Optiscan Imaging Limited

ABN 81 077 771 987

Annual Financial Report

for the year ended 30 June 2007

Contents

Corporate Information

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 5 to 26. The directors' report is not part of the financial report.

Directors

G. F. Latta (Chairman)
M.H. Barnett (Chief Executive Officer)
K.P. Daniel
P. M. Delaney
A. W. Rogers

Company Secretary

B.R. Andrew

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Australia

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Solicitors

Lander & Rogers
600 Bourke Street
Melbourne VIC 3000

Auditors

Ernst & Young
Australia

Bankers

ANZ Banking Group
National Australia Bank

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 2007.

Directors

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

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

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

Grant F. Latta *AM*
CPA, FAICD, B.Bus, MBA, FAIM, AAMI
Age 57

Grant Latta is Executive Chairman of GCMCorp Pty Ltd, a 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;
- Optiscan Imaging Limited
- Biota Holdings Limited
- Ricegrowers Limited

Directors' Report (continued)

Matthew H Barnett,
B Eng (Hons), MBA, GAICD
Age 44

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

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.

On 13 August 2007, the Group reported that Matthew Barnett would step down from the role of CEO before year end, and a replacement CEO is being sought.

Keith P. Daniel
FTSE, FIEAust, CPEng
Age 64

Keith Daniel is a non-executive director with extensive experience in the commercialisation of medical instruments. He has spent the last 38 years in the medical device industry largely taking innovative Australian technology to world markets. During most of that time he has held senior general management and technology management roles in various global subsidiaries of Nucleus Ltd. including the role of CEO and Chairman of Nucleus before his retirement in 1999. Nucleus has been the nurturer of many of Australia's leading health care companies including Cochlear Limited, the world's leading manufacturer of implantable prosthetic devices for the hearing impaired; the Telectronics group, developing and marketing implantable cardiac pacemakers and defibrillators, and AMBRI Pty Ltd, the developer of a breakthrough technology in the field of membrane biosensors.

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

Directors' Report (continued)

Peter M. Delaney *BSc(Pharm) (Hons.)* *Age 39*	Peter Delaney, Director of Technology, completed a science degree with honours in Pharmacology at Monash University in 1989. He has played a major role in the refinement of the fibre optic approach to produce a commercial instrument which received an R&D 100 Award in 1991. In 1993, Mr Delaney received the Victorian Young Achiever Award (Science and Technology) for his development of the company strategy and infrastructure. Mr Delaney was appointed a director of Optiscan Pty Ltd in March 1994, and was Managing Director until December 2002, at which time he assumed the role of Director of Technology.
Antony (Tony) Rogers *CPA, MAICD* *Age 64*	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 4 years. He also served on the Federal Government's Waterfront Commission. From 1993 to 1997, Mr Rogers was CEO of Smorgon ARC and served on the Smorgon Steel board and Smorgon Group Operations Executive. Mr Rogers was appointed a non-executive director of Optiscan in August 2002, and is Chairman of the Audit Committee.

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

On 13 August 2007, the Group reported that CEO, Matthew Barnett would step down from the role before year end.

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 date of this report are:

Holder	*Ordinary Shares*	*Employee Options*
Grant Latta	130,000	-
Matthew Barnett	100,000	1,000,000
Keith Daniel	160,000	-
Peter Delaney	3,206,259	450,000
Tony Rogers	200,000	-

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 twenty (20) Directors' meetings during the year. The attendances of the directors at meetings of the Board were:

Board of Directors		
Director	Attended	Maximum possible attended
Grant Latta	20	20
Matthew Barnett	20	20
Keith Daniel	20	20
Peter Delaney	18	20
Tony Rogers	20	20

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	3	3	3
Audit Committee Meetings Attended	3	2	3
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

Directors' Report (continued)

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 $2,139,481 after income tax. This represents a 46% decrease on the 2006 consolidated loss of $3,936,760.

Review of Operations

2006/07 has been a year of considerable advancement for Optiscan's business.

Optiscan's product sales increased substantially with the first full year of Pentax ISC 1000 flexible endomicroscope sales into global markets. Significant advances in training infrastructure, clinical trials and market development activities were completed in support of Pentax's released product. The first Optiscan FIVE 1 preclinical research instruments were also sold during the year adding to product sales growth.

Optiscan's first partnership in rigid endo-microscopy was formed with the Carl Zeiss Group just on year end. Carl Zeiss's global leadership in high precision optical instruments for medical markets makes them a perfect partner for Optiscan. Importantly, the agreement with Carl Zeiss covers specified areas of application so there are significant additional opportunities available for further partnerships or Optiscan branded instruments.

During the year, design and development of instruments commenced as a distinct revenue stream for our company. Agreements reached with Pentax and Carl Zeiss will have both partners contributing to future instrument design and development over the coming two years. Being able to design and develop endo-microscopes keeps our partners at the forefront of endomicroscope technology and is an important component of the value we offer.

Highlights During 2006/07:

- Record sales of $5.7 million, up 77% on pcp
- Record gross profit of $1.8 million, up 126% on pcp
- Net loss reduced to $2.14 million, down 46% on pcp
    - Profit from the product sales segment of the business $1.1 million, up 390% on pcp
- $20 million milestone based partnership deal with the Carl Zeiss Group in mutually agreed segments of rigid endo-microscopy
- $7 million further agreement with Pentax to develop market for endomicroscopy and fund further instrument development
- Sales of our first "own brand" product, the *Optiscan FIVE1*
- Settlement of royalty entitlements for $2.1 million

These major commercial achievements and the acknowledged utility and potential of our unique endomicroscope instruments will underwrite our future commercial success.

Directors' Report (continued)

Review of Operations (continued)

Pentax ISC 1000 : Market Penetration and Development

Following the global market release by Pentax of the ISC-1000 in March 2006, confocal endomicroscopy is now being adopted in leading gastrointestinal medical centres around the world.

Sales Progress

In Europe, there was good uptake of the product, with installations in numerous countries including France, Germany, Italy, Israel, United Kingdom and South Africa. Progress in the USA was less than what we had hoped, and it is tracking six to twelve months behind the rate of progress in Europe. However, toward year end, installations into several major sites including Mayo clinic and Tucson VA have established a solid base for further roll out over the coming year.

To date, sales into Asia and Australasia have been limited. Pentax's primary focus has been directed to the major US and European markets. Sales have been made in Singapore and Thailand and clinical trial sites are established in both Australia and New Zealand. Pentax's Australian distributor has several enquiries at present and we are hopeful that first sales in Australia are imminent.

Overall, initial market penetration has been satisfactory, and there is some short term upside from development of the US and Asia regions. However we have received advice from Pentax of an inventory build up in ISC 1000 control boxes that will reduce forward orders and forecasts for a time. By contrast, Pentax's requirements for miniaturised scanners have remained solid. We would have liked to achieve an uninterrupted, seamless increase in sales after product release, as might happen for example with a consumer product. However, we have always understood that the release of a new, paradigm shifting technology will invariably involve uncertainty in the rate of early adoption.

In the longer term, the choppy and unpredictable nature of sales will settle, as understanding of the technology becomes more widespread and forecasting procedures mature. There will be a number of drivers that will play a role in this process, in particular doctor training, the range of clinical applications, and clinical trials that lead to improved reimbursement.

Training

Training is an important consideration for any new medical instrument, device or technique. Doctors typically learn how to use new devices from other more experienced doctors. During the year, significant progress was made in the area of training infrastructure.

In the USA, Johns Hopkins Hospital announced that their doctors would work with Mainz University Hospital in Germany and Pentax in a collaboration on the use of endomicroscopy. This development built on the success achieved by Mainz in establishing the first endomicroscopy training centre, and would introduce training capability into the key US market.

In Europe, Mainz University Hospital training created a more formal structure of training program delivery and greatly increased the number of doctors trained during the year. There has been very strong demand for these courses, and most streams have been fully booked by endoscopists wanting to learn from the leading global centre in endomicroscopy.

In the United Kingdom, the Royal Hallamshire Hospital and the Sheffield Children's Hospital announced the formation of the Sheffield Academy of Endomicroscopy, which will offer training in both adult and paediatric endomicroscope procedures.

In addition, the educational website, www.endomicroscopy.org was substantially upgraded during the year. The site now provides an introduction to endomicroscopy with emphasis on clinical practice and techniques.

Directors' Report (continued)

Review of Operations (continued)

There are interactive case studies with patient histories, standard endoscope images, endomicroscope images and corresponding histology from biopsy.

Demand for training increased during the year as doctors presented at industry congresses and numerous journal publications continued to feature the utility of the instrument. This year's DDW congress featured 14 presentations on endomicroscopy and 8 articles have now appeared in leading journals for gastro-intestinal medicine. In addition, telecasts of live demonstrations of endomicroscope procedures at industry seminars and training days also increased demand for training.

These training initiatives are essential components of the process of introducing endomicroscopy to the world market.

Breadth of Applications

The broad uptake of confocal endomicroscopy will be influenced by the range of applications in flexible endomicroscopy. At the outset, most attention was directed toward procedures where multiple biopsies are used as standard of care. In colonoscopy this included conditions of colorectal cancer and inflammatory bowel disease (IBD) such as ulcerative colitis while in the upper GI tract it meant conditions such as Barrett's esophagus and Barrett's related cancer.

During the year, clinical trials continued to expand the utility of endomicroscopes. In addition to the strong applications already established, an expanding range of diseases and conditions are being successfully managed using endomicroscopy, including

- Diagnosis of the causes of persistent diarrhoea: microscopic colitis
- Management of gastritis and gastric cancer
- Diagnosis and mapping of squamous cell carcinoma of the esophagus
- Identification of non erosive reflux disease (NERD)
- Diagnosis of intestinal metaplasia
- Helicobacter pylori – positive gastritis
- Detection of graft versus host disease in stem cell recipients
- Post operative monitoring in restorative proctocolectomy surgery
- Small bowel diseases: coeliac disease, lymphoma

Expanding the range of conditions where confocal has demonstrated efficacy expands market interest and sales potential. Demonstrated applications of endomicroscopy now encompass major GI disorders encountered by gastrointestinal endoscopists.

Clinical Trials Leading to Additional Reimbursement

Obtaining additional reimbursement for endomicroscope procedures is probably the key accelerant of global sales growth.

With excellent single centre clinical data complete, the next stage of clinical trial activity is multi centre trials. These trials go beyond simply proving the efficacy of the technology. Multi centre trials are a controlled program where identical procedures are carried out across a range of sites by a range of doctors.

At the conclusion of these trials, the outcomes are collated and the data is analysed to assess the extent to which similar outcomes are achieved. When it can be demonstrated that the same conclusions and outcomes are being reached by a range of doctors, then strong efficacy based marketing claims can be made, and securing additional reimbursement from health insurers for endomicroscope procedures becomes possible.

The multi centre trial program conducted by Pentax progressed during the year, albeit at a pace that is slower than we expected. In Europe, arrangements are in hand for the commencement of trials in coming

Directors' Report (continued)

Review of Operations (continued)

months, with the data expected to be collated late in 2007. In the USA, the key sites for participation in trials have been identified. The timing is expected to lag behind Europe by approximately six months.

In a significant confirmation of their commitment to this crucial market development process, Pentax has formally agreed with Optiscan to spend approximately $4.5 million to fund achievement of reimbursement in Europe and the USA. Importantly, they have also confirmed a higher level of involvement from Optiscan personnel, which will increase our ability to influence both direction and progress.

Hoya's Acquisition of Pentax

During the year, Pentax announced plans to merge with Hoya Corporation, a Japanese company with highly profitable businesses in information technology components, photonics and eye care (glasses, contact lens and intraocular lenses). The intended merger process did not progress smoothly. It consumed considerable senior management time and resulted in two sets of changes in Board personnel. However, shortly after year end Hoya reported that its tender offer for Pentax shares had resulted in it acquiring more than 90% of Pentax and it would finalise the acquisition and make Pentax a full subsidiary company.

Hoya has stated that the strategic rationale for the merger is access to the growth potential in Pentax's Life Care (endoscope) business. Hoya has announced their intentions for aggressive growth and expansion of the endoscope business using the strong cashflows available from their more mature and highly profitable business streams. We expect Hoya will initiate a period of exciting growth and development for the Pentax endoscope business.

Optiscan FIVE 1 : Strong Response and Initial Sales

After clearing some unexpected hurdles with import regulations for the Optiscan FIVE 1 research confocal microscope, a number of sales were made during the year. The product is the first "own brand" endomicroscope taken to market by Optiscan.

As planned, there has been a modest level of activity and investment in the initial marketing of the instrument. Promotional activities have been focused on target markets with the potential to leverage value from the unique imaging capabilities of the instrument. The Optiscan FIVE 1 has been displayed at several exhibitions in USA, Europe and the Asia Pacific region. These activities have been conducted by existing Optiscan staff on a modest budget.

There is a good level of interest in the instrument, with several early sales secured and strong interest from a number of potential distributors. Due to the requirements of many potential customers to fit a purchase into annual grant funding cycles, the sales leadtime for Optiscan FIVE 1 instruments is significant. We continue to issue many quotes for instruments and expect a portion of these to translate into firm orders as grant funding is approved.

As we move forward, we will continue to refine the target market, our marketing materials and our marketing strategy, focusing on preclinical medical research and pharmaceutical development. We will continue to develop applications data and imaging protocols for these markets. As we progress through the funding and approval cycles, we will monitor the resourcing of our sales efforts and increase them as required.

Carl Zeiss Group : Our First Partner in Rigid Endomicroscopy

Our dialogue with potential partners in the US$1 billion rigid endoscopy market continued throughout the year, in parallel with a number of "First Time in Human" clinical trials.

Directors' Report (continued)

Review of Operations (continued)

In June, this culminated in reaching agreement with the Carl Zeiss Group to develop, market and sell rigid confocal endomicroscopes into mutually agreed segments of the market. The agreement was executed and announced on 3 July 2007.

The key features of the Carl Zeiss collaboration are:

- The A$20 million value of the agreement to Optiscan comprises milestone payments of $4 million over 3 years and expected product sales of $16 million over the first five years.
- Utilising its patented endomicroscope platform, Optiscan will work with Carl Zeiss to develop an endomicroscope instrument specifically designed for use by clinical specialists in key Zeiss markets.
- Carl Zeiss will be responsible for costs associated with endomicroscope integration into their existing product platform, as well as market development, marketing and instrument sales.
- Optiscan will manufacture Zeiss branded endomicroscopes in its recently upgraded, state of the art Australian manufacturing facility. The instruments will be exported to Carl Zeiss in Germany prior to shipping to global customers.

We are maintaining our dialogue with other participants in the rigid endoscope market, and our engagement in associated clinical trials is continuing. We expect that as the uptake of confocal endomicroscopy continues, there will be a corresponding increase in the identification of potential new applications in rigid endoscopy, as physicians recognise the power of the technique and look at how it might be applied to disease conditions and patients groups in the respective areas of practice. We expect this will lead to further collaborations in rigid endomicroscopy.

New Revenue Stream : Instrument Design and Development

In order to ensure our partners remain at the forefront of endomicroscopy, Optiscan has positioned itself to offer design and development of improved, new generation endomicroscope instruments. They will feature specified combinations of enhanced utility, smaller scanners, smarter service diagnostics, simpler manufacturability and lower cost.

As we improve our platform technology through these design and development efforts, we will provide instance specific systems for Pentax, Carl Zeiss, Optiscan FIVE 1 and other new product variations. These factors create a complex range of variables that must be managed along with the engineering and technological challenges inherent with each project.

In a significant development for our overall business model during the year, we reached separate agreements with our partners to make meaningful contributions to the costs of ongoing design and development.

- In June, a further collaboration agreement with Pentax committed them to contribute $2.5 million over coming years to the development of new instruments to meet their future needs. To ensure diagnostic capabilities are completely preserved, these instruments will offer users the same excellent image quality as the current ISC 1000,but will feature improved workflows and system integration functionality.

- The agreement reached with Carl Zeiss features $4 million of milestone payments for reaching agreed design, development and clinical trial outcomes.

Our strategy is to ensure we receive significant payments from our partners for this work while retaining our strong IP position over scanner technology. We believe that scanners embody much of our skills, know-how

Directors' Report (continued)

Review of Operations (continued)

and experience and will be our central intellectual property in years to come. Joint funding results in joint IP, so in order to optimise our position, we internally finance all new scanner developments. As we continue to seek development cost contributions from partners, they will relate to system design and development, clinical trials testing and other costs specific to each partner's instrument(s).

In addition to this development activity, we continued ongoing research projects in alternative lens design and deeper imaging, including multiphoton, which is the subject of the Commercial Ready Grant received from the Australian Government.

Our commitment to ongoing research, design and development means this activity was our largest expense category in 2006/07. During the year our expenditure increased 18% to $3.7 million, representing nearly 50% of total expenses and we received no contributions from our partners. This was a significant investment in the future but it ensured that we could attract partner contributions for future years. By purposefully maintaining ourselves at the forefront of global development, we have extended long term shareholder value.

Investor Relations

We are one of the few companies in our sector of the investment market that has navigated the development path and emerged with regulatory cleared product and sales revenues. We have a platform technology that is being commercialised across a number of fields in medicine and research. Progress with the evolution of our business makes us an increasingly compelling investment opportunity for professional investors and institutions.

We have maintained investor roadshow activity in 2006/2007, putting our story to key institutions and brokers in the Australian market. We also attended a US roadshow to present to some small cap institutional and professional investors with an interest in developing companies in Australia and Asia Pacific.

We will continue to target these investors, as they bring both credibility and stability to the share register, and reduce the volatility associated with investors who take short term, speculative positions. We will also maintain our efforts to keep all stakeholders appraised of our activities and progress.

Over the past year, our median share price was 47 cents, the same as the closing price at year end.

Financial Results

The net loss after tax for the year ended 30 June 2007 was $2.14 million. This compares to a loss of $3.94 million in the previous corresponding period, an improvement of $1.8 million or 46%.

Revenue from product sales was $5.71 million for the year, up 77% on last year's $3.23 million. Royalty income was $2.5 million, and included a one off settlement of royalty entitlements amounting to $2.07 million.

Total revenue from all sources including royalties and grants was $9.44 million up 68% on last year's total of $5.63 million.

Operating expenses, excluding the cost of goods sold amounted to $7.56 million, up 8% on the previous year total of $7.0 million. Cost of goods sold increased 61% to $3.95 million. Research and development expenses were up 18% on last year, at $3.68 million, representing 49% of total expenditure. All R&D expenditure was expensed in the year.

Directors' Report (continued)

Review of operations (continued)

Analysis of the segment contribution to the result shows product realisation made a profit of $1.1million, while Design & Development activities cost a net $3.1 million. There was a small loss of $0.15 million attributable to other activities, being administration costs, and other income from interest and royalties.

Investment in working capital has been generally steady, with a slight increase at year end as a result of increased receivables.

Cash at bank at end June 2007 was $5.9 million, compared to $6.7 million the year before. Cash consumed in operations was $2.4 million, less than half the previous year. A share purchase plan raised $1.6 million, reducing the overall net cash usage for the year to $0.8 million.

Optiscan Outlook

The short term outlook will be impacted by Pentax sales, and their marketing activities. We are confident that the ground work that has been completed to support introduction of the product, the training infrastructure, applications development and trial activity have created a sound base for long term growth.

In the short term we may continue to experience periods of accelerating and decelerating sales, but the longer term outlook is strong. It remains to be seen how long it will take Pentax to clear their excess inventory position and for a sustainable sales growth rate to emerge.

In the medium term, the outlook is very positive. Under Hoya control and with commitment from Pentax to obtain additional reimbursement in both US and Europe, we expect sales will move ahead strongly and extend well beyond the early adopters into the broader hospital and day procedure centre market.

The Carl Zeiss agreement will transition from collaborative development to product sales. New applications in the rigid endoscope market will be achieved through product developments, some internal, and others by partnering or joint venturing.

The Optiscan FIVE 1 will be established as an efficient and cost effective research tool and will provide moderate volumes of high margin contribution.

Further partnering of specific opportunities will remain a feature of our commercialisation plans, particularly where a strong market presence can be provided by a recognised and respected partner. However, if there are opportunities to capture a larger position in the supply chain, and develop Optiscan branded medical instruments, they will be carefully considered.

There is a rich matrix of commercial opportunities that will progressively deliver substantial shareholder value over the coming years.

Directors' Report (continued)

Dividends

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

Significant Changes in the State of Affairs

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

Significant Events After Balance Date

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

- On 2 July, 2007 the Group reported that it has entered into a collaboration with the Carl Zeiss Group to develop, market and sell confocal endomicroscopes into a segment of the rigid endoscope market. The agreement includes $4 million in milestone payments, and product sales of up to $16 million are anticipated over the first five years.
- On 2 August 2007, the Group reported that Pentax sales in the first half of 2007/2008 were expected to be below those in the previous corresponding year, due to an inventory build up.

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 15 in the financial statements

Since the end of the financial year, and up to the date of this report, 320,958 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 123,000 options have expired. The total number of options outstanding at the date of this report is 5,942,692.

Directors' Report (continued)

Indemnification and Insurance

During the financial year ended 30 June 2007, 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 2007. 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. It also provides the remuneration disclosures required by paragraphs Aus 25.4 to Aus 25.7.2 of AASB 124 *Related Party Disclosures*, which have been transferred to the Remuneration Report in accordance with Regulation 2M.6.04. 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.

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 Report (Audited) (continued)

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.

Compensation Structure

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

Non-executive Director Compensation

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. When the company was incorporated in 1997, the aggregate amount approved by shareholders to be available for remuneration of non-executive directors was set at $250,000 per annum. There have been no subsequent increases in this amount since that time.

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. 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 year ended 30 June 2007 and 30 June 2006 is detailed in Table 1 on page 22 of this report.

Executive Compensation

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

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.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

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.

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 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.

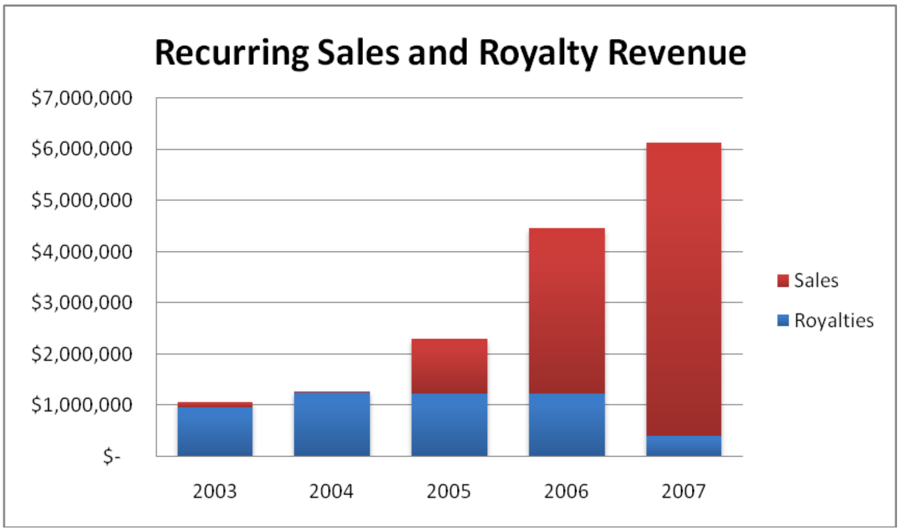
Over the past six years the group has been predominantly engaged in research and development activities. More recently, the focus has turned to commercialisation, as success in development endeavours has created prototype instruments, which have advanced to regulatory cleared, market released product.

Whilst the group has made substantial progress over this period, it has not yet manifested in a way that allows performance to be measured with conventional financial measurement tools. As the group has expensed all R&D expenditure over this period, losses have been reported and accordingly, conventional earnings measures such as profit growth, EPS or dividend yield and payout are not applicable.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

However, one metric that demonstrates the group's progress toward commercialisation is the growth in sales and royalty revenue achieved by the company, as follows:



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

2002	$20M agreement with Pentax to develop endo-microscope
2003	New commercially focussed board and CEO appointed; commercialisation strategy implemented; completion of core development activities with Pentax
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; $5M 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 FIVE1 First agreement to open up commercialisation of the rigid endoscope market Successful settlement of patent entitlements

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

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Short term Incentive Payments and Performance Conditions

During the year ended 30 June 2007, short term incentive payments amounting to $191,743 were earned by executive directors and senior managers. Details are set out in Table 1 on page 22. The performance conditions selected included product sales growth, funding commitments for product design and development, partnership formation in rigid endo-microscopy, initial sales of own brand product and progress with clinical objectives, which had a direct bearing on the group's current financial performance and future commercial success.

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, 2007, the Board resolved to grant a total of 1,237,000 options to executives and staff. The options were valued at $181,013. The performance criteria adopted included assessment of individual performance as well as overall group achievement of targets.

Employment Contracts

All key management personnel 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. Mr Barnett's contract provides for 6 months notice; Mr Delaney's contract provides for 3 months notice and 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 the executive group (key management personnel) 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.

Details of Key Management Personnel

(i) Directors

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

(ii) Executives

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

On 13 August 2007, the Group reported that CEO, Matthew Barnett would step down from the role before year end. There were no other changes of key management personnel after reporting date and the date the financial report was authorised for issue.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Compensation of Key Management Personnel

Table 1: Compensation of Key Management Personnel for the year ended 30 June 2007

	Short-Term			Post Employment		Long-Term	Long-Term	Total	Total Performance Related
30 June 2007	*Salary & Fees $*	*Cash Bonus $*	*Cash Bonus %[1]*	*Superannuation $*	*Termination $*	*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
	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 2: Compensation of Key Management Personnel for the year ended 30 June 2006

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

[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.

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Compensation of Key Management Personnel (continued)

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 15 in the financial statements.

Table 3: Options granted as part of remuneration during the year ended 30 June 2007

30 June 2007	*Grant Date*	*Grant Number*	*Value of options granted during the year*	*% remuner-ation 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*
Directors							
G. Latta	-	-	-	-	-	-	-
M. Barnett	-	-	-	0.5	-	-	-
P. Delaney	-	-	-	4.3	-	-	-
K. Daniel	-	-	-	-	-	-	-
A. Rogers	-	-	-	-	-	-	-
Executives							
J. Allen	19 Jun 2007	44,000	6,439	3.5	-	-	6,439
B. Andrew	19 Jun 2007	44,000	6,439	3.3	-	-	6,439
R. Pattie	19 Jun 2007	55,000	8,048	3.6	-	-	8,048
Total		143,000	20,926	2.3	-	-	20,926

Directors' Report (continued)

Remuneration Report (Audited) (continued)

Compensation of Key Management Personnel (continued)

Table 4: Options issued to Key Management Personnel for the year ended 30 June 2007

	Options Issued		Terms & Conditions for each Grant					
30 June 2007	*No. Granted*	*No. Vested*	*Grant Date*	*Fair Value per option at grant date ($) (note 15)*	*Exercise Price per option ($) (note 15)*	*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	-						

Table 5: Options issued to Key Management Personnel for the year ended 30 June 2006

	Options Issued		Terms & Conditions for each Grant					
30 June 2006	*No. Granted*	*No. Vested*	*Grant Date*	*Fair Value per option at grant date ($) (note 15)*	*Exercise Price per option ($) (note 15)*	*Expiry Date*	*First Exercise Date*	*Last Exercise Date*
Directors								
M. Barnett	-	-	-	-	-	-	-	-
P. Delaney	150,000	-	8 Nov 2005	0.07	0.34	8 Nov 2010	31 Aug 06	8 Nov 2010
P. Delaney	150,000	-	8 Nov 2005	0.06	0.37	8 Nov 2010	30 Jun 07	8 Nov 2010
P. Delaney	150,000	-	8 Nov 2005	0.05	0.41	8 Nov 2010	30 Jun 08	8 Nov 2010
Executives								
J. Allen	50,000	-	18 Oct 2005	0.09	0.32	18 Nov 2010	18 Oct 2006	18 Oct 2010
J. Allen	50,000	-	18 Oct 2005	0.10	0.32	18 Nov 2010	18 Oct 2007	18 Oct 2010
B. Andrew	50,000	-	18 Oct 2005	0.09	0.32	18 Nov 2010	18 Oct 2006	18 Oct 2010
B. Andrew	50,000	-	18 Oct 2005	0.10	0.32	18 Nov 2010	18 Oct 2007	18 Oct 2010
R. Pattie	50,000	-	18 Oct 2005	0.09	0.32	18 Nov 2010	18 Oct 2006	18 Oct 2010
R. Pattie	50,000	-	18 Oct 2005	0.10	0.32	18 Nov 2010	18 Oct 2007	18 Oct 2010
Total	750,000	-						

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 2007 and 30 June 2006.

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

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 2007, 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
Melbourne
12 September 2007

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, $11,000
- Other assurance services, $2,575

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

MATTHEW BARNETT
Director

Melbourne
12 September, 2007

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 2007 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	5 years
Matthew H Barnett	Executive, Managing Director	5 years
Keith P Daniel	Independent, Non-executive	6 years
Peter M Delaney	Executive	10 years
Tony W Rogers	Independent, Non-executive	5 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.

Corporate Governance Statement (continued)

Nomination Committee

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

Performance 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.

Audit Committee

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

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

Remuneration

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

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

Income Statement
FOR THE YEAR ENDED 30 JUNE 2007

	Note	*CONSOLIDATED*		*PARENT*	
		2007	*2006*	*2007*	*2006*
		$	*$*	*$*	*$*
Sale of goods		5,648,375	3,188,164	-	-
Rendering of services		59,161	43,851	-	-
Other revenue	4(a)	2,837,058	1,982,274	27,334	40,650
Revenue		8,544,594	5,214,289	27,334	40,650
Cost of sales		(3,950,856)	(2,455,309)	-	-
Gross Profit		4,593,738	2,758,980	-	-
Other income	4(b)	897,697	420,043	-	-
Marketing expenses		(398,912)	(181,705)	-	-
Research & development expenses		(3,677,808)	(3,121,821)	-	-
Administrative expenses		(3,303,797)	(3,357,402)	(498,977)	(549,916)
Other expenses		(179,967)	(339,503)	-	-
Investing expenses	4(g)	-	-	(1,667,838)	(3,427,494)
Fair value change in derivatives		2,874	(2,325)	-	-
Loss before income tax		(2,066,175)	(3,823,733)	(2,139,481)	(3,936,760)
Income tax expense	5	(73,306)	(113,027)	-	-
Loss attributable to members of the parent		(2,139,481)	(3,936,760)	(2,139,481)	(3,936,760)
Loss per share (cents per share)	6				
- basic loss per share for the year attributable to ordinary equity holders of the parent		(2.1)	(3.9)		
- diluted loss per share for the year attributable to ordinary equity holders of the parent		(2.1)	(3.9)		

Balance Sheet
AS AT 30 JUNE 2007

	Note	CONSOLIDATED		PARENT	
		2007 $	2006 $	2007 $	2006 $
ASSETS					
Current Assets					
Cash and cash equivalents	7	5,936,573	6,651,382	499,754	314,947
Trade and other receivables	8	1,588,094	1,336,705	-	3,321
Inventories	9	1,358,327	1,540,691	-	-
Prepayments		44,754	32,443	-	-
Derivatives	21	2,874	-	-	-
Total Current Assets		8,930,622	9,561,221	499,754	318,268
Non-current Assets					
Other financial assets	10	-	-	6,607,398	6,607,398
Other receivables	8	-	-	2,826,015	3,387,828
Plant and equipment	11	615,594	395,546	-	-
Intangible assets - Software	12	76,621	39,588	-	-
Goodwill	13	1,981,467	1,981,467	-	-
Total Non-current Assets		2,673,682	2,416,601	9,433,413	9,995,226
TOTAL ASSETS		11,604,304	11,977,822	9,933,167	10,313,494
LIABILITIES					
Current Liabilities					
Trade and other payables	16	758,108	970,537	-	-
Provisions	18	820,916	371,305	-	-
Derivatives	21	-	2,325	-	-
Unearned income		-	9,549	-	-
Total Current Liabilities		1,579,024	1,353,716	-	-
Non-current Liabilities					
Provisions	18	92,113	310,612	-	-
Total Non-current Liabilities		92,113	310,612	-	-
TOTAL LIABILITIES		1,671,137	1,664,328	-	-
NET ASSETS		9,933,167	10,313,494	9,933,167	10,313,494
EQUITY					
Equity attributable to equity holders of the parent					
Contributed equity	19	40,773,321	39,142,650	40,773,321	39,142,650
Accumulated losses	19	(31,356,717)	(29,217,236)	(31,356,717)	(29,217,236)
Reserves	19	516,563	388,080	516,563	388,080
TOTAL EQUITY		9,933,167	10,313,494	9,933,167	10,313,494

Statement of Recognised Income and Expense
FOR THE YEAR ENDED 30 JUNE 2007

	Note	*CONSOLIDATED*		*PARENT*	
		2007	*2006*	*2007*	*2006*
		$	*$*	*$*	*$*
Loss for the period		(2,139,481)	(3,936,760)	(2,139,481)	(3,936,760)
Total recognised income and expense for the period attributable to equity holders of the parent		(2,139,481)	(3,936,760)	(2,139,481)	(3,936,760)

Cash Flow Statement
FOR THE YEAR ENDED 30 JUNE 2007

	Note	CONSOLIDATED		PARENT	
		2007	2006	2007	2006
		$	$	$	$
Cash flows from operating activities					
Receipts from customers		5,480,487	2,338,409	-	-
Payments to suppliers and employees		(11,063,195)	(9,308,700)	(370,492)	(353,737)
Royalties received		2,460,832	1,308,662	-	-
Interest received		332,630	491,482	27,334	42,704
GST refund received		3,319	-	3,319	-
Income tax paid		(73,306)	(113,027)	-	-
Receipt of government grants		976,963	472,204	-	-
Net cash flows from (used in) operating activities	7	(1,882,270)	(4,810,970)	(339,839)	(311,033)
Cash flows from investing activities					
Proceeds from sale of plant and equipment		-	315	-	-
Purchase of plant and equipment	11	(496,575)	(242,136)	-	-
Purchase of intangible assets - software	12	(66,396)	(32,317)	-	-
Loans to controlled entity	8	-	-	(1,106,025)	(125,490)
Net cash flows used in investing activities		(562,971)	(274,138)	(1,106,025)	(125,490)
Cash flows from financing activities					
Proceeds from issue of shares	19	1,699,315	5,850	1,699,315	5,850
Transaction costs of issue of shares	19	(68,644)	-	(68,644)	-
Net cash flows from (used in) financing activities		1,630,671	5,850	1,630,671	5,850
Net increase (decrease) in cash and cash equivalents		(814,570)	(5,079,258)	184,807	(430,673)
Net foreign exchange differences		99,761	13,821	-	-
Cash and cash equivalents at beginning of period		6,651,382	11,716,819	314,947	745,620
Cash and cash equivalents at end of period	7	5,936,573	6,651,382	499,754	314,947

Notes to the Financial Statements
FOR THE YEAR ENDED 30 JUNE 2007

1 CORPORATE INFORMATION

The financial report of Optiscan Imaging Limited (the Company) for the year ended 30 June 2007 was authorised for issue in accordance with a resolution of the directors on 29 August 2007.

Optiscan Imaging Limited is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange. The nature of the operations and principal activities of the Group are described in note 3, 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 the requirements of the Corporations Act 2001 and Australian Accounting Standards. 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.

b) Statement of compliance
The financial report complies with Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards (AIFRS). The financial report also complies with International Financial Reporting Standards (IFRS).

Except for the amendments to AASB 101 Presentation of Financial Statements and AASB 2007-4 Amendments to Australian Accounting Standards arising from ED 151 and Other Amendments, which the Group has early adopted, Australian Accounting Standards and Interpretations that have recently

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Statement of compliance (continued)

been issued or amended but are not yet effective have not been adopted by the Group for the annual reporting period ending 30 June 2007. These are outlined in the table below.

Reference	Title	Summary	Application date of standard	Impact on Group financial report	Application date for Group
AASB 2005-10	Amendments to Australian Accounting Standards [AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 & AASB 1038]	Amending standard issued as a consequence of AASB 7 *Financial Instruments: Disclosures.*	1 January 2007	AASB 7 is a disclosure standard so will have no direct impact on the amounts included in the Group's financial statements. However, the amendments will result in changes to the financial instrument disclosures included in the Group's financial report.	1 July 2007
AASB 2007-1	Amendments to Australian Accounting Standards arising from AASB Interpretation 11 [AASB 2]	Amending standard issued as a consequence of AASB Interpretation 11 *AASB 2 – Group and Treasury Share Transactions*.	1 March 2007	This is consistent with the Group's existing accounting policies for share-based payments ,so the standard is not expected to have any impact on the Group's financial report.	1 July 2007
AASB 2007-3	Amendments to Australian Accounting Standards arising from AASB 8 [AASB 5, AASB, AASB 6, AASB 102, AASB 107, AASB 119, AASB 127, AASB 134, AASB 136, AASB 1023 & AASB 1038]	Amending standard issued as a consequence of AASB 8 *Operating Segments*.	1 January 2009	AASB 8 is a disclosure standard so will have no direct impact on the amounts included in the Group's financial statements. However the standard is expected to have an impact on the Group's segment disclosures as segment information included in internal management reports is more detailed than that currently reported under AASB 114 *Segment Reporting*.	1 July 2009

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

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 2007-6	Amendments to Australian Accounting Standards arising from AASB 123 [AASB 1, AASB 101, AASB 107, AASB 111, AASB 116 & AASB 138 and Interpretations 1 & 12]	Amending standard issued as a consequence of revisions to AASB 123 *Borrowing Costs*.	1 January 2009	The 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
AASB 2007-7	Amendments to Australian Accounting Standards [AASB 1, AASB 2, AASB 4, AASB 5, AASB 107 & AASB 128]	Amending standards for wording errors, discrepancies and inconsistencies.	1 July 2007	The amendments are minor and do not affect the recognition, measurement or disclosure requirements of the standards. Therefore the amendments are not expected to have any impact on the Group's financial report.	1 July 2007
AASB 7	*Financial Instruments: Disclosures*	New standard replacing disclosure requirements of AASB 130 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and AASB 132 *Financial Instruments: Disclosure and Presentation*.	1 January 2007	Refer to AASB 2005-10 above.	1 July 2007
AASB 8	*Operating Segments*	New standard replacing AASB 114 *Segment Reporting*, which adopts a management approach to segment reporting.	1 January 2009	Refer to AASB 2007-3 above.	1 July 2009

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

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 123 (amended)	*Borrowing Costs*	The amendments to AASB 123 require that all borrowing costs associated with a qualifying asset must be capitalised.	1 January 2009	Refer to AASB 2007-6 above.	1 July 2009
AASB Interpretati on 10	*Interim Financial Reporting and Impairment*	Addresses an inconsistency between AASB 134 *Interim Financial Reporting* and the impairment requirements relating to goodwill in AASB 136 *Impairment of Assets* and equity instruments classified as available for sale in AASB 139 *Financial Instruments: Recognition and Measurement*.	1 November 2006	The prohibitions on reversing impairment losses in AASB 136 and AASB 139, which are to take precedence over the more general statement in AASB 134, are not expected to have any impact on the Group's financial report.	1 July 2007
AASB Interpretati on 11	*Group and Treasury Share Transactions*	Addresses whether certain types of share-based payment transactions with employees (or other suppliers of good and services) should be accounted for as equity-settled or as cash-settled transactions under AASB 2 *Share-based Payment*. It also specifies the accounting in a subsidiary's financial statements for share-based payment arrangements involving equity instruments of the parent.	1 March 2007	Refer to AASB 2007-1 above.	1 July 2007

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

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

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 estimates and assumptions

In applying the Group's accounting policies, management continually evaluates judgments, estimates and assumptions based on experience and other factors, including expectations of future events that may have an impact on the Group. All judgments, 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 judgments, estimates and assumptions. The more significant judgments, 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 14.

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

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 all employees at 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.

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.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

d) Significant accounting estimates and assumptions (continued)

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 income tax assets is dependent upon a judgment as to 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. In the light of the continuing expenditure on R&D there is not yet adequate probability of taxable profit that will enable utilisation of 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 judgment. 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 4(c).

Impairment of loans to subsidiaries
Where a subsidiary entity incurs a loss, the parent entity records an impairment loss against the value of its loans to the subsidiary.

e) Revenue recognition

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

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

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

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

(iii) Interest income
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.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

h) Cash and cash equivalents
Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less 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, 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.

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.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivative financial instruments and hedging (continued)

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

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

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 unused tax assets and unused tax losses, but are not recognised in the accounts unless it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be 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.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

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.

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.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 was 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.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill (continued)

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, and there has been no change in policy in relation to software. The amounts capitalised (refer note 12) represent the acquisition cost of software packages used in the design, development and administrative activities of the group. These amounts are amortised over a period of no more than three years.

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, 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 nominal value. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are generally paid on 30 day terms.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

t) Provisions and employee leave benefits

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

Employee leave benefits

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

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

(ii) Long service leave

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

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 15.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Share-based payment transactions (continued)

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.

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 per share (see note 6).

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.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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 SEGMENT INFORMATION

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.

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.

In relation to geographic segment revenue, more than 90% of external revenue relates to Pentax, located in Japan.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

3 SEGMENT INFORMATION

		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)
	Capital expenditure	(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)

		Trading $	R&D $	Unallocated $	Total $
Year ended 30 June 2006					
Revenue					
	Sales to external customers	3,232,015	-	-	3,232,015
	Other revenues from external customers	-	-	1,982,589	1,982,589
	Inter segment revenue	-	-	-	-
	Total consolidated revenue	3,232,015	-	1,982,589	5,214,604
Result					
	Net profit (loss) for year by segment	284,227	(3,250,763)	(970,225)	(3,936,760)
Assets and liabilities					
	Segment assets *	4,682,156	115,498	7,180,168	11,977,822
	Segment liabilities	(724,473)	(365,965)	(573,890)	(1,664,328)
	Segment net assets	3,957,683	(250,467)	6,606,278	10,313,494
Cash flow					
	Segment net cash flow from operating activities	(941,514)	(2,890,090)	(979,367)	(4,810,970)
	Capital expenditure	(80,053)	(70,756)	(123,329)	(274,138)
	Financing cash flows	-	-	5,850	5,850
	Net cash flow for year	(1,021,567)	(2,960,846)	(1,096,846)	(5,079,258)

* Unallocated segment assets include cash

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

4 REVENUES AND EXPENSES

		CONSOLIDATED		PARENT	
		2007 $	2006 $	2007 $	2006 $
Revenue and Expenses					
(a)	**Other revenue**				
	(i) Royalty revenue				
	Recurring royalty revenue	422,337	1,226,028	-	-
	Royalty entitlement settlements	2,076,957	285,032	-	-
	Total royalty revenue	2,499,294	1,511,060	-	-
	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 income – bank interest received	337,764	471,214	27,334	40,650
	Total other revenue	2,837,058	1,982,274	27,334	40,650
(b)	**Other income**				
	Government grants	897,697	419,728	-	-
	Net gains on disposal of plant and equipment	-	315	-	-
		1,235,461	891,257	27,334	40,650
(c)	**Depreciation and amortisation**				
	-Depreciation included in Cost of sales	63,307	52,480	-	-
	- Depreciation included in Marketing expenses	7,054	9,434	-	-
	- Depreciation included in R&D expenses	97,382	147,932	-	-
	- Depreciation included in Administration expenses	108,784	65,382	-	-
		276,527	275,228	-	-
	- Amortisation of software included in Administration expenses	29,363	17,951	-	-
		305,890	293,179	-	-
(d)	**Employee benefits expense**				
	Wages and salaries	4,478,689	3,520,740	220,000	220,000
	Workers' compensation costs	45,302	71,431	-	-
	Defined contribution plan expense	378,610	367,847	-	-
	Annual leave provision	91,863	44,408	-	-
	Long service leave provision	(10,473)	131,140	-	-
	Share-based payments expense	128,483	188,417	128,483	188,417
		5,112,474	4,323,983	348,483	408,417

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

		CONSOLIDATED		PARENT	
		2007 $	2006 $	2007 $	2006 $
4	**REVENUES AND EXPENSES (continued)**				
(e)	**Cost of inventories recognised as an expense**				
	Consumed in R&D	127,523	186,487	-	-
	Provision for obsolescence	-	123,597	-	-
		127,523	310,084	-	-
(f)	**Other expenses included in income statement**				
	Minimum lease payments – operating lease	290,575	282,762	-	-
	Warranty provision (note 18)	149,722	91,182	-	-
(g)	**Impairment losses**				
	Impairment loss in respect of loans to subsidiaries (Refer note 2(p))	-	-	1,667,838	3,427,434

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

5 INCOME TAX

	CONSOLIDATED		PARENT	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
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	(73,306)	(113,027)	-	-
Deferred income tax				
Relating to origination and reversal of temporary differences	-	-	-	-
Income tax expense reported in the income statement	(73,306)	(113,027)	-	-
Statement of Income and expense				
Deferred income tax related to items charged or credited directly to equity	-	-	-	-
Income tax expense reported in equity	-	-	-	-

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

	CONSOLIDATED		PARENT	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
5 INCOME TAX (continued)				
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	(2,066,175)	(3,823,733)	(2,139,481)	(3,936,760)
At the Group's statutory income tax rate of 30% (2006: 30%)	(619,852)	(1,147,120)	(641,844)	(1,181,028)
Adjustments in respect of current income tax of previous years	-	-	-	-
Non assessable gains	(6,009)	-	-	-
Share based payments not deductible	38,545	56,525	38,545	56,525
R&D Tax Concession allowance	(228,435)	(209,451)	-	-
Expenditure not allowable for income tax purposes	23,797	9,875	481,411	1,028,248
Deductible movements through equity	(20,593)	-	-	-
Deferred tax assets not recognised	812,547	1,290,171	121,888	96,255
Foreign withholding tax deductions from royalties	73,306	113,027	-	-
Income tax expense reported in the consolidated income statement	73,306	113,027	-	-

	Balance Sheet		Income Statement	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
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 assets				
Undeducted patent costs	112,078	108,004	21,818	20,939
Employee benefit & warranty provisions	273,909	204,575	69,334	80,019
Expenses not yet deductible	56,368	68,537	17,509	22,996
Inventory impairment provision	91,380	180,960	(89,580)	(25,665)
Deferred deductible equity issue costs	48,523	64,095	451	(16,024)
Tax Losses and foreign tax credits available for offset against future taxable income	10,103,707	9,937,632	793,015	1,007,707
Gross deferred income tax assets	10,685,965	10,563,803		
Less amounts not recognised in accounts	(10,685,965)	(10,563,803)		
Gross deferred income tax assets	-	-		
Deferred tax income/ (expense) incurred			812,547	1,089,972
Less deferred income tax not recognised in accounts			(812,547)	(1,089,972)
Deferred tax income/ (expense)			-	-

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

5 INCOME TAX (continued)

	Balance Sheet		*Income Statement*	
	2007	*2006*	*2007*	*2006*
	$	*$*	*$*	*$*
PARENT				
Deferred tax liabilities				
Deferred assessment of receivables	-	-	-	(616)
	-			
Deferred tax assets				
Deferred deductible equity issue costs	48,054	47,368	686	(15,790)
Deferred tax assets not brought to account	48,054	47,368		
Increase (Decrease) in Deferred tax asset not recognised in accounts			686	(15,174)

Tax Losses

The Group has unconfirmed, unrecouped tax losses in Australia of $30,825,151 (2006: $28,227,053) 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 the losses will be utilised.

Withholding tax

A total of $856,161 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.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

6 EARNINGS PER SHARE

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

	CONSOLIDATED	
	2007	*2006*
	$	*$*
Net loss attributable to ordinary equity holders of the parent	(2,139,481)	(3,936,760)
	2007 Number	*2006 Number*
Weighted average number of ordinary shares for basic earnings per share	100,448,035	100,144,765
Effects of dilution:		
Share options	-	-
Weighted average number of ordinary shares adjusted for the effect of dilution	100,448,035	100,144,765
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:

	2007	2006
- Number of options exercised at price of $0.32	190,625	-
- Number of options exercised at price of $0.39	101,000	10,000
- 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	10,000

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

7 CASH AND CASH EQUIVALENTS

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. At balance date the weighted average interest rate is 6.38% (2006, 5.88%), and the weighted average term to maturity is 45 days (2006, 27 days). The fair value of cash at bank and on deposit approximates the carrying amount, in view of the short term to maturity.

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*	
	2007 $	*2006 $*	*2007 $*	*2006 $*
Cash at bank and in hand	4,481,598	2,933,567	499,754	314,947
Short-term deposits	1,472,512	3,728,365	-	-
Amounts owing on credit card facilities	(17,537)	(10,550)	-	-
	5,936,573	6,651,382	499,754	314,947

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

Net loss	(2,139,481)	(3,936,760)	(2,139,481)	(3,936,760)
Adjustments for:				
Depreciation and amortisation	305,890	293,179	-	-
Net (profit) on disposal of plant and equipment	-	(315)	-	-
Net fair value change on derivatives	(2,874)	2,325	-	-
Impairment of non current assets	-	-	1,667,838	3,427,494
Net exchange differences	(99,761)	(13,821)	-	-
Share options expensed	128,483	188,417	128,483	188,417
Changes in assets and liabilities				
(Increase)/decrease in trade and other receivables	(251,389)	(1,109,126)	3,321	9,816
(Increase)/decrease in inventories	182,364	(869,066)	-	-
(Increase)/decrease in prepayments	(12,311)	9,882	-	-
(Decrease)/increase in derivatives	(2,325)	-	-	-
(Decrease)/increase in trade and other payables	(212,429)	348,036	-	-
(Decrease)/increase in unearned income	(9,549)	9,549	-	-
(Decrease)/increase in provisions	231,112	266,730	-	-
Net cash from (used in) operating activities	(1,882,270)	(4,810,970)	(339,839)	(311,033)

Disclosure of financing facilities - Refer to note 17.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

8 TRADE AND OTHER RECEIVABLES

	CONSOLIDATED		PARENT	
	2007 $	2006 $	2007 $	2006 $
CURRENT				
Trade receivables	1,222,053	992,731	-	-
Royalties receivable	240,860	202,398	-	-
GST refund receivable	95,714	110,826	-	-
Interest receivable	21,252	16,118	-	-
Other receivables	8,216	14,632	-	3,321
	1,588,095	1,336,705	-	3,321
NON CURRENT				
Related party receivables – wholly owned group				
Amounts receivable from controlled entities (note 23)	-	-	33,279,982	32,173,957
Accumulated impairment	-	-	(30,453,967)	(28,786,129)
	-	-	2,826,015	3,387,828
Total Receivables	1,588,095	1,336,705	2,826,015	3,391,149

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

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

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

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

(v) The fair value of receivables approximates the carrying amount, in view of the trading terms.

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

9 INVENTORIES

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
Raw materials (at net realisable value)	1,140,963	1,139,174	-	-
Work in progress (at cost)	202,867	394,768	-	-
Finished goods (at cost)	14,497	6,749	-	-
Total inventories at the lower of cost and net realisable value	1,358,327	1,540,691	-	-
Inventory write-downs of potentially obsolete raw materials are recognised as an expense (Note 4(e))	-	123,597	-	-

10 OTHER FINANCIAL ASSETS (NON-CURRENT)

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
Investments in controlled entities at cost (Note 23)	-	-	6,607,398	6,607,398

11 PLANT AND EQUIPMENT

CONSOLIDATED *	*Office Furniture & Equipment*	*Production Equipment*	*R&D Equipment*	*Total Plant & Equipment*
Year ended 30 June 2007	*2007* *$*	*2007* *$*	*2007* *$*	*2007* *$*
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
Disposals	-	-	-	-
Impairment	-	-	-	-
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 1 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

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

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

11 PLANT AND EQUIPMENT (continued)

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

The useful life of the assets for both for 2006 and 2007 is estimated to be between 2 and 5 years.
* Consolidated totals only. The parent entity has no plant and equipment.

12 INTANGIBLE ASSETS – SOFTWARE

	CONSOLIDATED		***PARENT***	
	2007 $	*2006 $*	*2007 $*	*2006 $*
Opening balance net of accumulated amortisation and impairment	39,588	25,222	-	-
Additions during year	66,396	32,317	-	-
Amortisation	(29,363)	(17,951)	-	-
Net carrying amount	76,621	39,588	-	-
At cost	103,316	62,002	-	-
Accumulated amortisation	(26,695)	(22,414)	-	-
Net carrying amount	76,621	39,588	-	-

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

13 GOODWILL

	CONSOLIDATED		PARENT	
	2007 $	2006 $	2007 $	2006 $
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 14). No impairment loss was recognised in the 2007 financial year.

14 IMPAIRMENT TESTING OF GOODWILL

Annual impairment testing requires an assessment of the recoverable amount of goodwill, 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 goodwill. 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 growth in sales to Pentax, carrying forward into 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 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 15%, Pentax sales at 25% to allow for future growth and volume uncertainty and future rigid sales, which have not yet been realised, have been discounted at 40%.

Key assumptions used in value in use calculations
The key assumptions on which management has based its cash flow projections when determining the value in use of goodwill are as follows:

Sales volumes of flexible endomicroscopes
Sales volumes of flexible 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 new products, and this is reflected in the discount rate adopted by management (25%).

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

14 IMPAIRMENT TESTING OF GOODWILL (continued)

Flexible endomicroscopy partnership with Pentax
The partnership with Pentax will continue in accordance with the agreement, consistent with experience to date. The merger with Hoya is not expected to impact on the relationship, and there are no reasonable grounds to form any other assumption.

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 a high discount rate (40%) to take accounts of these risk factors.

Optiscan FIVE 1
Management has assumed that there will be continuing modest sales of the Optiscan FIVE 1 research instrument. As sales have already been achieved, business plans have been activated, and sales targets are modest, this is considered comparatively low risk, and anticipated cash flows have been discounted at 15%, 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 40% and 60% to reflect the inherent uncertainty in these assumptions.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

15 SHARE-BASED PAYMENT PLANS

Employee Share Option Plan

Share options are granted to all employees including senior executives with more than 12 months service. The exercise price of the options is calculated as the weighted average market price of the shares in the two weeks prior to the date of grant, increased by a minimum of 10%. Options vest in gradual amounts over two to four years and no options can be exercised within 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 4(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 2007		WAEP 2007	No. Options 2006		WAEP 2006
Outstanding at the beginning of the year	5,570,900	[1]	0.46	4,554,780		0.67
Granted during the year	1,237,000		0.50	2,340,750		0.33
Forfeited during the year	-		-	(1,018,250)		0.69
Exercised during the year	(81,250)	[2]	0.37	(15,000)		0.39
Expired during the year	(340,000)		1.07	(291,380)		1.92
Outstanding at the end of the year	6,386,650	[1]	0.44	5,570,900	[1]	0.46
Exercisable at the end of the year	3,399,850		0.45	1,230,048		0.47

[1] Included within this balance are options over 123,000 shares (2006: 529,000 shares) that have not been recognised in accordance with AASB 2 as the options were granted on or before 7 November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with AASB 2.

[2] The weighted average share price at the date of exercise was $0.46.

The outstanding balance as at 30 June 2007 is represented by:

Options expiring in the year :	No Options	WAEP $
- 2007/2008	565,250	0.52
- 2008/2009	1,589,650	0.54
- 2009/2010	710,250	0.40
- 2010/2011	2,284,500	0.33
- 2011/2012	1,237,000	0.50
	6,386,650	0.44

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

15 SHARE BASED PAYMENT PLANS (continued)

The weighted average remaining contractual life for the share options outstanding as at 30 June 2007 is 2 years,10 months (34 months).

The weighted average fair value of options granted during the year was $0.146 (2006: $0.09).

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

The following tables list the inputs to the model used for option issues during the years ended 30 June 2007 and 30 June 2006:

	2007	*2006*	*2006*	*2006*
	Issue to staff 19 June 2007	Issue to staff 18 Oct 2005	AGM Approved issue to executive director	Issue to Staff 12 Sep 2005
Number of options	1,237,000	1,770,750	450,000	120,000
Dividend yield (%)	-	-	-	-
Expected volatility (%)	40.0	40.0	40.0	40.0
Risk-free interest rate (%)	6.405	5.22	5.42	5.11
Expected life of option (years)	4.5	4.5	4.5	4.5
Option exercise price ($)	0.50	0.32	0.33, 0.34, 0.41	0.36
Share price at grant date ($)	0.445	0.295	0.30	0.325

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.

16 TRADE AND OTHER PAYABLES (CURRENT)

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2006* *$*	*2005* *$*
Trade payables (i)	221,256	531,394	-	-
Accrued expenses	536,852	439,143	-	-
	758,108	970,537	-	-

(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 in view of the trading terms.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

17 BANK FACILITIES AND BORROWINGS

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

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

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2006* *$*	*2005* *$*
Total facilities provided by the group's bankers:				
- foreign currency hedging	400,000	400,000	-	-
- credit cards	120,000	120,000	-	-
- bank guarantees and indemnities	200,000	110,000	-	-
- electronic transaction facility	50,000	50,000	-	-
	770,000	680,000	-	-
Facilities used at reporting date:				
- foreign currency hedging	46,000	48,000	-	-
- credit cards	17,537	10,550	-	-
- bank guarantees and indemnities	158,250	90,500	-	-
- electronic transaction facility	-	-	-	-
	221,787	149,050	-	-
Facilities unused at reporting date:				
- foreign currency hedging	354,000	352,000	-	-
- credit cards	102,463	109,450	-	-
- bank guarantees and indemnities	41,750	19,500	-	-
- electronic transaction facility	50,000	50,000	-	-
	548,213	530,950	-	-
Total facilities	770,000	680,000	-	-
Facilities used at reporting date	221,787	149,050	-	-
Facilities unused at reporting date	548,213	530,950	-	-

Assets pledged as security
The bank facilities are secured by charges over specific term deposits amounting to $890,000.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

18 PROVISIONS

	Annual Leave $	*Long Service Leave $*	*Warranty $*	*Total $*
*CONSOLIDATED **				
At 1 July 2007	280,123	310,612	91,182	681,917
Arising during the year	91,863	(10,473)	164,435	245,825
Utilised	-	-	(14,713)	(14,713)
Unused amounts reversed	-	-	-	-
Discount rate adjustment	-		-	-
At 30 June 2007	371,986	300,139	240,904	913,029
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
Current 2006	280,123	-	91,182	371,305
Non-current 2006	-	310,612	-	310,612
	280,123	310,612	91,182	681,917

* 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 (continued)
FOR THE YEAR ENDED 30 JUNE 2007

19 CONTRIBUTED EQUITY AND RESERVES

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
Ordinary shares - Issued and fully paid	40,773,321	39,142,650	40,773,321	39,142,650

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.

Movement in ordinary shares on issue	*No of Shares*	*$*
At 1 July 2005	100,144,573	39,136,800
Issued for cash upon exercise of employee options	15,000	5,850
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

Share options

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

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

19 CONTRIBUTED EQUITY AND RESERVES (continued)

	CONSOLIDATED		*PARENT*	
	2007	*2006*	*2007*	*2006*
	$	*$*	*$*	*$*
Accumulated losses				
Movements in accumulated losses were as follows:				
Balance 1 July	(29,217,236)	(25,280,476)	(29,217,236)	(25,280,476)
Net loss for the year	(2,139,481)	(3,936,760)	(2,139,481)	(3,936,760)
Balance 30 June	(31,356,717)	(29,217,236)	(31,356,717)	(29,217,236)
Reserves				
Movements in reserves were as follows:				
Employee Equity Benefits Reserve				
Balance 1 July	388,080	199,663	388,080	199,663
Share based payments	128,483	188,417	128,483	188,417
Balance 30 June	516,563	388,080	516,563	388,080

Nature and purpose of reserves

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

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

20 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

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

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

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

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

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

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

At 30 June 2007, the Group had economic hedges of US$460,000 in respect of net US$ receivables amounting to US$832,000, representing of 55% of the foreign currency exposure. The contracts expire during July 2007, reflecting the underlying payment terms.

Credit risk
The Group trades only with recognised, creditworthy third parties.

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

There is a significant concentration of credit risk in relation to the exclusive licensing agreement with Pentax. All sales of the ISC-1000 are made to Pentax. The amount outstanding at balance date is $941,882 (2006, $901,989).

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

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

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

21 DERIVATIVES AND HEDGING

Economic hedging activities

At 30 June 2007, the Group held one currency option contract and one forward exchange contract designated 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 have been 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 2).

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

The terms of the forward contracts at 30 June 2006 were as follows:

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

* Option contract

Fair value change in derivatives

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
Non-hedging foreign currency receivable (payable)	2,874	(2,325)	-	-
	2,874	(2,325)	-	-

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

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

22 COMMITMENTS AND CONTINGENCIES

Operating lease commitments – Group as lessee

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

The Group has entered into a commercial property lease for a small research facility with a six monthly lease renewal.

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

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
Within one year	52,572	274,000	-	-
After one year but not more than five years	-	45,667	-	-
	52,572	319,667	-	-

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 $96,000 and has committed to provide future research funding of $163,000 over the term of the agreement, subject to achievement of nominated milestones.

Capital commitments

At 30 June 2007 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 $158,250 (2006: $90,500).

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*	*2007*	*2006*	*2007*	*2006*
Optiscan Pty Ltd	Australia	100	100	6,605,396	6,605,396
Optiscan Inc	United States	100	100	2,002	2,002
				6,607,398	6,607,398

Optiscan Imaging Limited is the ultimate Australian parent entity.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

23 RELATED PARTY DISCLOSURE (continued)

Transactions with Subsidiaries

Inter-company transactions between the parent entity, Optiscan Imaging Limited and subsidiary, Optiscan Pty Ltd amounted to $1,106,025 (2006, $125,490). Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

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

24 EVENTS AFTER THE BALANCE SHEET DATE

The directors are not aware of any events after balance date that would have a material impact on the financial statements at 30 June 2007. The following post balance date events have occurred:

- On 2 July, 2007 the Group reported that it has entered into a collaboration with the Carl Zeiss Group to develop, market and sell confocal endo-microscopes into a segment of the rigid endoscope market. The agreement includes $4 million in milestone payments, and product sales of up to $16 million over the first five years are anticipated.
- On 2 August 2007, the Group reported that Pentax sales in the first half of 2007/2008 are expected to be below those in the previous corresponding year, due to an inventory build up.
- On 13 August 2007, the Group reported that CEO, Matthew Barnett would step down from the role before year end.

25 AUDITORS' REMUNERATION

The auditor of Optiscan Imaging Limited is Ernst & Young.

	CONSOLIDATED		*PARENT*	
	2007 *$*	*2006* *$*	*2007* *$*	*2006* *$*
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	51,480	45,990	1,225	1,970
• Other services in relation to the entity and any other entity in the consolidated group				
- tax compliance	11,000	36,502	-	-
- other assurance services	2,575	-	-	-
	65,055	82,492	1,225	1,970

Notes to the Financial Statements (continued)
FOR THE YEAR ENDED 30 JUNE 2007

26 DIRECTOR AND EXECUTIVE DISCLOSURES

Details of Key Management Personnel

(i) Directors

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

(ii) Executives

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

On 13 August 2007, the Group reported that CEO, Matthew Barnett would step down from the role before year end. 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 2007

	CONSOLIDATED		*PARENT*	
	2007	*2006*	*2007*	*2006*
	$	*$*	*$*	*$*
Short term employee benefits	1,376,559	1,251,889	220,000	220,000
Post Employment benefits	114,890	103,670	10,800	10,800
Other Long-Term	6,468	5,485	-	-
Share-based payment	35,354	54,857	35,354	54,857
	1,533,271	1,415,900	266,154	285,657

The company has applied the option under Corporations Amendments Regulation 2006 to transfer management personnel remuneration disclosures required by AASB 124 Related Party Disclosures paragraphs Aus 25.4 to Aus 25.7.2 to the Remuneration Report section of the Directors' Report. These transferred disclosures have been audited.

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

26 DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

Option holdings of Key Management Personnel

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*	*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	-

No options were exercised during the year ended 30 June 2007.

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

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

Notes to the Financial Statements (continued)

FOR THE YEAR ENDED 30 JUNE 2007

26 DIRECTOR AND EXECUTIVE DISCLOSURES (continued)

Shareholdings of Key Management Personnel

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

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

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

Other transactions and balances with Key Management Personnel

Purchases

During the year, purchases amounting to $636 (2006: $920) at normal market prices have been made from CBC Consolidated Bearings Pty Ltd, a subsidiary of Inenco Pty Ltd, a company of which Matthew Barnett is a director. The amounts are included in R&D expenses and cost of sales. There is no balance outstanding at reporting date.

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 report 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 2007 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 2007.

On behalf of the Board

Matthew Barnett

Director

Melbourne, 12 September 2007

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Independent auditor's report to the members of Optiscan Imaging Limited

We have audited the accompanying financial report of Optiscan Imaging Limited (the company), which comprises the balance sheet as at 30 June 2007, 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.

The company has disclosed information as required by paragraphs Aus 25.4 to Aus 25.7.2 of Accounting Standard 124 *Related Party Disclosures* ("remuneration disclosures"), under the heading "Remuneration Report" on pages 17 to 24 of the directors' report, as permitted by Corporations Regulation 2M.6.04.

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(b), the directors also state that the financial report, comprising the consolidated/parent financial statements and notes, comply with International Financial Reporting Standards. The directors are also responsible for the remuneration disclosures contained in the directors' report.

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 and that the remuneration disclosures comply with Accounting Standard AASB 124 *Related Party Disclosures*.

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. The Auditor's Independence Declaration would have been expressed in the same terms if it had been given to the directors at the date this auditor's report was signed. In addition to our audit of the financial report and the remuneration disclosures, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Auditor's Opinion
In our opinion:

1. the financial report of Optiscan Imaging Limited is in accordance with:

(a) the *Corporations Act 2001*, including:

- (i) giving a true and fair view of the financial position of Optiscan Imaging Limited and the consolidated entity at 30 June 2007 and of their performance for the year ended on that date; and
- (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations); and

(b) other mandatory financial reporting requirements in Australia.

2. the consolidated/parent financial statements and notes or financial report also comply with International Financial Reporting Standards as disclosed in Note 2(b)

3. the remuneration disclosures that are contained on pages 17 to 24 of the directors' report comply with Accounting Standard AASB 124 *Related Party Disclosures*.

Ernst + Young

Ernst & Young

Brumley

Don Brumley
Partner
Melbourne
12 September 2007

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 39 granted patents from 40 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 developed in 1998 and 1999. These patents are fundamental to the miniaturisation that has enabled clinical, in vivo imaging. Their 20 year life extend out to around 2019.

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 two 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 judgment must be exercised in determining which jurisdictions should be covered.

Information about patent activity carried out by Optiscan during 2006/2007 is set out in the Directors' Review of Operations on 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 2006/2007 are set out in the Directors' Review of Operations on 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.

ASX AusBiotech Code of Best Practice (continued)

Details of the accreditations achieved by Optiscan are as follows:

Accreditation	Description	Expiry Date	Issuing authority
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.

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 the Pentax Corporation is now able to apply for specific product registration for the ISC-1000 within Canada.

ASX AusBiotech Code of Best Practice (continued)

Pentax's Australian distributor will be applying for 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 Optiscan Patents

Patent Title	Countries Applied	Countries Granted	Expiry Date
Scanning Confocal Microscope		USA 5120953 Australia 652713	13 Nov 2009 13 Jul 2009
Scanning Confocal Microscope	Europe 02012428.5		13 Jul 2009
Scanning Confocal Endoscope		Switzerland 0393165 France " UK " Italy " Germany 68928345.8	13 Jul 2009
Scanning Confocal Endoscope with Fibre Scanning		France 0782027 UK " Italy " Germany 68929464.6	13 Jul 2009
Confocal Microscope		Australia 610430 USA 5161053 Canada 1325537 Japan 3583125 UK 0764866 France " Italy " Germany 68929262.7	1 Aug 2009
Confocal Microscope		Australia 643787 Japan 3052150 USA 5323009 UK 0523159 Canada 2079882 Germany 69112394.2	21 Jun 2011
Confocal Microscope		Australia 669760 USA 5659642	19 Aug 2014
Confocal Microscope		Australia 672876	8 Feb 2014
Optical Fibre Confocal Imager with Variable Near Confocal Control	Japan P1996-528700 Germany 19681304.2 Canada 2215975	USA 5926592 Australia 694005	24 Mar 2016
Scanning Microscope with Miniature Head	Germany 19882512.9	UK 2340332 USA 6967772	16 Jul 2018
Endoscope or Microscope Method and Apparatus		UK 2353369	17 Jun 2019
Compact Confocal Endoscope and Endomicroscope	Germany 19940421.6 USA 09/382457	UK 2341943	25 Aug 2019
Electrically Operated Tuning Fork	Europe 00934807.9 Japan P2001-501929	Australia 759742 USA 7010978	8 Jun 2020

ASX AusBiotech Code of Best Practice (continued)

Summary of Optiscan Patents (continued)

Patent Title	Countries Applied		Countries Granted		Expiry Date
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 USA Japan	102004018110.1 10/822718 P2004-118579			
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 US Germany	P2003-314204 P2003-357896 10/933308 102004043049.7			
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 2007.

(a) Distribution of equity securities

104,189,912 fully paid ordinary shares are held by 4,620 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	928	583,756
1,001 – 5,000	1,650	4,842,517
5,001 – 10,000	680	5,703,276
10,001 – 100,000	1,241	38,379,992
100,001 – and over	121	54,680,371
	4,620	100,189,912
Holding less than a marketable parcel	1,028	697,210

(b) Substantial shareholders

Name	Number	Percentage
Fibre Optics Pty Ltd	6,396,021	6.14

(c) Twenty largest holders of quoted equity securities

	Ordinary shareholders	Fully Paid Number	Fully Paid Percentage
1.	Fibre Optics Pty Ltd	6,396,021	6.14
2.	Ixohoxi Pty Ltd	4,976,248	4.78
3.	Asahi Optical Company Limited	3,330,000	3.20
4.	Mr Peter Maxwell Delaney	3,206,259	3.08
5.	HSBC Custody Nominees (Australia) Limited	3,151,875	3.03
6.	National Nominees Limited	3,151,364	3.02
7.	Dixson Trust Pty Limited	1,626,020	1.56
8.	S W R Harris Holdings Pty Ltd	1,543,004	1.48
9.	Mr Brian Catley & Mrs Julia Catley <B N Catley Super Fund A/C>	1,510,000	1.45
10.	ANZ Nominees Limited <Cash Income A/C>	1,454,922	1.40
11.	Mr Alfred Joseph Winkelmeier & Mrs Christine Edith Winkelmeier	1,000,000	0.96
12.	Merrill Lynch (Australia) Nominees Pty Limited	950,057	0.91
13.	Citicorp Nominees Pty Limited	921,867	0.88
14.	Eryri Pty Ltd	650,000	0.62
15.	Mr Peter Leonard Druce	644,400	0.62
16.	Laton Holdings Pty Ltd	590,869	0.57
17.	SWR Harris Pty Ltd <Superannuation Fund A/C>	509,071	0.49
18.	Lappin Consulting Pty Ltd <Super Fund A/C>	460,132	0.44
19.	Mr David Ian Mitchell	450,863	0.43
20.	Mr David Kenley	442,277	0.42
		36,965,249	35.48