2,655,094	1,630,671
Net increase (decrease) in cash and cash equivalents		(1,995,568)	(814,570)	2,598,095	184,807
Net foreign exchange differences		49,515	99,761	-	-
Cash and cash equivalents at beginning of period		5,936,573	6,651,382	499,754	314,947
Cash and cash equivalents at end of period	8	3,990,520	5,936,573	3,097,849	499,754

Notes to the Financial Statements

for the year ended 30 June 2008

1 Corporate Information

The financial report of Optiscan Imaging Limited (the Company) for the year ended 30 June 2008 was authorised for issue in accordance with a resolution of the directors on 28 August 2008.

Optiscan Imaging Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange. The nature of the operations and principal activities of the Group are described in note 4, Segment Information.

2 Summary of Significant Accounting Policies

Table of contents

a) Basis of preparation

The financial report is a general-purpose financial report, which has been prepared in accordance with Australian Accounting Standards ('AASBs') (including Australian Interpretations) as issued by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001. The financial report is presented in Australian dollars and has been prepared on a historical cost basis, except for derivative financial instruments which have been measured at fair value.

Going Concern (Significant Uncertainty as at 30 June 2008)

In common with many entities in the biotechnology sector, the company's operations are subject to considerable risk due to the nature of the development and commercialisation being undertaken. A part of this risk relates to funding of the Company's activities, and related issues including the conditions prevailing in local and international financial markets. In the context of this operating environment, it is likely that the company will need to raise additional capital in order to execute its near term and medium term plans for expansion of its product portfolio.

As at 30 June 2008, the financial position of the consolidated entity as disclosed in the financial statements reflects a net asset position of $7,703,514. This balance has been determined after a consolidated net loss for the year of $4,984,340 (2007, loss $2,139,481), and a net cash outflow from operations of $4,094,939 (2007, 1,882,270).

The accounts have been prepared on a going concern basis, which includes the presumption that sufficient funds will be available to finance the operations of the consolidated entity. In adopting this position, the directors have had regard to:

- Cash on hand at 30 June 2008 is $3,990,520, and a further capital issue since balance date has raised $450,000
- The directors believe the Company has the ability to raise additional capital from existing and new investors
- The Company has a successful track record in raising capital to fund its operations
- The Company may have the ability to raise additional income, or accelerate forecast cash flows if required

The directors cannot be certain of the Company's ability to achieve success in its activities, as these are dependent on future events. Thus, should these activities result in a position where there are insufficient funds to allow continuation of current activities, the directors will consider scaling back activities until further funding is obtained, or undertake a reassessment of the company's activities. The strategy for any potential future capital raising and its timing will be determined by the directors based upon an assessment of the financial and operational circumstances of the consolidated entity at the time.

2 Summary of Significant Accounting Policies (continued)

The directors plan to continue the Company and the consolidated entity's operations on the basis outlined above, and believe there will be sufficient funds for the Group to conduct its affairs for at least twelve months from the date of this report. To the extent that future arrangements may not be concluded on a timely basis, and in the absence of new capital or additional income, there is significant uncertainty whether the Group will continue as a going concern, and therefore, whether the Group will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report. The financial statements take no account of the consequences, if any, of the effects of unsuccessful product development, commercialisation or capital raising, nor the ability of the company to continue as a going concern. Hence, the financial report does not include adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Company and consolidated entity not continue as going concerns.

b) Statement of compliance

The financial report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards (IFRS), including interpretations, as issued by the International Accounting Standards Board.

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet effective have not been adopted by the Group for the annual reporting period ending 30 June 2008. These are outlined in the table below.

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB Int. 4 (Revised)	Determining whether an Arrangement contains a Lease	The revised Interpretation specifically scopes out arrangements that fall within the scope of AASB Interpretation 12.	1 January 2008	These amendments are only expected to affect the presentation of the Group's financial report and will not have a direct impact on the measurement and recognition of amounts disclosed in the financial report. The Group has not determined at this stage whether to present a single statement of comprehensive income or two separate statements.	1 July 2008
AASB 8 and AASB 2007-3	Operating Segments and consequential amendments to other Australian Accounting Standards	New standard replacing AASB 114 Segment Reporting, which adopts a management reporting approach to segment reporting.	1 January 2009	The Group has share-based payment arrangements that may be affected by these amendments. However, the Group has not yet determined the extent of the impact, if any.	1 July 2009
AASB 123 (Revised) and AASB 2007-6	Borrowing Costs and consequential amendments to other Australian Accounting Standards	The amendments to AASB 123 require that all borrowing costs associated with a qualifying asset be capitalised.	1 January 2009	These amendments to AASB 123 require that all borrowing costs associated with a qualifying asset be capitalised. The Group has no borrowing costs associated with qualifying assets and as such the amendments are not expected to have any impact on the Group's financial report.	1 July 2009

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

2 Summary of Significant Accounting Policies (continued)

b) Statement of compliance

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 101 (Revised) and AASB 2007-8	Presentation of Financial Statements and consequential amendments to other Australian Accounting Standards	Introduces a statement of comprehensive income. Other revisions include impacts on the presentation of items in the statement of changes in equity, new presentation requirements for restatements or reclassifications of items in the financial statements, changes in the presentation requirements for dividends and changes to the titles of the financial statements.	1 January 2009	These amendments are only expected to affect the presentation of the Group's financial report and will not have a direct impact on the measurement and recognition of amounts disclosed in the financial report. The Group has not determined at this stage whether to present a single statement of comprehensive income or two separate statements.	1 July 2009
AASB 2008-1	Amendments to Australian Accounting Standard – Share-based Payments: Vesting Conditions and Cancellations	The amendments clarify the definition of 'vesting conditions', introducing the term 'non-vesting conditions' for conditions other than vesting conditions as specifically defined and prescribe the accounting treatment of an award that is effectively cancelled because a non-vesting condition is not satisfied.	1 July 2009	The Group has share-based payment arrangements that may be affected by these amendments. However, the Group has not yet determined the extent of the impact, if any.	1 July 2009

2 Summary of Significant Accounting Policies (continued)

b) Statement of compliance (continued)

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
AASB 3 (Revised)	Business Combinations	The revised standard introduces a number of changes to the accounting for business combinations, the most significant of which allows entities a choice for each business combination entered into – to measure a non-controlling interest (formerly a minority interest) in the acquiree either at its fair value or at its proportionate interest in the acquiree's net assets. This choice will effectively result in recognising goodwill relating to 100% of the business (applying the fair value option) or recognising goodwill relating to the percentage interest acquired. The changes apply prospectively.	1 July 2009	The Group may enter into some business combinations during the next financial year and may therefore consider early adopting the revised standard. The Group has not yet assessed the impact of early adoption, including which accounting policy to adopt.	1 July 2009
AASB 127 (Revised)	Consolidated and Separate Financial Statements	Under the revised standard, a change in the ownership interest of a subsidiary (that does not result in loss of control) will be accounted for as an equity transaction.	1 July 2009	If the Group changes its ownership interest in existing subsidiaries in the future, the change will be accounted for as an equity transaction. This will have no impact on goodwill, nor will it give rise to a gain or a loss in the Group's income statement.	1 July 2009
AASB 2008-3	Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127	Amending standard issued as a consequence of revisions to AASB 3 and AASB 127.	1 July 2009	Refer to AASB 3 (Revised) and AASB 127 (Revised) above.	1 July 2009

2 Summary of Significant Accounting Policies (continued)

b) Statement of compliance (continued)

Reference	Title	Summary	Application date of standard*	Impact on Group financial report	Application date for Group*
Amendments to International Financial Reporting Standards***	Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate	The main amendments of relevance to Australian entities are those made to IAS 27 deleting the 'cost method' and requiring all dividends from a subsidiary, jointly controlled entity or associate to be recognised in profit or loss in an entity's separate financial statements (i.e., parent company accounts). The distinction between pre- and post-acquisition profits is no longer required. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment. AASB 127 has also been amended to effectively allow the cost of an investment in a subsidiary, in limited reorganisations, to be based on the previous carrying amount of the subsidiary (that is, share of equity) rather than its fair value.	1 January 2009	Recognising all dividends received from subsidiaries, jointly controlled entities and associates as income will likely give rise to greater income being recognised by the parent entity after adoption of these amendments. In addition, if the Group enters into any group reorganisation establishing new parent entities, an assessment will need to be made to determine if the reorganisation meets the conditions imposed to be effectively accounted for on a 'carry-over basis' rather than at fair value.	1 July 2009
Amendments to International Financial Reporting Standards***	Improvements to IFRSs	The improvements project is an annual project that provides a mechanism for making non-urgent, but necessary, amendments to IFRSs. The IASB has separated the amendments into two parts: Part 1 deals with changes the IASB identified resulting in accounting changes; Part II deals with either terminology or editorial amendments that the IASB believes will have minimal impact.	1 January 2009 except for amendments to IFRS 5, which are effective from 1 July 2009.	The Group has not yet determined the extent of the impact of the amendments, if any.	1 July 2009

* *Designates the beginning of the annual reporting period unless otherwise stated*

*** *These are pronouncements that have been issued by the IASB and IFRIC but have not yet been issued by AASB*

2 Summary of Significant Accounting Policies (continued)

c) Basis of consolidation

The consolidated financial statements comprise the financial statements of Optiscan Imaging Limited and its subsidiaries as at 30 June each year (the Group). Subsidiaries are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities.

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

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

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

d) Significant accounting judgements, estimates and assumptions

In applying the Group's accounting policies, management continually evaluates judgements, estimates and assumptions based on historical experience and other factors, including expectations of future events that may have an impact on the Group. All judgements, estimates and assumptions made are believed to be reasonable based on the most current set of circumstances available to management. Actual results may differ from the judgements, estimates and assumptions. The more significant judgements, estimates and assumptions made by management in the preparation of these financial statements are outlined below:

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash generating units to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill are discussed in note 15.

Share-based payment transactions

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined using a Black Scholes valuation model, using the assumptions detailed in note 16.

Long service leave provision

The liability for long service leave is recognised and measured at the present value of the estimated future cash flows to be made in respect of services provided by all employees up to balance date. In determining the present value of the liability, years of service, attrition rates, future pay increases and inflation have been taken into account. Expected future payments are discounted using market yields at the reporting date on government bonds with terms to maturity that match, as closely as practicable, the estimated future cash outflows.

Warranty provision

A provision for warranty at the rate of 3% of sales has been provided since the commencement of product sales in March 2006. The incidence of warranty claims is monitored by management on an ongoing basis to assess the adequacy of the provision.

Capitalisation of research and development expenditure

The group expenses all research and development expenditure (refer note 2(r)). The group's development activities are at an early stage and there is not yet adequate probability that the tests for capitalisation can be met. The matter is kept under regular review.

Recognition of deferred tax assets

The carrying amount of deferred tax assets is dependent upon a judgement as to whether it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. In the light of the continuing expenditure on R&D there is not yet adequate probability of taxable profit in the future that will enable the utilisation of these deductible temporary differences, which include tax losses (refer note 2 (m)).

Useful lives of assets

The estimation of the useful lives of assets has been based on historical experience and management judgement. In addition, the condition of assets is assessed annually and considered in the context of remaining useful life, and adjustments to useful life are made where necessary. Depreciation charges are disclosed in note 5(c). Details of useful lives by major asset category are included in note 2(o).

Impairment of loans to, and investment in, subsidiaries

Where a subsidiary entity incurs a loss, the parent entity assesses the recoverability of any loans due from, or investments in, any subsidiary. Where required, the parent entity will then record an impairment loss against the value of its loans to, or investment in, the subsidiary.

2 Summary of Significant Accounting Policies (continued)

e) Revenue recognition

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

(i) Sale of goods

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

(ii) Rendering of services

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

iii) Royalty revenue

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

(iv) Interest revenue

Interest revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

f) Government grants

Government grants are recognised in the balance sheet as a liability when there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where expenditure has been incurred that gives rise to an entitlement under a grant agreement, the grant income is accrued.

g) Leases

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

(i) Group as lessor

Leases in which the Group retains substantially all the risks and benefits of ownership are classified as operating leases. Rental income is recognised in the income statement in accordance with the term of the lease.

(ii) Group as lessee

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

h) Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and short term deposits are stated at nominal values.

For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding credit card liabilities.

i) Trade and other receivables

Trade receivables and other receivables, both of which generally have 30 to 60 day terms, are non interest bearing and are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

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

j) Inventories

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

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

- Raw materials – purchase cost on a first-in, first-out basis; cost comprises the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to acquisition
- Finished goods and work-in-progress – cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity.

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

2 Summary of Significant Accounting Policies (continued)

k) Derivative financial instruments and hedging

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

As the Group economically hedges but does not meet the strict criteria for hedge accounting under AASB 139 Financial Instruments: Recognition and Measurement, any gains or losses arising from changes in the fair value of derivatives are taken directly to profit or loss for the year. For information on the Group's financial risk management objectives and policies with respect to its economic hedging program, refer to Note 3.

l) Foreign currency translation

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

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

All transactional exchange differences are recognised in the income statement. Exchange variations arising on consolidation from the translation of the net investment in foreign subsidiaries, including loans forming part of the net investment, are recognised in the foreign currency translation reserve in equity.

m) Income tax

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

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

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

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

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised. Exceptions to this position arise:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date to determine whether it is probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. The carrying amount of deferred tax assets is reduced to the extent that it is not probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

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

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

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

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

2 Summary of Significant Accounting Policies (continued)

Tax consolidation

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

n) Other taxes

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

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

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

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

o) Plant and equipment

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

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

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

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

Disposal

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

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

p) Investments and other financial assets

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

The carrying values of investments in controlled entities are reviewed for impairment at each reporting date. The recoverable amount of investments in and loans to controlled entities is the higher of estimated fair value less costs to sell and value in use.

q) Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment.

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

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units, or groups of cash generating units, that are expected to benefit from the goodwill, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. The cash generating units are the same as the business segments referred to in Note 2(x), and no goodwill is allocated to R&D activities.

Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Impairment losses recognised for goodwill are not subsequently reversed.

r) Intangible assets

The only intangible assets other than goodwill recognised by the group are software assets. There has been no change in policy in relation to software. The amounts capitalised (refer note 13) represent the acquisition cost of software packages used in the design, development and administrative activities of the group. These amounts are amortised over a period of no more than three years, and are assessed for impairment on an annual basis.

2 Summary of Significant Accounting Policies (continued)

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, a review of activity will be conducted on a project by project basis, and the cost model will be applied, requiring the development asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is to be amortised over the period of expected benefits from the related project. No such expenditure has yet been capitalised by the Group.

s) Trade and other payables

Trade payables and other payables are non interest bearing and are carried at amortised cost. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are generally paid on 30 day terms.

t) Provisions and employee leave benefits

Provisions

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

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

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at balance date using a discounted cashflow methodology. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the time value of money and the risks specific to the liability.

Employee leave benefits

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

Liabilities for wages and salaries, including non-monetary benefits, superannuation and annual leave expected to be settled within 12 months of the reporting dates are recognised in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. Expenses for non-accumulating sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

(ii) Long service leave

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

u) Share-based payment transactions

(i) Equity settled transactions:

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

There is an Employee Share Option Plan (ESOP) in place, which provides benefits to employees.

The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined using a Black Scholes valuation model, further details of which are provided in note 16.

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

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

At each reporting date until vesting the cumulative charge to the income statement is the product of (i) the grant date fair value of the award; (ii) the current best estimate of the number of equity instruments that will ultimately vest, taking into account such factors as the likelihood of employee turnover during the vesting period, and the likelihood of non market performance conditions being met, and (iii) the expired portion of the vesting period.

The charge to the income statement for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding entry to equity.

2 Summary of Significant Accounting Policies (continued)

Until an award has vested, any amounts recorded are contingent and will be adjusted if more or fewer awards vest than were originally anticipated to do so. Any award subject to a market condition is considered to vest irrespective of whether or not that market condition is fulfilled, provided all other conditions are satisfied.

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

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

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings / (loss) per share (see note 7).

v) Contributed equity

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

w) Earnings (Loss) per share

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

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

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

divided by the weighted average number of ordinary shares and dilutive potential ordinary shares.

x) Segment reporting

A business segment is a distinguishable component of the entity that is engaged in providing products or services that are subject to risks and returns that are different to those of other operating business segments.

A geographical segment is a distinguishable component of an entity that is engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different from those of segments operating in other economic environments.

3 Financial Risk Management Objectives and Policies

The Group's principal financial instruments comprise receivables, payables, cash and short-term deposits and derivatives.

In the context of the Group's overall risk profile, financial instruments do not represent the most significant exposure. Commercial risk associated with our business partnerships, technology risk around future development and market risk relating to adoption of the technology will have considerably more impact on our risk profile than the risks relating to financial instruments.

The Group monitors its exposure to key financial risks, principally currency and liquidity risk, with the objective of achieving the Group's financial targets whilst protecting future financial security.

The Group enters into derivative transactions from time to time, mainly forward currency contracts. The purpose is to manage the currency risks arising from the Group's operations. These derivatives provide economic hedges, but do not qualify for hedge accounting and are based on limits set by the Board. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are, foreign currency risk, liquidity risk, interest rate risk and credit risk. The Group uses different methods to measure and manage different types of risks to which it is exposed. These include monitoring levels of exposure to interest rate and foreign exchange risk and assessments of market forecasts for interest and foreign exchange rates. Liquidity risk is monitored through the development of future rolling cash flow forecasts and regular internal reporting. There is a lesser degree of risk management in relation to interest rate risk and credit risk, as these are considered to have less capacity to materially impact the Group's financial position at the present time.

The Board reviews and agrees policies for managing each of these risks as summarised below. Primary responsibility for identification and control of financial risks rests with the Board. It reviews and agrees policies for managing each of the risks, including the use of derivatives, hedging cover of foreign currency, credit allowances, and future cash flow forecast projections.

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

3 Financial Risk Management Objectives and Policies (continued)

Risk Exposures and Responses

Interest rate risk

The Group's exposure to market interest rates relates primarily to the Group's cash and cash equivalents. The Group has no interest bearing debt obligations. Interest rate risk affects interest income, so a climate of increasing interest rates will increase income and conversely, falling rates will reduce income. However, the impact of movements in interest rates is not material in the context of the Group's operations or trading results.

At balance date, the Group had the following financial assets exposed to Australian Variable interest rate risk that are not designated in cash flow hedges:

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Cash and cash equivalents	3,925,361	5,224,771	547,919	499,754

The following sensitivity analysis is based on the interest rate risk exposures in existence at the balance sheet date:

At 30 June 2008, if interest rates had moved throughout the year, as illustrated in the table below, with all other variables held constant, post tax loss and equity would have been affected as follows:

Judgements of reasonably possible movements in interest rates:	Net Loss (Higher) Lower		Equity Higher (Lower)	
	2008 $	2007 $	2008 $	2007 $
Consolidated				
+1.25% (125 basis points)	56,735	69,221	-	-
-1.25% (125 basis points)	(56,735)	(69,221)	-	-
Parent				
+1.25% (125 basis points)	10,738	5,724	-	-
-1.25% (125 basis points)	(10,738)	(5,724)	-	-

The movement factor of 1.25% was selected as reasonably possible because it was the amount of change that occurred in Australian official interest rates during the year to 30 June 2008. The movements in net loss are due to higher and lower amounts of interest received from interest bearing cash balances. There is no movement in equity as there are no derivative instruments designated as cash flow hedges.

Foreign currency risk

As nearly all of the Group's sales revenue, as well as some expenses and inventory purchases, are denominated in United States Dollars, the Group's balance sheet can be affected by significant movements in the US$/A$ exchange rates.

Group policy is to hedge a minimum of 50% of any individual transactions in excess of $100,000 for which payment or receipt is anticipated more than one month after the Group has entered into a firm commitment for a sale or purchase. These contracts usually have a term that reflects the underlying transaction term, which is 30 or 45 day payment for receivables, and 30 day payment for payables.

It is the Group's policy not to enter into forward contracts until a firm commitment is in place and to negotiate the terms of the economic hedge to match the terms of the hedged item.

At 30 June 2008, there were no economic hedges in place in respect of net US$ exposures, as the balance outstanding was below the materiality threshold. At 30 June 2008, unhedged net payables amounted to US$75,222. At 30 June, 2007, net receivables amounted to US$830,600, of which US$460,000 was hedged.

3 Financial Risk Management Objectives and Policies (continued)

At 30 June 2008, the Group had the following exposure to US$ foreign currency that is not designated in cash flow hedges:

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Financial Assets				
Cash and cash equivalents	48,352	590,776	-	-
Trade and other receivables	70,590	916,721	-	-
Financial Liabilities				
Trade and other payables	(145,812)	(86,121)	-	-
Net exposure	(26,870)	1,421,376	-	-

The following sensitivity is based on the foreign currency risk exposures in existence at the balance sheet date:

At 30 June 2008, had the Australian Dollar moved by the same amount experienced during the past year, as illustrated in the table below, with all other variables held constant, post tax loss and equity would have been affected as follows:

Judgements of reasonably possible movements in A$/US$ exchange rates:	Net Loss (Higher) Lower		Equity Higher (Lower)	
	2008 $	2007 $	2008 $	2007 $
Consolidated				
AUD/USD +13.07%	2,797	(167,276)	-	-
AUD/USD - 13.07%	(3,492)	208,879	-	-
Parent				
AUD/USD +13.07%	-	-	-	-
AUD/USD - 13.07%	-	-	-	-

The movements in net loss in 2007 are significantly more sensitive than in 2008 due to the higher level of US Dollar exposures at balance date, as disclosed in the table above.

Management believe the balance date risk exposures are representative of the risk exposure inherent in the financial instruments.

Credit risk

Credit risk arises from the financial assets of the Group, which comprise cash and cash equivalents, trade and other receivables and derivative instruments. The Group's exposure to credit risk arises from potential default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. Exposure at balance date is addressed in each applicable note. The Group does not hold any credit derivatives to offset its credit exposure.

The Group trades only with recognised, creditworthy third parties, and as such collateral is not requested nor is it the Group's policy to securitise its trade and other receivables. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures including an assessment of their independent credit rating, financial position, past experience and industry reputation. Risk limits are set for each individual customer, and are regularly monitored. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

There is a significant concentration of credit risk in relation to the exclusive licensing agreement with Pentax (Hoya). All sales of the ISC-1000 are made to Pentax. The amount outstanding at balance date is $81,830 (2007: $941,882).

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

3 Financial Risk Management Objectives and Policies (continued)

Liquidity risk and capital management

The Group's objective is to maintain adequate funding of its activities. To date, all capital financing has been derived from issues of equity, and as the business model evolves, the Group will consider the use of debt financing, should this be appropriate. Capital management is therefore a process of monitoring cash reserves and forecast cash requirements. There are no externally imposed capital requirements.

The table below reflects all contractually fixed pay-offs and receivables for settlement from recognised financial assets and liabilities, including derivative financial instruments as of 30 June 2008. For derivative financial instruments the market value is presented, whereas for the other payables and receivables, the amounts disclosed are undiscounted cash flows anticipated to eventuate in the next fiscal year. Cash flows for financial assets and liabilities without fixed amount or timing are based on the conditions existing at 30 June 2008.

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
At call				
Cash and cash equivalents	3,368,892	4,963,814	547,919	499,537
90 days or less				
Cash and cash equivalents	621,628	972,759	-	-
Trade and other receivables	482,491	1,588,094	-	-
Derivatives	-	2,874	-	-
Trade and other payables	(608,188)	(758,108)	-	-
Net maturity	3,864,823	6,769,433	547,919	499,537
Greater than 90 days	-	-	-	-

The contractual maturities of the Group's and parent entity's financial assets and liabilities set out in the table are equivalent to the maturity analysis of financial assets and liability based on management's expectation.

The risk implied from the values in the table reflects a balanced view of cash inflows and outflows. Trade payables and other financial liabilities mainly originate from investments in working capital, principally inventories and trade receivables. These assets are considered in the Group's overall liquidity risk, which is monitored through review of forecasts of liquidity reserves on the basis of expected cash flow.

The cash and cash equivalent balance classified as being capable of settlement within 90 days includes term deposits which are secured by the bank (refer note 18). These amounts could be released within 90 days upon cancellation of the underlying bank facilities, or upon a re-negotiation of the security arrangements, for example, by providing a charge over assets other than cash.

The Group's activities are funded from its cash reserves. There are no unused credit facilities. Bank facilities are non credit lines, details of which are disclosed in note 18.

Fair value

The methods for estimating fair value are outlined in the relevant notes to the financial statements, and unless specifically stated, carrying value approximates fair value for all financial instruments.

4 Segment Information

The Group's primary segment reporting format is business segments. The group does not operate in multiple geographic segments, as all activities are conducted in Australia.

The group has two separate business segments, being product realisation (trading), where activities comprise manufacturing and sales of confocal imaging products, and research and development, where activities include design and development of new products and technologies.

	Trading $	R&D $	Unallocated $	Total $
Year ended 30 June 2008				
Revenue				
Sales to external customers	1,427,035	-	-	1,427,035
Other revenues	-	324,874	1,073,077	1,397,951
Inter segment revenue	-	-	-	-
Total consolidated revenue	1,427,035	324,874	1,397,951	2,824,986
Result				
Net profit (loss) for year by segment	(857,913)	(2,751,439)	(1,374,988)	(4,984,340)
Assets and liabilities				
Segment assets *	4,109,737	328,191	4,792,152	9,230,080
Segment liabilities	(711,610)	(422,392)	(392,564)	(1,526,566)
Segment net assets	3,398,127	(94,201)	4,399,588	7,703,514
Cash flow				
Segment net cash flow from operating activities	(35,797)	(2,534,737)	(1,524,405)	(4,094,939)
Investing cash flows	(13,671)	(304,948)	(237,104)	(555,723)
Financing cash flows	-	-	2,655,094	2,655,094
Net cash flow for year	(49,468)	(2,839,685)	893,585	(1,995,568)
Other Segment information				
Non cash expenses				
Depreciation and amortisation	64,777	139,339	199,160	403,276
Share based payments	18,747	59,759	22,019	100,525
Revenue by geographic segment (location of customer)				
Asia	1,083,975	-	508,615	1,592,590
Australia	116,470	-	292,949	409,419
Europe	-	324,874	265,246	590,120
USA	226,590	-	6,267	232,857
Total	1,427,035	324,874	1,073.077	2,824,986

* Unallocated segment assets include cash

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

4 Segment Information (continued)

	Trading $	R&D $	Unallocated $	Total $
Year ended 30 June 2007				
Revenue				
Sales to external customers	5,707,536	-	-	5,707,536
Other revenues from external customers	-	-	2,837,058	2,837,058
Inter segment revenue	-	-	-	-
Total consolidated revenue	5,707,536	-	2,837,058	8,544,594
Result				
Net profit (loss) for year by segment	1,110,936	(3,095,920)	(154,496)	(2,139,481)
Assets and liabilities				
Segment assets *	4,767,619	162,584	6,674,101	11,604,304
Segment liabilities	(581,245)	(404,789)	(685,103)	(1,671,137)
Segment net assets	4,186,374	(242,205)	5,988,998	9,933,167
Cash flow				
Segment net cash flow from operating activities	1,032,060	(2,879,660)	(34,669)	(1,882,270)
Investing cash flows	(245,049)	(144,468)	(173,454)	(562,971)
Financing cash flows	-	-	1,630,671	1,630,671
Net cash flow for year	787,011	(3,024,128)	1,422,548	(814,570)
Other Segment information				
Non cash expenses				
Depreciation and amortisation	98,816	97,382	109,692	305,890
Share based payments	13,995	80,849	33,639	128,483
Revenue by geographic segment (location of customer)				
Asia	5,439,951	-	654,702	6,094,653
Australia	28,425	-	337,764	366,189
Europe	-	-	1,837,438	1,837,438
USA	239,160	-	7,154	246,314
Total	5,707,536	-	2,837,058	8,544,594

* Unallocated segment assets include cash

5 Revenues and Expenses

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Revenue and Expenses				
(a) Other revenue				
(i) Royalty revenue				
Recurring royalty revenue	360,663	422,337	-	-
Initial license fees	324,874	-	-	-
Royalty entitlement settlements [1]	419,465	2,076,957	-	-
Total royalty revenue	1,105,002	2,499,294	-	-
[1] In 2004/2005, Optiscan announced that following hearings in the Japanese Patent Office and European Patent Office, the geographic coverage of its first generation of core patents had been extended to Japan and key European countries. The nature of these hearings meant that unpaid and outstanding royalties from existing licensees of Optiscan technology could be pursued.				
(ii) Finance revenue – bank interest received	292,949	337,764	47,771	27,334
Total other revenue	1,397,951	2,837,058	47,771	27,334
(b) Other income				
Design and development income	413,614	-	-	-
Lease income	25,685	-	-	-
Government grants	643,090	897,697	-	-
Total Other Income	1,082,389	897,697	-	-
(c) Depreciation and amortisation				
-Depreciation included in Cost of sales	64,777	63,307	-	-
- Depreciation included in Marketing expenses	32,715	7,054	-	-
- Depreciation included in R&D expenses	139,339	97,382	-	-
- Depreciation included in Administration expenses	124,493	108,784	-	-
	361,324	276,527	-	-
- Amortisation of software included in Administration expenses	41,952	29,363	-	-
	403,276	305,890	-	-
(d) Employee benefits expense				
Wages and salaries	4,258,713	4,478,689	220,000	220,000
Workers' compensation costs	40,257	45,302	-	-
Defined contribution plan expense	394,716	378,610	-	-
Annual leave provision	4,674	91,863	-	-
Long service leave provision	54,050	(10,473)	-	-
Share-based payments expense	100,525	128,483	128,483	128,483
	4,852,935	5,112,474	348,483	348,483

Notes to the Financial Statements

for the year ended 30 June 2008 (continued)

5 Revenues and Expenses (continued)

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
(e) Cost of inventories recognised as an expense				
Consumed in R&D	39,030	127,523	-	-
(f) Other expenses included in income statement				
Minimum lease payments – operating lease	266,019	290,575	-	-
Warranty provision (note 19)	(19,349)	149,722	-	-
(g) Impairment losses				
(included as part of "Investing expenses" in the income statement)				
Impairment loss in respect of loans to subsidiaries (Refer note 9)	-	-	2,000,741	1,667,838
Impairment loss in respect of investment in subsidiaries (Refer note 2(p) and notes 11 and 23)	-	-	2,609,396	-
	-	-	4,610,137	1,667,838

6 Income Tax

The components of income tax expense are:				
Income Statement				
Current income tax				
Current income tax charge	-	-	-	-
Adjustments in respect of current income tax of previous year	-	-	-	-
Withholding tax deducted from royalty revenue	(52,288)	(73,306)	-	-
Deferred income tax				
Relating to origination and reversal of temporary differences	-	-	-	-
Income tax expense reported in the income statement	(52,288)	(73,306)	-	-
A reconciliation between tax expense and the product of accounting loss before income tax multiplied by the Group's applicable income tax rate is as follows:				
Accounting loss before income tax	(4,932,052)	(2,066,175)	(4,985,272)	(2,139,481)
Prima facie income tax (benefit) at the Parent entity's statutory income tax rate of 30% (2007: 30%)	(1,495,302)	(619,852)	(1,495,582)	(641,844)
Adjustments in respect of current income tax of previous years	-	-	-	-
Current year adjustments				
Non assessable gains	(5,387)	(6,009)	-	-
Share based payments not deductible	30,158	38,545	30,158	38,545
R&D Tax Concession allowance	(319,320)	(228,435)	-	-
Expenditure not allowable for income tax purposes	2,506	23,797	1,383,041	481,411
Deductible movements through equity	(2,388)	(20,593)	(2,388)	-
Deferred tax assets not recognised	1,789,533	812,547	84,771	121,888
Foreign withholding tax deductions from royalties	52,288	73,306	-	-
Income tax expense	52,288	73,306	-	-

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

6 Income Tax (continued)

	Balance Sheet		Income Statement	
	2008 $	2007 $	2008 $	2007 $
Deferred income tax - not brought to account				
Deferred income tax at 30 June relates to the following items and has not been brought to account (Refer note 2(m):				
CONSOLIDATED				
Deferred tax liability				
Accrued income not yet assessable	(23,945)	-	(23,945)	-
Deferred tax assets				
Undeducted patent costs	137,950	112,078	25,872	21,818
Employee benefit & warranty provisions	275,512	273,909	1,604	69,334
Expenses not yet deductible	50,592	56,368	(5,777)	17,509
Inventory impairment provision	91,380	91,380	-	(89,580)
Deferred deductible equity issue costs	30,290	48,523	(18,232)	451
Tax Losses and foreign tax credits available for offset against future taxable income	11,420,537	10,103,707	1,810,011	793,015
Gross deferred income tax assets	11,982,316	10,685,965		
Less amounts not recognised in accounts	(11,982,316)	(10,685,965)		
Gross deferred income tax assets	-	-		
Deferred tax income/ (expense) incurred			1,789,533	812,547
Less deferred income tax not recognised in accounts			(1,789,533)	(812,547)
Deferred tax income/ (expense)			-	-
PARENT				
Deferred tax assets				
Deferred deductible equity issue costs	30,056	48,054	(17,998)	686
Less amounts not recognised in accounts	(30,056)	(48,054)		
Gross deferred income tax assets	-	-		
Deferred tax income/ (expense) incurred			(17,998)	686
Less deferred income tax not recognised in accounts			17,998	(686)
Deferred tax income/ (expense)			-	-

6 Income Tax (continued)

Tax Losses

The Group has unconfirmed, unrecouped tax losses in Australia of $36,858,522 (2007: $30,825,151) that are available indefinitely for offset against future taxable profits of the companies in which the losses arose. These amounts have not been brought to account as it is not yet probable, in the context of AASB112 Income Taxes, that taxable profit will be available against which the deductible temporary differences can be utilised.

Withholding tax

A total of $362,980 has been deducted from remittances of royalties to the group in accordance with the withholding tax obligations of the payers. These deductions represent foreign tax credits which may be available to reduce Australian income tax payable in future years. These amounts have not been brought to account as it is not yet probable, in the context of AASB112 Income Taxes, that the tax credits will be utilised.

Tax Consolidation

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

7 Earnings (Loss) Per Share

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

	CONSOLIDATED	
	2008 $	2007 $
Net loss	(4,984,340)	(2,139,481)

	2008 Number	2007 Number
Weighted average number of ordinary shares for basic earnings per share	104,332,044	100,448,035
Effects of dilution:		
Share options	-	-
Weighted average number of ordinary shares adjusted for the effect of dilution	104,332,044	100,448,035
Weighted average number of converted, lapsed or cancelled potential ordinary shares included in diluted earnings per share	-	-
Options on issue have been determined to be not dilutive, as a loss was incurred during the year.		
There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements, other than the issue of ordinary shares pursuant to the exercise of employee options as follows:		
- Number of options exercised at price of $0.32	-	190,625
- Number of options exercised at price of $0.39	-	101,000
- Number of options exercised at price of $0.40	-	9,333
- Number of options exercised at price of $0.45	-	20,000
Total number of shares issued since balance date	-	320,958

8 Cash and Cash Equivalents

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. At balance date the weighted average interest rate is 7.39% (2007: 6.38%), and the weighted average term to maturity is 79 days (2007: 45 days). The fair value of cash at bank and on deposit approximates the carrying amount, in view of the short term to maturity. Term deposits amounting to $590,000 are subject to a charge which secure banking facilities made available to the group (refer note 18).

Reconciliation to Cash Flow Statement

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

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Cash at bank and in hand	2,831,160	4,481,598	3,097,849	499,754
Short-term deposits	1,169,548	1,472,512	-	-
Amounts owing on credit card facilities	(10,188)	(17,537)	-	-
	3,990,520	5,936,573	3,097,849	499,754
Reconciliation of net loss after tax to net cash flows from operations				
Net loss	(4,984,340)	(2,139,481)	(4,985,272)	(2,139,481)
Adjustments for:				
Depreciation and amortisation	403,276	305,890	-	-
Net fair value change on derivatives	-	(2,874)	-	-
Impairment of non current assets	-	-	4,610,137	1,667,838
Net exchange differences	(49,515)	(99,761)	-	-
Share options expensed	100,525	128,483	100,525	128,483
Exchange differences recognised in equity	(932)	-	-	-
Changes in assets and liabilities				
(Increase)/decrease in trade and other receivables	1,105,603	(251,389)	(6,967)	3,321
(Increase)/decrease in inventories	(526,941)	182,364	-	-
(Increase)/decrease in prepayments	(918)	(12,311)	-	-
(Increase)/decrease in derivatives	2,874	(2,325)	-	-
(Decrease)/increase in trade and other payables	(149,918)	(212,429)	7,959	-
(Decrease)/increase in unearned income	-	(9,549)	-	-
(Decrease)/increase in provisions	5,347	231,112	-	-
Net cash from / (used in) operating activities	(4,094,939)	(1,882,270)	(273,618)	(339,839)

Disclosure of financing facilities - Refer to note 18.

9 Trade and Other Receivables

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
CURRENT				
Trade receivables	86,184	1,222,053	-	-
Royalties receivable	209,763	240,860	-	-
Grants receivable	79,815	-	-	-
GST refund receivable	82,992	95,714	-	-
Interest receivable	9,320	21,252	6,967	-
Other receivables	14,417	8,215	-	-
Related party receivables – wholly owned group				
Amounts receivable from controlled entities (note 23)	-	-	33,063,362	33,279,982
Accumulated impairment	-	-	(33,063,362)	(30,453,967)
Net carrying amount	482,491	1,588,095	6,697	2,826,015

Ageing Analysis of Receivables

	Total	0-30 Days	31-60 Days	61-90 Days PDNI*	90+ Days PDNI*
Consolidated – 2008	482,491	360,093	105,066	-	17,332
Consolidated – 2007	1,588,094	1,130,412	266,631	162,780	28,271

* Past due not impaired (“PDNI”)

(i) All receivables shown as past due were received shortly after balance date, as a result of follow up action by the company.

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

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

(iv) The fair value of receivables approximates the carrying amount, in view of the short term nature of the trading terms.

(v) The maximum exposure to credit risk is the fair value of receivables. Collateral is not held as security, nor is it the Group’s policy to transfer or on sell receivables to special purpose vehicles.

(vi) Details regarding foreign exchange risk exposure of current receivables are disclosed in note 3.

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

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

10 Inventories

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Raw materials (at net realisable value)	1,201,366	1,140,963	-	-
Work in progress (at cost)	175,873	202,867	-	-
Finished goods (at cost)	508,029	14,497	-	-
Total inventories at the lower of cost and net realisable value	1,885,268	1,358,327	-	-

11 Other Financial Assets (Non-Current)

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Investments in controlled entities at cost (Note 23)	-	-	6,607,398	6,607,398
Accumulated impairment	-	-	(2,000,741)	-
Investments in controlled entities at cost (Note 23)	-	-	4,606,657	6,607,398

12 Plant and Equipment

Consolidated*

YEAR ENDED 30 JUNE 2008	Office Furniture & Equipment 2008 $	Production Equipment 2008 $	R&D Equipment 2008 $	Total Plant & Equipment 2008 $
Opening balance, net of accumulated depreciation and impairment	257,538	195,472	162,584	615,594
Additions	222,409	13,671	304,946	541,026
Depreciation charge for the year	(157,208)	(64,777)	(139,339)	(361,324)
At 30 June 2008, net of accumulated depreciation and impairment	322,739	144,366	328,191	795,296
At 1 July 2007				
Cost	389,515	317,260	291,934	998,709
Accumulated depreciation and impairment	(131,976)	(121,788)	(129,351)	(383,115)
Net carrying amount	257,539	195,472	162,583	615,594
At 30 June 2008				
Cost	542,291	322,165	476,834	1,341,290
Accumulated depreciation and impairment	(219,552)	(177,799)	(148,643)	(545,994)
Net carrying amount	322,739	144,366	328,191	795,296

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

12 Plant and Equipment (continued)

Consolidated*

YEAR ENDED 30 JUNE 2007	Office Furniture & Equipment 2007 $	Production Equipment 2007 $	R&D Equipment 2007 $	Total Plant & Equipment 2007 $
Opening balance, net of accumulated depreciation and impairment	112,780	167,268	115,498	395,546
Additions	260,596	91,511	144,468	496,575
Depreciation charge for the year	(115,837)	(63,307)	(97,383)	(276,527)
At 30 June 2007, net of accumulated depreciation and impairment	257,539	195,472	162,583	615,594
At I July 2006				
Cost	223,400	253,251	210,860	687,511
Accumulated depreciation and impairment	(110,620)	(85,983)	(95,363)	(291,965)
Net carrying amount	112,780	167,268	115,498	395,546
At 30 June 2007				
Cost	389,515	317,260	291,934	998,709
Accumulated depreciation and impairment	(131,976)	(121,788)	(129,351)	(383,115)
Net carrying amount	257,539	195,472	162,583	615,594

The useful lives of the assets for both for 2008 and 2007 are estimated to be between two and five years.
* Consolidated totals only. The parent entity has no plant and equipment.

13 Intangible Assets – Software

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Opening balance net of accumulated amortisation and impairment	76,621	39,588	-	-
Additions during year	14,697	66,396	-	-
Amortisation	(41,952)	(29,363)	-	-
Net carrying amount	49,366	76,621	-	-
At cost	111,104	103,316	-	-
Accumulated amortisation	(61,738)	(26,695)	-	-
Net carrying amount	49,366	76,621	-	-

14 Goodwill

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Carrying amount	1,981,467	1,981,467	-	-

Goodwill was purchased as part of a business combination in 1997. As from 1 July 2004, goodwill is no longer amortised but is now subject to annual impairment testing (see note 15). No impairment loss was recognised in the 2008 financial year.

15 Impairment Testing of Goodwill

Annual impairment testing requires an assessment of the recoverable amount of the cash-generating unit ("CGU") to which the goodwill relates, which is the higher of its fair value less costs to sell, and its value in use.

The fair value less costs to sell is estimated by reference to the market value of the group. The market capitalisation, when adjusted to exclude net trading assets and costs to sell is substantially in excess of an estimate of the value in use, and both amounts exceed the current carrying amount of the CGU to which the goodwill has been allocated. Accordingly, no impairment adjustment is required.

Value in use has been assessed by reference to cash flows from both royalties and from the sale of products. Forecasts of cash flows are based on the Group's five year budget. They assume modest sales to Pentax, carrying forward into more robust volumes in the second generation product during the forecast period. They also assume sales of rigid endoscope products and sales of the FIVE1 research instrument.

The full carrying amount of goodwill has been allocated to the product realisation segment of the group's business. No goodwill is allocated to the research and development segment.

Varying pre tax discount rates have been applied to the cash flow projections, reflecting management's assessment of the risk profile associated with each cash flow. Royalty cash flows have a relatively high degree of certainty, and have been discounted at 10%. FIVE1 sales have been discounted at 20%, and Pentax sales at 20% to 25% to allow for future growth and volume uncertainty. Sales of rigid endomicroscopes, through the Carl Zeiss collaboration, as well as own brand products have been discounted at 20 to 25% to allow for price and volume uncertainty.

Key assumptions used in the value in use calculations

The key assumptions on which management has based its cash flow projections when determining the value in use of the CGU to which goodwill has been allocated are as follows:

Sales volumes of endomicroscopes
Sales volumes of endomicroscopes will continue to grow as confocal microscopy is progressively adopted, and when multi-centre trials achieve proof of efficacy and enable reimbursement by insurers. There is a degree of risk with forward sales estimates of second generation products, and this is reflected in the discount rate adopted by management (20% - 25%).

Flexible endomicroscopy partnership with Pentax/Hoya
The partnership with Pentax will continue in accordance with the relevant agreements. Although it is difficult to assess the effect of the merger of Pentax and Hoya on the ISC-1000 confocal microscope product, we have assumed that Pentax and Hoya will continue to observe their obligations under our agreements. We anticipate a reinvigorated marketing campaign, and enhanced efforts to achieve key marketing goals including multi centre trials leading to reimbursement by insurers.

Development and commercialisation of rigid endoscope products and partnerships
The company will successfully develop applications in rigid endoscopy, and will form partnerships to commercialise new products. There is a degree of risk in identifying potential partners, reaching appropriate agreements, developing products and achieving sales. Management has assigned discount rates of 20% to 25% to take account of these risk factors, notwithstanding that they have been significantly mitigated over the past year.

Optiscan FIVE 1
Management has assumed that there will be continuing increasing sales of the Optiscan FIVE 1 research instrument. As early sales have already been achieved, business plans have been activated, and sales executives have been engaged in Australia and USA. The sales targets are modest, and anticipated cash flows have been discounted at 20%, reflecting uncertainty around timing, rather than volume of cash flows.

Gross margins will be consistent with those achieved in the current year
Management has assumed that current manufacturing costs and sales values will be maintained. Negotiated pricing arrangements and agreements are incorporated in cash flows, providing a high degree of confidence that margins will be maintained.

Growth rates used to extrapolate cash flow projections
There is little historical or industry data to guide the extrapolation of growth rates beyond the five year horizon in the budget. The group has adopted conservative terminal values based on 2.5% annual sales growth until 2020, representing the current patent portfolio life. The resultant cash flows have been discounted at 60% to reflect the inherent uncertainty in these assumptions.

Sensitivity to changes in assumptions.

The key sensitivities relate to the discount rates applied in the impairment model.

Future sales projections have been discounted at various rates, with the result that the overall average discount rate is 25%. If this rate rises above 36%, the impairment model indicates a likelihood of impairment of goodwill. If a lower discount rate is applied, an increasing safety margin over the impairment threshold is achieved. Similarly, if terminal values are discounted by more than 77%, impairment of goodwill may eventuate.

16 Share-Based Payment Plans

Employee Share Option Plan

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

The expense recognised in the income statement in relation to share-based payments is disclosed in note 5(d).

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

	No. Options 2008	WAEP 2008	No. Options 2007	WAEP 2007
Outstanding at the beginning of the year	6,386,650	0.45	5,570,900	0.46
Granted during the year	865,000	0.31	1,237,000	0.50
Forfeited during the year	(1,326,200)	0.54	-	-
Exercised during the year	(320,958)[1]	0.35	(81,250)	0.37
Expired during the year	(464,250)	0.54	(340,000)	1.07
Outstanding at the end of the year	5,140,242	0.39	6,386,650[1]	0.44
Exercisable at the end of the year	2,951,943	0.36	3,399,850	0.45

[1] The weighted average share price at the date of exercise was $0.55 (2007, $0.46)

The outstanding balance as at 30 June 2008 is represented by:

Options expiring in the year :	No. Options	WAEP
- 2008/2009	548,650	0.45
- 2009/2010	665,667	0.40
- 2010/2011	1,962,625	0.32
- 2011/2012	1,135,800	0.50
- 2012/2013	827,500	0.31
	5,140,242	0.39

The weighted average remaining contractual life for the share options outstanding as at 30 June 2008 is 2 years, 8 months (32 months).

The weighted average fair value of options granted during the year was $0.0628 (2007: $0.146).

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

16 Share Based Payment Plans (continued)

The following tables list the inputs to the model used for option issues during the years ended 30 June 2008 and 30 June 2007:

	2008	2007
	Issue to staff 22 Jan 2008	Issue to staff 19 June 2007
Number of options	865,000	1,237,000
Dividend yield (%)	-	-
Expected volatility (%)	50.00	40.0
Risk-free interest rate (%)	6.287	6.405
Expected life of option (years)	4.5	4.5
Option exercise price ($)	0.31	0.50
Share price at grant date ($)	0.21	0.445

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

17 Trade and Other Payables (Current)

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Trade payables (i)	383,452	221,256	-	-
Accrued expenses	224,738	536,852	7,959	-
	608,190	758,108	7,959	-

(i) Trade payables are non-interest bearing and are normally settled on 30-day terms. The fair value of trade payables approximates the carrying amount due to the short term nature of the trading terms.

18 Bank Facilities And Borrowings

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

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

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Total facilities provided by the group's bankers:				
- foreign currency hedging	100,000	400,000	-	-
- credit cards	70,000	120,000	-	-
- bank guarantees and indemnities	250,000	200,000	-	-
- bills negotiated under credit	240,000	-	-	-
- electronic transaction facility	50,000	50,000	-	-
	710,000	770,000	-	-
Facilities used at reporting date:				
- foreign currency hedging	-	46,000	-	-
- credit cards	10,188	17,537	-	-
- bank guarantees and indemnities	221,500	158,250	-	-
- bills negotiated under credit	-	-	-	-
- electronic transaction facility	-	-	-	-
	231,688	221,787	-	-
Facilities unused at reporting date:				
- foreign currency hedging	100,000	354,000	-	-
- credit cards	59,812	102,463	-	-
- bank guarantees and indemnities	28,500	41,750	-	-
- bills negotiated under credit	240,000	-	-	-
- electronic transaction facility	50,000	50,000	-	-
	478,312	548,213	-	-
Total facilities	710,000	770,000	-	-
Facilities used at reporting date	231,688	221,787	-	-
Facilities unused at reporting date	478,312	548,213	-	-
Assets pledged as security				
The bank facilities are secured by charges over specific term deposits on an ongoing floating basis	590,000	890,000		

Terms of Security

The bank has a charge over term deposits amounting to $590,000 which secures the facilities outlined above. The charge provides the bank with the right of set off any amounts owing under these facilities against the balance of the term deposit. The charge endures for as long as the group maintains its banking facilities.

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

19 Provisions

	Annual Leave	Long Service Leave	Warranty	Total
	$	$	$	$
CONSOLIDATED *				
At 1 July 2007	371,986	300,139	240,904	913,029
Arising during the year	4,673	54,050	40,106	98,829
Utilised	-	-	(34,027)	(34,027)
Unused amounts reversed	-	-	(59,455)	(59,455)
At 30 June 2008	376,659	354,189	187,528	918,376
Current 2008	376,659	305,940	187,528	870,127
Non-current 2008	-	48,249	-	48,249
	376,659	354,189	187,528	918,376
Current 2007	371,986	208,026	240,904	820,916
Non-current 2007	-	92,113	-	92,113
	371,986	300,139	240,904	913,029

* There are no provisions in the parent entity

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

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

Warranty
A provision for warranty at the rate of 3% of sales has been provided since product release in March 2006. The incidence of warranty claims will be monitored on an ongoing basis to assess adequacy of the provision.

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

20 Contributed Equity and Reserves

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Ordinary shares - Issued and fully paid	43,428,415	40,773,321	43,428,415	40,773,321

Effective 1 July 1998, the Corporations legislation abolished the concepts of authorised capital and par value shares. Accordingly, the Parent does not have authorised capital nor par value in respect of its issued shares.

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

	No of Shares	$
Movement in ordinary shares on issue		
At 1 July 2006	100,159,573	39,142,650
Issued for cash pursuant to share purchase plan	3,628,131	1,668,940
Issued for cash upon exercise of employee options	81,250	30,375
Transaction costs on share issue	-	(68,644)
At 30 June 2007	103,868,954	40,773,321
Issued for cash upon exercise of employee options	320,958	113,123
Issued for cash on placement	11,086,653	2,549,930
Transaction costs on share issue	-	(7,959)
At 30 June 2008	115,276,565	43,428,415

Share options

The company has a share based payment option plan under which options to subscribe for the company's shares have been granted to employees (refer note 16).

20 Contributed Equity and Reserves (continued)

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Accumulated losses				
Movements in accumulated losses were as follows:				
Balance 1 July	(31,356,717)	(29,217,236)	(31,356,717)	(29,217,236)
Net loss for the year	(4,984,340)	(2,139,481)	(4,985,272)	(2,139,481)
Balance 30 June	(36,341,057)	(31,356,717)	(36,341,989)	(31,356,717)
Reserves				
Movements in reserves were as follows:				
Employee Equity Benefits Reserve				
Balance 1 July	516,563	388,080	516,563	388,080
Share based payments	100,525	128,483	100,525	128,483
Balance 30 June	617,088	516,563	617,088	516,563
Foreign Currency Translation Reserve				
Balance 1 July	-	-	-	-
Foreign currency translation difference	(932)	-	-	-
Balance 30 June	(932)	-	-	-
Total reserves	616,156	516,563	617,088	516,563

Nature and purpose of reserves

Employee equity benefits reserve
This reserve is used to record the value of equity benefits provided to employees as part of their remuneration. Refer to note 16 for further details of the option plan.

Foreign currency translation reserve
This reserve is used for foreign currency translation differences arising on the consolidation of the USA subsidiary, Optiscan Inc.

21 Derivatives and Hedging

Economic hedging activities

At 30 June 2008, there were no currency option contracts or forward exchange contracts in existence, as the currency exposures from underlying operations were below the materiality threshold.

At 30 June 2007, the Group held one currency option contract and one forward exchange contract treated as economic hedges of contracted sales to customers in United States dollars.

The terms of the forward contracts were as follows:

	Maturity	Exchange rate
Forward contracts to hedge US$ sales		
Sell		
US$230,000*	16 July 2007	A$/US$0.8435
US$230,000	18 July 2007	A$/US$0.8435
* Option contract		

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

The forward exchange and option contracts were marked to fair value at balance date, with a gain of $2,874 taken to the income statement (refer Note 2k).

Fair value change in derivatives

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Non-hedging foreign currency receivable (payable)	-	2,874	-	-
	-	2,874	-	-

Non-hedging foreign currency receivable/(payable) represents the net receivable/(payable) arising from foreign currency forward and option contracts.

22 Commitments and Contingencies

Operating lease commitments – Group as lessee

The previous property lease over the premises occupied by the Group expired in September 2007. The Group has indicated its preparedness to enter into a further lease, but no new lease has yet been executed. The Group currently occupies the premises on a monthly tenancy.

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

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Within one year	-	52,572	-	-
After one year but not more than five years	-	-	-	-
	-	52,572	-	-

The Group has entered into a collaborative research agreement with an Australian University. The term of the agreement is 2 years, and expires in September 2008. The Group has contributed $225,000 and has committed to provide future research funding of $34,000 over the remaining term of the agreement, subject to achievement of nominated milestones.

22 Commitments and Contingencies (continued)

Capital commitments

At 30 June 2008 there were no material capital commitments outstanding.

Contingent Liabilities

The group has contingent liabilities in relation to bank guarantees on issue at balance date amounting to $221,500 (2007: $158,250).

23 Related Party Disclosure

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

		% Equity interest		Investment $	
Name	Country of incorporation	2008	2007	2008	2007
At cost:					
Optiscan Pty Ltd	Australia	100	100	6,605,396	6,605,396
Optiscan Inc	United States	100	100	2,002	2,002
Accumulated impairment				(2,000,741)	-
				4,606,657	6,607,398

Optiscan Imaging Limited is the ultimate Australian parent entity.

Transactions with Subsidiaries

Inter-company transactions between the parent entity, Optiscan Imaging Limited and subsidiary, Optiscan Pty Ltd amounted to $216,619 (2007, $1,106,025). Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash. The balances are classified current by the parent entity.

The amounts outstanding at year end are set out in Note 9. An impairment assessment is undertaken each financial year by examining the financial position of the subsidiaries to determine whether there is objective evidence that a related party receivable is impaired. When such objective evidence exists, an impairment loss is recognised.

24 Events After the Balance Sheet Date

Subsequent to 30 June 2008, the company issued 1,956,966 fully paid ordinary shares at $0.23 each, raising $450,102. Other than this matter, the directors are not aware of any events after balance date that would have a material impact on the financial statements at 30 June 2008.

25 Auditors' Remuneration

The auditor of Optiscan Imaging Limited is Ernst & Young (Australia).

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Amounts received or due and receivable by Ernst & Young (Australia) for:				
• An audit or review of the financial report of the entity and any other entity in the consolidated group	53,728	51,480	1,415	1,225
• Other services in relation to the entity and any other entity in the consolidated group				
- tax compliance	15,750	11,000	-	-
- other assurance services	2,884	2,575	-	-
	72,362	65,055	1,415	1,225

26 Director and Executive Disclosures

Details of Key Management Personnel

(i) Directors

G. Latta	Chairman (non-executive)
M. Barnett	Chief Executive Officer (Resigned 31 December 2007)
V. Tutungi	Chief Executive Officer (Appointed 4 February 2008)
P. Delaney	Director of Technology
K. Daniel	Director (non-executive)
A. Rogers	Director (non-executive)

(ii) Executives

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

On 1 July 2008, James Fox was appointed as a non-executive director. There were no other changes of key management personnel after reporting date and the date the financial report was authorised for issue.

Compensation of Key Management Personnel

Table 1: Compensation of Key Management Personnel for the year ended 30 June 2008

	Consolidated		Parent	
	2008 $	2007 $	2008 $	2007 $
Short term employee benefits	1,218,270	1,376,559	180,000	220,000
Post Employment benefits	104,244	114,890	10,800	10,800
Other Long-Term	18,106	6,468	-	-
Share-based payment	16,161	35,354	16,161	35,354
	1,356,781	1,533,271	206,961	266,154

Other transactions and balances with Key Management Personnel

Purchases
During the year, purchases amounting to $550 (2007: $636) at normal market prices have been made from CBC Consolidated Bearings Pty Ltd, a subsidiary of Inenco Pty Ltd, a company of which Matthew Barnett is a director.

Notes to the Financial Statements
for the year ended 30 June 2008 (continued)

26 Director and Executive Disclosures (continued)

Option holdings of Key Management Personnel

Options holdings of Key Management Personnel for the year ended 30 June 2008

						Vested at 30 June 2008		
30 June 2008	Balance at beginning of period 01-Jul-07	Granted as Remuneration	Options Exercised	Options Expired Forfeited	Balance at end of period 30-Jun-08	Total Vested	Exercisable	Not Exercisable
Directors								
G. Latta	-	-	-	-	-	-	-	-
M. Barnett	1,000,000	-	-	(1,000,000)	-	-	-	-
P. Delaney	450,000	-	-	-	450,000	450,000	450,000	-
K. Daniel	-	-	-	-	-	-	-	-
A. Rogers	-	-	-	-	-	-	-	-
V. Tutungi	-	-	-	-	-	-	-	-
Executives								
J. Allen	349,000	40,000	-	(95,000)	294,000	191,667	191,667	-
B. Andrew	321,500	40,000	-	(81,250)	280,250	177,917	177,917	-
R. Pattie	280,000	40,000	-	(30,000)	290,000	176,667	176,667	-
Total	2,400,500	120,000	-	(1,206,250)	1,314,250	996,251	996,251	-

No options were exercised during the year ended 30 June 2008.

Options holdings of Key Management Personnel for the year ended 30 June 2007

						Vested at 30 June 2007		
30 June 2007	Balance at beginning of period 01-Jul-06	Granted as Remuneration	Options Exercised	Options Expired Forfeited	Balance at end of period 30-Jun-07	Total Vested	Exercisable	Not Exercisable
Directors								
G. Latta	-	-	-	-	-	-	-	-
M. Barnett	1,000,000	-	-	-	1,000,000	1,000,000	1,000,000	-
P. Delaney	450,000	-	-	-	450,000	300,000	300,000	-
K. Daniel	-	-	-	-	-	-	-	-
A. Rogers	-	-	-	-	-	-	-	-
Executives								
J. Allen	360,000	44,000	-	(55,000)	349,000	200,000	200,000	-
B. Andrew	307,500	44,000	-	(30,000)	321,500	177,083	177,083	-
R. Pattie	245,000	55,000	-	(20,000)	280,000	125,000	125,000	-
Total	2,362,500	143,000	-	(105,000)	2,400,500	1,802,083	1,802,083	-

26 Director and Executive Disclosures (continued)

Shareholdings of Key Management Personnel

Shares held in Optiscan Imaging Limited for the year ended 30 June 2008 (number)

Vested at 30 June 2008

30 June 2008	Balance at beginning of period 01-Jul-07	Granted as Remuneration	Options Exercised	Purchased on market	Balance at end of period 30-Jun-08
Directors					
G. Latta	130,000	-	-	100,000	230,000
P. Delaney	3,476,349	-	-	-	3,476,349
K. Daniel	160,000	-	-	-	160,000
A. Rogers	200,000	-	-	75,000	275,000
V. Tutungi	-	-	-	-	-
Executives					
J. Allen	-	-	-	-	-
B. Andrew	40,000	-	-	-	40,000
R. Pattie	-	-	-	-	-
Total	4,006,349	-	-	275,000	4,281,349

Shares held in Optiscan Imaging Limited for the year ended 30 June 2007 (number)

30 June 2007	Balance at beginning of period 01-Jul-06	Granted as Remuneration	Options Exercised	Purchased on market	Balance at end of period 30-Jun-07
Directors					
G. Latta	130,000	-	-	-	130,000
M. Barnett	100,000	-	-	-	100,000
P. Delaney	3,476,349	-	-	-	3,476,349
K. Daniel	160,000	-	-	-	160,000
A. Rogers	200,000	-	-	-	200,000
Executives					
J. Allen	-	-	-	-	-
B. Andrew	40,000	-	-	-	40,000
R. Pattie	-	-	-	-	-
Total	4,106,349	-	-	-	4,106,349

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

Post balance date purchase of shares by directors.
Following approval in a general meeting held on 12 August 2008, certain directors purchased shares as disclosed in the directors' report, under Directors' Interests.

Directors' Declaration

In accordance with a resolution of the directors of Optiscan Imaging Limited, I state that:

1 In the opinion of the directors:

(a) the financial statements, notes and the additional disclosures included in the Directors' Report designated as audited, of the company and of the consolidated entity are in accordance with the Corporations Act 2001, including:

i giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2008 and of their performance for the year ended on that date; and

ii complying with Australian 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.

2 This declaration has been made after receiving the declarations required to be made to the directors in accordance with sections 295A of the Corporations Act 2001 for the financial year ending 30 June 2008.

On behalf of the Board

Vicki Tutungi
Director

Melbourne, 28 August 2008

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Independent audit report to members of Optiscan Imaging Limited

Report on the Financial Report

We have audited the accompanying financial report of Optiscan Imaging Limited, which comprises the balance sheet as at 30 June 2008, and the income statement, statement of recognised income and expense and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the Financial Report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 2(a), the directors also state that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

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

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

Independence

In conducting our audit we have met the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report. 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.

Auditor's Opinion

In our opinion:

1. the financial report of Optiscan Imaging Limited is in accordance with 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 2008 and of their performance for the year ended on that date; and

   ii complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.

2. the financial report also complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Inherent Uncertainty Regarding Continuation as a Going Concern

Without qualification to the opinion expressed above, attention is drawn to the following matter:

As outline in Note 2 (a) to the financial statements, in common with other biotechnology companies, the operations of the consolidated entity and company are subject to substantial risks due primarily to the nature of the product development and commercialisation being undertaken.

In addition, in order for the consolidated entity and company to execute their longer term plans, it will be necessary to raise additional funds in the future. The Directors cannot be certain of the success of any intended fund raising or the success of any product development or commercialisation. As a result of these factors there is significant uncertainty whether the consolidated entity and company will be able to continue as going concerns, and the company and consolidated entity therefore may not be able to pay their debts as and when they become due and payable, and therefore whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

The financial report does not include adjustments relating to the recoverability and classification of recorded amounts or to the amounts and classification of liabilities that might be necessary should the company and consolidated entity not continue as going concerns.

Report on the Remuneration Report

We have audited the Remuneration Report included in pages 20 to 28 of the directors' report for the year ended 30 June 2008. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

ERNST & YOUNG

Auditor's Opinion

In our opinion the Remuneration Report of Optiscan Imaging Limited for the year ended 30 June 2008 complies with section 300A of the *Corporations Act 2001*.

Ernst & Young

Ernst & Young

Don Brumley
Partner

Melbourne
28 August 2008

ASX AusBiotech Code of Best Practice

The following information is provided in accordance with the ASX AusBiotech Code of Best Practice.

Patent information

Optiscan has a substantial patent portfolio comprising 45 granted patents from 54 patent families. A table of the Group's patents is set out on pages 78-79.

The portfolio comprises three key groups of patents. The first relates to the use of fibre optics in laser scanning confocal microscopes. These core patents expire in 2009, and enabled the company to design and build its first benchtop confocal microscope for the research market in 1995.

The second group of patents relate to the miniaturised scanner created in 1998 and 1999, and to its further refinement and development. These patents are fundamental to the miniaturisation that has enabled clinical, in vivo imaging. Their 20 year life extends out to 2020 and beyond.

The third core group of patents relate to the collaborative development of the endo-microscope with Pentax. These patents have been jointly registered with Pentax over the past few years, and are currently undergoing examination prior to application for formal registration.

All of the patents are registered in key international markets. There is a substantial cost associated with application, registration and renewal of patents, so judgement must be exercised in determining which jurisdictions should be covered.

Information about patent activity carried out by Optiscan during 2007/2008 is set out in the Directors' Review of Operations in the Directors' Report.

R&D Activities

R&D activities represent a substantial proportion of the overall activity of companies in this sector. A description of Optiscan's R&D activities during the past year is included in the Directors' Review of Operations in the Directors' Report.

Clinical Trials

Clinical trials are central to the business model of Optiscan. They provide direction for new applications of existing products; they assist the development of new products by identifying areas of medical need, and they provide a path to commercialisation of products by satisfying various regulatory requirements.

Details of the clinical trial activity carried out by Optiscan during 2007/2008 are set out in the Directors' Review of Operations in the Directors' Report.

Quality System

The Optiscan Quality System covers all activities related to the Design, Development, Manufacture and Servicing of Rigid and Flexible Confocal Endo-microscope Imaging Systems.

Details of the accreditations achieved by Optiscan are as follows:

Accreditation	Description	Expiry Date	Issuing authority EN ISO
EN ISO 13485:2003	Design, Development, Manufacture and Servicing of Rigid and Flexible Confocal Endomicroscope Imaging Systems.	1 Mar 2011	TUV-Rheinland.
ISO 13485:2003 (CMDCAS)		2 Apr 2009	Standards Council of Canada (via TUV-Rheinland)
European Medical Device Directive EC 93/42/EEC Annex II	Design, development, manufacture and servicing of Confocal Endoscopic Imaging Systems.	1 Mar 2011	TUV Rheinland

Optiscan is also subject to NRTL factory inspection with Pentax for the final testing of the ISC-1000 to UL60601-1:2003 and CAN/CSA-C22.2 No.601.1-M90:2005. In addition, the US subsidiary of Pentax Corporation has obtained FDA Regulatory Approval under a Section 510(k) notification for the sale and medical use of the ISC-1000 and the Confocal Endoscope as an imaging device. Optiscan has also completed NRTL factory inspection audits for the final testing of the FIVE 1 pre clinical imaging system and the CEIS for clinical imaging in rigid endoscopic applications.

ASX AusBiotech Code of Best Practice (continued)

Key Regulatory Matters

The regulatory landscape for Optiscan varies considerably between medical devices destined for the clinical (human) market, and those for the research (non human) market. There is, understandably, a substantially higher regulatory requirement where a device is intended for use in humans.

There is no universal regime for regulation of medical devices. As a result, regulatory issues must be considered in the context of various regions and regulatory authorities.

Furthermore, regulatory requirements are product specific, so the descriptions of regulatory matters outlined below relate to the Pentax ISC 1000.

The ISC-1000 is currently being sold in the USA with a 510(k) clearance provided by the FDA. This clearance enables sales, but does not allow claims to be made about the efficacy or diagnostic abilities of the device, for example, “it detects early stage cancer”. Such claims can only be made after they have been substantiated by sound, statistical evidence. Therefore, multi-centre trials need to be conducted to demonstrate that such outcomes can be consistently achieved across a range of sites and patients. When this data is provided to, and accepted by the FDA, sales and marketing with such claims are possible.

The ISC-1000 is currently being sold throughout Europe (the EU designated countries), as both Optiscan and Pentax have satisfied the requirements of the European Medical Device Directive. The instrument is sold with marketing claims of providing an image. As with USA, multi-centre trials need to be conducted to derive statistical data to demonstrate and enable diagnostic claims.

Optiscan has achieved the required Canadian Quality Assurance Certification and the Canadian subsidiary of Pentax Corporation has obtained specific product registration for the ISC-1000 within Canada.

Pentax’s Australian distributor, C R Kennedy, has obtained TGA device approval using the harmonised approach with the European CE Mark system for medical devices.

Whilst other major countries have unique processes and requirements they generally have a degree of overlap with the requirements of the European Medical Device Directive. Pentax Corporation is currently pursuing product registration for the ISC-1000 in a number of other major countries, particularly in Asia.

Summary of Key Optiscan Patents

Patent Title	Countries Applied	Countries Granted		Expiry Date
Scanning Confocal Microscope		USA Australia	5120953 652713	13 Nov 2009 13 Jul 2009
Scanning Confocal Microscope		Italy France UK Germany	1243987 “ “ 689295537	
Scanning Confocal Endoscope		Switzerland France UK Italy Germany	0393165 “ “ “ 68928345.8	13 Jul 2009
Scanning Confocal Endoscope with Fibre Scanning		France UK Italy Germany	0782027 68929464.6	13 Jul 2009
Confocal Microscope		Australia USA Canada Japan UK France Italy Germany	610430 5161053 1325537 3583125 0764866 “ “ 68929262.7	1 Aug 2009
Confocal Microscope		Australia Japan USA UK Canada Germany	643787 3052150 5323009 0523159 2079882 69112394.2	21 Jun 2011
Confocal Microscope		Australia USA	669760 5659642	19 Aug 2014
Confocal Microscope		Australia	672876	8 Feb 2014

ASX AusBiotech Code of Best Practice (continued)

Summary of Key Optiscan Patents (continued)

Patent Title	Countries Applied		Countries Granted		Expiry Date
Optical Fibre Confocal Imager with Variable Near Confocal Control	Japan Germany Canada	P1996-528700 19681304.2 2215975	USA Australia	5926592 694005	24 Mar 2016
Scanning Microscope with Miniature Head	Germany	19882512.9	UK USA	2340332 6967772	16 Jul 2018
Endoscope or Microscope Method and Apparatus			UK	2353369	17 Jun 2019
Compact Confocal Endoscope and Endomicroscope	Germany USA	19940421.6 09/382457	UK	2341943	25 Aug 2019
Electrically Operated Tuning Fork	Europe Japan	00934807.9 P2001-501929	Australia USA	759742 7010978	8 Jun 2020
Z Sharpening for Fibre Confocal Microscope			UK USA	363,025 6567585	4 Apr 2020
Scanning Method & Apparatus	US Germany Japan	60/422119 10393608.4 P2004-547279	UK	2411071	30 Oct 2023
Light Scanning Device *	USA Germany Japan	10/508541 103924426 P2003-578994			
Laser Scanning Confocal Microscope with Fibre Bundle Return	USA	10/510175			
Method & Apparatus for Providing Depth Control for Z Actuation *	Germany Japan	102004018110.1 P2004-118579	USA	7294102	13 April 2024
Optical Connector *	Germany USA Japan	102004024396 10/845223 P2004-145424			
Multiplexed Fibre Optic Sensor	USA	10/917213			
Endoscope *	Japan USA Germany	P2003-138009 10/774,450 102004006541.1			
Objective Lens Unit - 2 Frames *	Japan Germany USA	P2003-31818 102004006543.8 10/771,043			
Confocal Optical Systems *	Japan Japan Germany	P2003-314204 P2003-357896 102004043049.7	USA	7338439	11 Feb 2030
Fluid Harmonic Scanner	Australia USA	2004901059 11/069044			
Actuation Control Switch *	Japan USA	P2005-182150 60/462324			
Scanning Apparatus	PCT/AU20050/01466				
Endoscope	PCT/AU2005/001782				
Fibre Bundle Confocal Endomicroscope	PCT/AU2006/000069				
Fibre Bundle for Contact Endomicroscopy	PCT/AU2005/001954				

* Indicates patents that have been filed in the joint names of Optiscan Pty Ltd and Pentax Corporation.
Patent applications that are in earlier stages of filing or where the specifications have not been published have not been included in the above list.

ASX Additional Information

Additional information required by the Australian Stock Exchange Ltd and not shown elsewhere in this report is as follows. The information is current as at 31 August 2008.

(a) Distribution of equity securities

117,233,531 fully paid ordinary shares are held by 4,339 individual shareholders. All issued ordinary shares carry one vote per share and carry the rights to dividends.

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

	Total Holders	No of Fully paid ordinary shares
1 – 1,000	884	547,714
1,001 – 5,000	1,551	4,549,527
5,001 – 10,000	605	5,068,104
10,001 – 100,000	1,162	36,178,484
100,001 – and over	137	70,889,702
	4,339	117,233,531
Holding less than a marketable parcel	1,551	1,705,058

(b) Substantial shareholders

Name	Number	Percentage
Fibre Optics Pty Ltd	8,135,151	6.94

(c) Twenty largest holders of quoted equity securities

	Fully Paid	
Ordinary shareholders	Number	Percentage
1. Fibre Optics Pty Ltd	8,135,151	6.94
2. Gralaw Pty Ltd	5,826,000	4.97
3. Ixohoxi Pty Ltd	4,976,248	4.24
4. Asahi Optical Company Limited	3,330,000	2.84
5. Mr Peter Maxwell Delaney	3,206,259	2.73
6. HSBC Custody Nominees (Australia) Limited	3,137,538	2.68
7. Dixson Trust Pty Limited	2,626,020	2.24
8. National Nominees Limited	2,572,716	2.19
9. Mr Brian Catley & Mrs Julia Catley <B N Catley Super Fund A/C>	1,611,770	1.37
10. S W R Harris Holdings Pty Ltd	1,543,004	1.32
11. WAL Assets Pty Ltd	1,436,957	1.23
12. Exwere Investments Pty Ltd	1,134,696	0.97
13. Latta Nominees Pty Ltd <Super Fund A/C>	1,100,000	0.94
14. ANZ Nominees Limited <Cash Income A/C>	1,072,955	0.92
15. Mr Alfred Joseph Winkelmeier	1,000,000	0.85
16. Eryri Pty Ltd	888,888	0.76
17. Traders Macquarie Pty Ltd	869,566	0.74
18. Citicorp Nominees Pty Limited	834,266	0.71
19. Merrill Lynch (Australia) Nominees Pty Limited	780,682	0.67
20. Mr Antony Rogers & Mrs Dawn Rogers <Cooinda Super Fund A/C>	709,783	0.61
	36,965,249	35.48

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