

CONTENTS	PAGE
Chairman's Report	2
Directors' Report	3
Statement of Financial Performance.....	7
Statement of Financial Position	8
Statement of Cash Flows	9
Notes to the Financial Statements.....	10
Directors' Declaration.....	26
Independent Audit Report	27
Additional Information.....	28

CORPORATE DIRECTORY

Registered Office

Unit 5, 15 Walters Drive
Osborne Park
Western Australia 6017

Contact Information

Postal Address: P.O. Box 2067
Churchlands
Western Australia 6018

Telephone: +61 8 9204 4844
Facsimile: +61 8 9204 4866
Email: sms@smsystems.com.au
Website: www.smsystems.com.au

Independent Auditors

Ernst & Young
152 St Georges Terrace
Perth
Western Australia 6000

Share Registry

Advanced Share Registry Services
Level 7, 200 Adelaide Terrace
Perth
Western Australia 6000

Telephone: +61 8 9221 7288
Facsimile: +61 8 9221 7869

CHAIRMAN'S REPORT

As predicted in my report last year, the period since the last AGM has been extremely busy with many exciting developments for SMS. The emphasis during this period has been on commercialisation of our products with a strong focus on the aviation industry.

During the year Capital Growth Corp Limited (CGC) joined the Company as a major investor also providing a Finance Director while three of our long serving Directors resigned as part of the restructure. I welcome Tony Brennan to The Board. Tony is also serving as Deputy Chairman. I would also like to thank the three retiring Directors, Ken Clements (a previous Chairman), Mike Wynne and Rhys Jones for their contribution to the Company during the difficult formative years. So as not to disadvantage existing shareholders a recent rights issue was made so that shareholders could subscribe for more shares at the same price that CGC subscribed for its shares in the Company. The rights issue was well supported by shareholders.

There have been some significant developments in the military aviation side of the business, we are very close to a contract signature with the Republic of Singapore Air Force to fit sensors to the RSAF's Marchetti S211 jet trainer aircraft as well as a trial fit out to their F5E jet fighter. The first installation of SMS sensors on a RAAF P3 has been successfully completed. Three more P3's are to be fitted out in the coming months. The trial being conducted with sensors fitted on a US Navy CH53 helicopter in January 2002 was successfully completed with our sensors detecting the growth of a pre-existing crack in January 2003. At this stage the US Navy continue to fly the SMS system accumulating valuable data on the reliability and robustness of the SMS technology and to monitor the continued growth of the crack detected. We expect that this valuable data point in the US military will lead to contracts in the future as soon as SMS is able to establish commercial and technical support on the ground in the US.

Commercially, the most important and critical project the company is working on at present is to gain FAA certification for the installation of sensors on the main spar and inside the fuel tank of the DC9 (Boeing 717) aircraft. This is a most challenging installation as the sensors will be inside a fuel tank immersed in fuel. The Company has established a strong relationship with Northwest Airlines in the US who are sponsoring the DC9 wing spar certification while Boeing is funding the project. Boeing, Northwest and SMS are collaborating well with a significant flow of information and cooperation between the three parties. Sensor development for the application is well advanced and the final phase testing for FAA certification is due to begin the fourth quarter of 2003. Northwest maintenance managers are working closely with SMS identifying further locations for the installation of SMS sensors across other aircraft in their fleet. Northwest is one of the biggest operators of Boeing and Airbus passenger aircraft in the US

More recently QANTAS and Air Asia have agreed to cooperate with SMS to develop SMS sensors to address stress cracking on Boeing 737 aircraft.

Airbus continues to be a major customer driver for many SMS products. They continue to use our sensors in the Laboratory testing which is a lead in for use of the sensors for future new Airbus aircraft. In conjunction with the Australian Defence Science and Technology Organisation, Airbus has also become involved in an environmental testing program to validate the durability of the SMS sensors. Airbus has supplied metal coupons with various samples of Airbus paint finishes to be included in the two year durability trials.

The company's technical resources have been expanded primarily to refine the next generation Portable Monitor (PM4) periodic monitoring system to suit all types of customer requirements from airframe inspection to inspection of stationary and mobile equipment. The PM4 was developed as the main tool for the retro fit market such as existing aircraft and is being used in the RAAF P3 program.

The Company has established a good relationship with John Hopkins University (JHU) who invited SMS to join it in a US Government (DARPA) funded research program on polymer technology developed by JHU. This is an important recognition of the SMS technology by one of the leading technical institutions in the US. It will also improve the company profile in its most important market. The relationship with JHU is already paying dividends for SMS as it has made available advanced fluoro-polymers and adhesives, such as Teflons, for the development of a new range of sensors that can operate in more hostile environments, this broadens the range of applications for the SMS technology.

As you can see, this has been a critical year for SMS. The next twelve months will see a very different company emerging hopefully as a successful provider of a very important product and service on the world stage. The Managing Director and all staff are to be commended on an extraordinary year's achievement.



Alan Reed
Chairman

DIRECTORS' REPORT

The Directors submit their report together with the financial report of Structural Monitoring Systems Limited for the year ended 30 June 2003 and the auditor's report thereon.

DIRECTORS

The names and details of the Company's directors in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

Alan Raymond Reed, AO, Air Vice Marshal (RAAF Rtd) (Chairman)

Air Vice Marshal Reed retired from the Royal Australian Air Force in 1990 after a distinguished career which included several senior command and staff appointments, including a term as air attaché in Washington. His final appointment was air officer commanding logistics command where he held responsibility for maintenance and engineering standards for the RAAF. He is currently managing director of Altech International, a defence-consulting organisation.

Anthony Thomas Brennan, CA (Deputy Chairman and Director- Corporate), Appointed 26 May 2003

Mr Brennan has played a leading role in a number of Australian public companies over the past 13 years, having been the Managing Director of Mount Edon Gold Mines (Aust) Ltd and Kilkenny Gold N.L. In 2001 he was instrumental in the ASX listing of Dolomatrix International Ltd, a company specialising in the treatment of hazardous waste. He is Non-executive Chairman of two other ASX listed companies, Gleneagle Gold Ltd and Plexus International Ltd. Both companies operate in areas that do not present a conflict of interest for the company. A Chartered Accountant by profession, he was previously a partner in a national accounting firm in Australia and has extensive experience in financial management.

Robin John Dean, B.Ec (Managing Director and Chief Executive Officer)

Mr Dean has extensive experience in management, corporate and investment banking, having held the position as the Head of Project Finance at Bankwest (1989 – 1995). Robin was also CEO of St Barbara Mines (1995 – 1997) which, at the time, was a successful Australian gold mining company with a market capitalisation of in excess of \$250 million and 300 employees. Robin has also held prior corporate finance positions with Westchester Corporate Finance and Westpac Banking Corporation. Robin is primarily responsible for the day to day management of the Company as well as the execution of strategy and the commercialisation of the CVMTM technology. Robin holds a Bachelor of economics from University of Western Australia, Perth.

Lennard Steve Brajkovich, OAM, JP.

Mr Brajkovich is the president of the West Australian Chicken Growers Association and sits on several government boards and committees in that capacity. He is Director and President of the Australian Chicken Growers Council Limited and is a recipient of the Australian World Poultry Science Award for 2000. Mr Brajkovich is the chairman of several companies involved in bio-technical processing and brings to SMS a wealth of business experience and corporate stewardship. He was a founding investor in the SMS technology.

Paul Ejnar Kristensen, B.Sc. (Hons.), Mech.Eng. (Copenhagen 1968), CPEng., MIEAust.

Mr Kristensen is the owner and Executive Chairman of Capital Technologies Pty Ltd, a seed capital firm he established in 1986. Between 1968 and 1978 he was involved as project manager in major nuclear and particle physics research projects at the Paul Scherrer Institute in Switzerland and CERN in Geneva and has co-published papers with leading physicists and engineers. For five years he operated his own consulting business in Geneva, involved in R&D management and international licensing. In 1983 he moved to Perth, WA, where he has been a founding director and investor of a number of technology companies, including ERG Limited, Arbortech Pty Ltd and Kinetic Limited, as well as the following technology companies where he remains on the board of directors, IQ Investments Ltd, VentureAcess Capital Ltd and Data-Cast.Net Ltd. He is Chairman of DDD Group Plc, a company listed on AIM Market of the London Stock Exchange and is a director of most of the DDD Group companies in North America and Australia. He has served as a Governor and Acting Chairman of Central TAFE until 2001.

DIRECTORS' REPORT continued

Michael John Wynne, (Alternate for R.J. Dean)

Mr Wynne is the managing director and major shareholder of the Marmion Group Pty Ltd a large contract plumbing business in Western Australia. Mr Wynne resigned from the board on 29 May 2003 to facilitate the streamlining and restructure of the board and was subsequently appointed as Alternate for R J Dean on 17 June 2003.

Kenneth Francis Clements

Mr Clements is a former chairman of the Company and is a director of a number of property development, technology and investment companies. He has a technical background including formal education with the Royal Australian Air Force as a radio technician, followed by pilot training and experience as a radio instructor, air traffic control officer and graduation from the Officer Training School. Some of his major property developments have included the Vines Resort and Country Club and Molloy Island Holiday Resort in Western Australia. His directorships of other technology companies have included Kinetic Limited and Dynamic Digital Depth Inc. Mr Clements resigned from the board on 21 May 2003 to facilitate the streamlining and restructure of the board.

Professor Rhys Jones

Professor Jones is chairman of the Department of Mechanical Engineering at Monash University. He is a former head of structural engineering at Aeronautical and Maritime Research Laboratories (Australian Department of Defence) in Melbourne, with responsibility for the structural integrity of a number of platforms including the F111 fighter/bomber and the PC9 trainer. He is currently an advisor on ageing structures to the director of the Federal Aviation Authority in the USA and holds a range of other international and national positions. He is a member of the editorial board of three international journals within his field and has received numerous awards for his work. Professor Jones has written many publications, significantly contributing to the fields of ageing structures, stress analysis, composite materials and fracture mechanics. Professor Jones resigned from the board on 27 June 2003 to facilitate the streamlining and restructure of the board.

PRINCIPAL ACTIVITIES

The principal activities during the year were:

- research and development of the SMS technology;
- commercialisation of the technology in Australia and internationally.

RESULTS AND DIVIDENDS

The operating loss, after income tax, for the year was \$3,126,461 (2002: \$1,702,637). No dividends were proposed or paid during the financial year.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

Shareholders' equity increased from \$4,595,076 to \$4,634,316, an increase of \$39,240. During the year losses of \$3,126,461 incurred in the ongoing development and commercialisation of the Company's CVM™ were more than offset by an increase in contributed equity. The Company issued 22,848,170 ordinary shares largely through a private placement to raise a net amount of \$3,165,701.

DIRECTORS' REPORT continued**SIGNIFICANT EVENTS AFTER BALANCE DATE**

The Company issued a Prospectus dated 26 August 2003 for a non-renounceable entitlements issue to Participating Shareholders of one ordinary share for every 17 ordinary shares held by Participating Shareholders. The Prospectus offered up to 5,311,442 ordinary shares at an issue price of 18 cents per share to raise a maximum of \$956,059 before costs of the issue.

The Prospectus closed on 15 September 2003 and a total of 3,681,937 ordinary shares were issued on 19 September 2003 raising \$662,749 before costs of the issue.

On 20 August 2003, 2,105,050 ordinary shares were issued to Capital Growth Corp Limited. Additional information regarding the shares issue are provided at Note 18.

The financial effect of each of the above has not been recognised in the financial statements.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Likely future developments in the operations of the Company are referred to in other sections of this Annual Report. Other than as referred to above and in other sections of this report, further information as to likely developments in the operations of the Company and the likely results of those operations would, in the opinion of the Directors, be speculative.

ENVIRONMENTAL REGULATION

The Directors are not aware of any breaches of any environmental regulations during the period covered by this report.

INDEMNIFICATION AND INSURANCE OF OFFICERS AND AUDITORS

Shareholders approved the entry into an Officer Protection Deed with each of the Directors, other than Mr A T Brennan, at an annual general meeting held on 15 December 2000. Under the Deeds, to the extent permitted by law and the Constitution, each Director has a continuing indemnity against any Legal Proceedings, damage, loss, liability, cost, charges, expense, outgoing or payment (including legal expenses on a solicitor/client basis) suffered, paid or incurred by the Director in connection with the Director being a director of the Company, the employment of the Director with the Company or a breach by the Company of its obligations under the Deed.

MEETINGS OF DIRECTORS

The numbers of meetings of Directors held during the year and the number attended by each Director was as follows:

Director	Directors' Meetings attended	Meetings held while a Director	Audit Committee Meetings attended	Audit Committee Meetings held
L S Brajkovich	7	8	3	3
A T Brennan	1	1	-	-
K F Clements	5	6	-	-
R J Dean	7	8	-	-
R Jones	-	8	-	-
P E Kristensen	8	8	3	3
A R Reed	8	8	-	-
M J Wynne	6	7	-	-

DIRECTORS' REPORT continued**CORPORATE GOVERNANCE**

The Directors recognise the need to maintain high standards of corporate behaviour and accountability. The Directors established an audit committee during the year as the first step in establishing formal corporate governance policies and procedures. The committee provides the board with additional assurance regarding the reliability of financial information contained in the financial reports. The members of the audit committee are as follows:

L S Brajkovich

P E Kristensen

S W Randell (Mr Randell is Company Secretary and a non-director)

Signed in accordance with a resolution of the Directors.



R.J. Dean

Director

Perth, Western Australia
30 September 2003

STATEMENT OF FINANCIAL PERFORMANCE
For The Year Ended 30 June 2003

	Note	2003 \$	2002 \$
Sales revenue		376,728	-
Cost of sales		(29,248)	-
Gross profit		347,480	-
Other revenues from ordinary activities	2	198,831	1,556,551
Net revenues from ordinary activities		546,311	1,556,551
Administration expenses		(1,085,993)	(1,304,419)
Marketing expenses		(962,710)	(620,083)
Occupancy expenses		(92,009)	(119,693)
Research and development expenses		(1,532,060)	(1,214,993)
Loss from ordinary activities before income tax		(3,126,461)	(1,702,637)
Income tax expense relating to ordinary activities	4	-	-
Net loss	11	(3,126,461)	(1,702,637)
Share issue costs	10	(634,299)	(1,100)
Total Expenses Attributable To Members Of Structural Monitoring Systems Limited And Recognised Directly In Equity		(634,299)	(1,100)
Total Changes In Equity Other Than Those Resulting From Transactions With Owners As Owners Attributable to Members Of Structural Monitoring Systems Limited		(3,760,760)	(1,703,737)

The accompanying notes form part of these financial statements.

STATEMENT OF FINANCIAL POSITION**As At 30 June 2003**

	Note	2003 \$	2002 \$
Current assets			
Cash	12(b)	3,753,485	3,272,924
Inventories, at cost		41,497	-
Receivables	5	74,082	58,887
Other - prepayments		63,578	14,781
Total current assets		<u>3,932,642</u>	<u>3,346,592</u>
Non-current assets			
Property, plant and equipment	6	206,060	214,928
Intangibles	7	516,517	881,140
Deferred research and development costs	8	673,709	498,826
Total non-current assets		<u>1,396,286</u>	<u>1,594,894</u>
Total assets		<u>5,328,928</u>	<u>4,941,486</u>
Current liabilities			
Payables	9	639,548	299,974
Provision – employee benefits		55,064	46,436
Total current liabilities		<u>694,612</u>	<u>346,410</u>
NET ASSETS		<u>4,634,316</u>	<u>4,595,076</u>
Equity			
Contributed equity	10	14,585,692	11,419,991
Accumulated losses	11	(9,951,376)	(6,824,915)
TOTAL EQUITY		<u>4,634,316</u>	<u>4,595,076</u>

The accompanying notes form part of these financial statements.

STATEMENT OF CASH FLOWS
For The Year Ended 30 June 2003

	Note	2003 \$	2002 \$
Cash flows from operating activities			
Receipts from customers		376,353	1,277,968
Payments to suppliers and employees		(3,508,842)	(2,783,672)
Royalty fees		(66,905)	(127,658)
Interest received		92,852	133,594
Government grants		105,979	144,989
Net cash outflows from operating activities	12(a)	(3,000,563)	(1,354,779)
Cash flows from investing activities			
Purchase of property, plant and equipment		(60,682)	(107,632)
Loan – SMS plc		(25,302)	-
Deposits and advances		6,909	-
Net cash outflows from investing activities		(79,075)	(107,632)
Cash flows from financing activities			
Proceeds from issue of shares		3,800,000	3,037,865
Payment of share issue costs		(239,801)	(12,295)
Net cash flows from financing activities		3,560,199	3,025,570
Net increase in cash held		480,561	1,563,159
Cash at the beginning of the financial year		3,272,924	1,709,765
Cash at the end of the financial year	12(b)	3,753,485	3,272,924

The accompanying notes form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

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

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

Changes in accounting policy

The accounting policies adopted are consistent with those of the previous year except for the accounting policies with respect to the provision for employee benefits.

Employee Benefits

The Company has adopted the revised Accounting Standard AASB 1028 "Employee Benefits" which has resulted in a change in the accounting policy for the measurement of employee benefit liabilities. Previously, the Company measured the provision for employee benefits based on remuneration rates at the date of recognition of the liability. In accordance with the requirements of the revised Standard, the provision for employee benefits is now measured based on the remuneration rates expected to be paid when the liability is expected to be settled. The adoption of the revised policy did not have a material effect.

Comparative information

Where necessary comparative information has been reclassified to achieve consistency in disclosure with the current financial year amounts and other disclosures.

Foreign currencies

Translation of foreign currency transactions

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

Amounts payable to and by the Company that are outstanding at the reporting date and are denominated in foreign currencies have been converted to local currency using rates of exchange ruling at the end of the financial year.

The Company does not hedge against movements in exchange rates, all resulting exchange differences arising on settlement or re-statement are brought to account in determining the net profit or loss for the financial year. The Company has not entered into any forward currency contracts.

Cash and cash equivalents

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

For the purposes of the Statement of Cash Flows, cash includes cash on hand and in banks, and money market investments readily converted to cash within 2 working days, net of outstanding bank overdrafts.

Bank overdrafts are carried at the principal amount. Interest is charged as an expense as it accrues.

Notes to the Financial Statements continued**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued****Receivables**

Trade receivables are recognised and carried at original invoice amount less a provision for any uncollectable debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written-off as incurred.

Receivables from related parties are recognised and carried at the nominal amount due. Interest is taken up as income on an accrual basis.

Bills of exchange and promissory notes are measured at the lower of cost and net realisable value.

Recoverable Amount

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

Plant and Equipment*Cost*

Items of plant and equipment acquired are carried at cost.

Depreciation

Depreciation is provided on a straight line basis on each item of plant and equipment over its expected useful life to the Company, that ranges from 2 ½ years (computer software) to 15 years.

Intangibles*Patents and licences*

Patents are amortised over being 5 years. Technology licences are amortised over their useful lives, being 10 years.

Deferred research and development costs

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

Payables

Liabilities for trade creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the company.

Payables to related parties are carried at the principal amount. Interest, when charged by the lender, is recognised as an expense on an accrual basis.

Deferred cash settlements are recognised at the present value of the outstanding consideration payable on the acquisition of an asset discounted at prevailing commercial borrowing rates.

Interest-bearing liabilities

All loans are measured at the principal amount. Interest is charged as an expense as it accrues.

Notes to the Financial Statements continued

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Provisions

Provisions are recognised when the company has a legal, equitable or constructive obligation to make a future sacrifice of economic benefits to other entities as a result of past transactions or other past events, it is probable that a future sacrifice of economic benefits will be required and a reliable estimate can be made of the amount of the obligation.

Contributed equity

Issued and paid up capital is recognised at the fair value of the consideration received by the company.

Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

Revenue recognition

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

Sale of goods

Control of the goods has passed to the buyer.

Rendering of services

Where the contract outcome can be reliably measured, control of the right to be compensated for the services and the stage of completion can be reliably measured. Stage of completion is measured by reference to the labour hours incurred to date as a percentage of total estimated labour hours for each contract.

Where the contract outcome cannot be reliably measured, revenue is recognised only to the extent that costs have been incurred.

Interest

Control of the right to receive the interest payment.

Income Tax

Tax-effect accounting is applied using the liability method whereby income tax is regarded as an expense and is calculated on the accounting profit after allowing for permanent differences. To the extent timing differences occur between the time items are recognised in the financial statements and when items are taken into account in determining taxable income, the net related taxation benefit or liability, calculated at current rates, is disclosed as a future income tax benefit or a provision for deferred income tax. The net future income tax benefit relating to tax losses and timing differences is not carried forward as an asset unless the benefit is virtually certain of being realised.

Notes to the Financial Statements continued

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued Goods and Services Tax (GST)

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

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

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

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

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

Employee Benefits

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

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

Employee benefits expenses and revenues arising in respect of the following categories:

- wages and salaries, non-monetary benefits, annual leave, long service leave, sick leave and other leave benefits; and
- other types of employee benefits are recognised against profits on a net basis in their respective categories.

In respect of employer contributions to superannuation plans, any contributions made by the company are charged against profits when due.

Derivative financial instruments

The Company has an exposure to changes in interest rates on its short term deposits, derivative financial instruments have not been used to hedge against this risk.

Notes to the Financial Statements continued

	2003	2002
	\$	\$
2. REVENUE FROM ORDINARY ACTIVITIES		
Revenues from operating activities		
Revenue from sale of goods	376,728	-
Revenue from services and hire of equipment	-	1,277,968
Total revenues from operating activities	<u>376,728</u>	<u>1,277,968</u>
Revenues from non-operating activities		
Interest – other corporations	92,852	133,594
Government grants	105,979	144,989
Total revenues from non-operating activities	<u>198,831</u>	<u>278,583</u>
Total revenues from ordinary activities	<u>575,559</u>	<u>1,556,551</u>
3. EXPENSES AND LOSSES/(GAINS)		
(a) Expenses		
Depreciation of non-current assets		
Plant and equipment	49,526	45,572
Leasehold improvements	20,025	2,707
Total depreciation of non-current assets	<u>69,551</u>	<u>48,279</u>
Amortisation of non-current assets		
Patents	352,123	352,123
Research and development costs	236,726	154,404
Technology licences	12,500	12,500
Total amortisation of non-current assets	<u>601,349</u>	<u>519,027</u>
Operating lease rental		
Minimum lease payments	70,000	67,927
Research and development costs written off	411,610	313,323
(b) Losses/(gains)		
Net foreign currency loss	16,688	-

Notes to the Financial Statements continued

	2003 \$	2002 \$
4. INCOME TAX		
The income tax attributable to operating loss is reconciled to the prima facie tax payable as follows:		
Operating loss before income tax	3,126,461	1,702,639
Prima facie tax on operating loss at 30%	(937,938)	(510,792)
Tax effect of permanent differences		
Non-deductible items	24,479	28,754
R & D tax concession	(100,882)	(151,190)
Tax losses and timing differences not brought to account	1,014,341	633,228
Income tax expense attributable to operating loss	-	-
Future income tax benefit arising from tax losses not brought to account at balance date as realisation of the benefit is not regarded as virtually certain.	3,473,507	2,468,287

This future income tax benefit will only be obtained if:

- (a) future assessable income is derived of a nature and of an amount sufficient to enable the benefit to be realised;
- (b) the conditions for deductibility imposed by tax legislation continue to be complied with; and
- (c) no changes in tax legislation adversely affect the Company in realising the benefit.

	2003 \$	2002 \$
5. RECEIVABLES (CURRENT)		
Trade debtors	375	-
Deposit – Bond for Bassendean premises	-	6,909
Loan – SMS plc	25,302	-
GST receivable	48,405	51,978
	74,082	58,887
Related party receivables		
Directors and director-related entities		
– loan to director related entity	25,302	

Terms and conditions relating to the above financial instruments:

- (i) Trade debtors are non-interest bearing and generally on 30 day terms.
- (ii) Loans to associated companies are non-interest bearing and repayable on demand.
- (iii) Details of the terms and conditions of related party receivables are set out in note 18.

Notes to the Financial Statements continued

	2003	2002
	\$	\$
6. PROPERTY, PLANT AND EQUIPMENT		
Leasehold improvements at cost	61,215	53,112
Accumulated depreciation	(22,732)	(2,707)
Total leasehold improvements	<u>38,483</u>	<u>50,405</u>
Plant and equipment at cost	290,122	237,542
Accumulated depreciation	(122,545)	(73,019)
Total plant and equipment	<u>167,577</u>	<u>164,523</u>
Total property, and equipment	<u>206,060</u>	<u>214,928</u>
(a) Reconciliation		
Reconciliations of the carrying amounts of plant and equipments and leasehold improvements at the beginning and end of the current and previous years are set out below:		
<i>Leasehold improvements</i>		
Carrying amount at beginning	50,405	-
Additions	8,103	53,112
Depreciation expense	(20,025)	(2,707)
Total leasehold improvements	<u>38,483</u>	<u>50,405</u>
<i>Plant and equipment</i>		
Carrying amount at beginning	164,523	201,772
Additions	52,579	54,521
Recoverable amount write-down	-	(46,198)
Depreciation expense	(49,525)	(45,572)
Total plant and equipment	<u>167,577</u>	<u>164,523</u>
Total property, plant and equipment	<u>206,060</u>	<u>214,928</u>
7. INTANGIBLES		
Patents	1,760,616	1,760,616
Accumulated amortisation	(1,269,099)	(916,976)
	<u>491,517</u>	<u>843,640</u>
Technology licences	125,000	125,000
Accumulated amortisation	(100,000)	(87,500)
	<u>25,000</u>	<u>37,500</u>
	<u>516,517</u>	<u>881,140</u>

Notes to the Financial Statements continued

	2003 \$	2002 \$
8. DEFERRED RESEARCH AND DEVELOPMENT COSTS		
Balance at beginning	772,021	407,195
Expenditure incurred during year	823,219	678,149
Costs written off	(411,610)	(313,323)
	<u>1,183,630</u>	<u>772,021</u>
Accumulated amortisation	(509,921)	(273,195)
	<u>673,709</u>	<u>498,826</u>
9. PAYABLES (CURRENT)		
Trade creditors	195,945	194,817
Royalties	69,381	67,000
Accruals	336,000	12,000
Superannuation	38,222	26,157
	<u>639,548</u>	<u>299,974</u>
Aggregate amounts payable to related parties included in the above:		
Directors and director-related entities		
- director-related entities	<u>69,381</u>	<u>99,083</u>

Terms and conditions relating to the above financial instruments:

- (i) Trade creditors are non-interest bearing and are normally settled on 30 day terms.
- (ii) Royalties are non-interest bearing and are payable within 7 days of the Company lodging its statutory financial statements with the ASIC.
- (iii) Superannuation is non-interest bearing and is payable by 28 July 2003.
- (iv) Details of the terms and conditions of related party payables are set out in note 18.

Notes to the Financial Statements continued

	2003		2002	
	\$		\$	
10. CONTRIBUTED EQUITY				
(a) Issued and paid up capital				
136,586,530 (2002: 113,738,360) ordinary shares.		14,585,692		11,419,991
(b) Movements in shares on issue				
	2003		2002	
	Number	\$	Number	\$
A class ordinary shares				
Beginning of the financial year	25,001,200	2,500,120	25,001,200	2,500,120
Converted to Ordinary shares	(25,001,200)	(2,500,120)	-	-
End of the financial year	-	-	25,001,200	2,500,120
Ordinary shares				
Beginning of the financial year	88,737,160	8,919,871	66,060,720	5,883,106
Issued during the year:				
- conversion of A class shares	25,001,200	2,500,120	-	-
- public equity raising	-	-	614,960	307,480
- private placements (Note (i))	21,848,170	3,650,000	-	-
- exercise options (Note (ii))	1,000,000	150,000	22,061,480	2,730,385
- share issue costs	-	(634,299)	-	(1,100)
End of the financial year	136,586,530	14,585,692	88,737,160	8,919,871
Total issued and paid up capital	136,586,530	14,585,692	113,738,360	11,419,991

- (i) On 28 May 2003, 21,848,170 ordinary shares were issued to Capital Growth Corp Limited at an average price of 16.7 cents per share to raise a total of \$3,650,000 before costs of the issue. Additional information regarding this transaction is provided at Note 18.
- (ii) On 12 November 2002, 1,000,000 ordinary shares were issued at an issue price of 15 cents per share as a consequence of the exercise of options by a Director. Additional information regarding transactions of Directors and Director-related entities concerning shares and share options is provided at Note 18.

Options

At 30 June 2003 the following options over unissued ordinary shares were outstanding:

Latest exercise date	Price	Number
31 December 2004	60.0 cents	100,000

2003	2002
\$	\$

11. ACCUMULATED LOSSES		
Accumulated losses	9,951,376	6,824,915
Balance at beginning of year	6,824,915	5,122,278
Net loss	3,126,461	1,702,637
Balance at end of year	9,951,376	6,824,915

Notes to the Financial Statements continued

	2003 \$	2002 \$
12. STATEMENT OF CASH FLOWS		
(a) Reconciliation of the operating loss after tax to the net cash flows from operations:		
Operating loss after tax	3,126,461	1,702,637
Non-cash items		
Depreciation of property, plant and equipment	(69,551)	(48,279)
Amortisation	(601,349)	(519,027)
Write-down of plant and equipment	-	(46,198)
Changes in assets and liabilities		
Decrease/(increase) in inventories	41,497	(27,313)
(Decrease) in deposit – Bond for Bassendean premises	-	(3,091)
Increase in trade debtors	375	-
Increase/(decrease) in prepayments	48,797	6,281
Increase in deferred research and development costs	411,610	364,826
Increase in goods and services tax receivable	(3,573)	11,879
(Increase) in trade creditors	69,370	(96,972)
(Increase)/decrease in accrued royalty	(2,381)	56,935
(Increase) in accrued charges	-	(2,000)
Decrease in other payables	-	1,058
(Increase) in accrued superannuation	(12,065)	(25,403)
(Increase) in provision for employee benefits	(8,628)	(20,554)
Net cash outflows from operating activities	3,000,563	1,354,779
(b) Reconciliation of cash		
For purposes of the statement of cash flows, cash includes cash on hand and at bank and short term deposits at call. Cash at the end of the financial year as shown in the statements of cash flows is reconciled to the related item in the balance sheet as follows:		
Cash on hand	269	500
Cash at bank	364,474	164,875
Deposits at call	3,388,742	3,107,549
	3,753,485	3,272,924

Notes to the Financial Statements continued**13. EXPENDITURE COMMITMENTS***Royalty payments*

The Company entered into an agreement dated 29 November 1999 with Tulip Bay Pty Ltd and Kenneth John Davey to acquire the patent and intellectual property rights of Tulip Bay. Under the terms of the agreement the Company will pay Tulip Bay an annual royalty, being the greater of:

- a) 3% of the payments received by the Company from the grant of licences to use the SMS technology plus 3% of the gross invoice price received by the Company from the sale of the SMS technology (less the cost of goods sold and certain other nominated costs); and
- b) \$60,000, adjusted for movements in the Cost of Living Index.

	2003 \$	2002 \$
<i>Operating lease (premises)</i>		
Minimum lease payments		
- not later than one year	70,000	70,000
- later than one year and not later than five years	64,167	134,167
Aggregate lease rental expenditure contracted for at balance date	134,167	204,167

14. EMPLOYEE BENEFITS AND SUPERANNUATION COMMITMENTS

	2003 \$	2002 \$
Employee Benefits		
The aggregate employee benefit liability is comprised of:		
Accrued wages, salaries and on-costs	38,222	26,157
Provisions (current)	55,064	46,436
	93,286	72,593

Employee Share Option Plan

An employee share option plan has been established under which the Directors may issue options over ordinary shares of the Company to full or permanent part-time employees or officers of the Company who have been in continuous employment with the Company for at least six months. Options, issued for nil consideration, are issued at the discretion of the Directors. The options are issued for a term determined by the Directors and are exercisable within 3 years of the issue date or as otherwise determined by the Directors. Currently 1 director and 13 employees are eligible for this scheme.

Notes to the Financial Statements continued**14. EMPLOYEE BENEFITS AND SUPERANNUATION COMMITMENTS continued**

Information with respect to the number of options granted under the employee share option plan is as follows:

	2003		2002	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance at beginning of year	100,000	60 cents	100,000	60 cents
- granted	100,000	60 cents	-	N/A
- forfeited	-	N/A	-	N/A
- lapsed	(100,000)	N/A	-	N/A
- exercised	-	N/A	-	N/A
Balance at end of year	100,000	60 cents	100,000	60 cents
Exercisable at end of year	100,000	60 cents	100,000	60 cents

(a) Options held at the beginning of the reporting period:

The following table summarises information about options held by employees as at 1 July 2002:

Number of Options	Grant Date	Vesting Date	Expiry Date	Weighted average exercise price
100,000	19 April 2001	19 April 2001	1 June 2001	60 cents

(b) Options granted during the reporting period:

The following table summarises information about options granted by the Company during the year:

	2003	2002
Grant date	20 December 2002	-
Vesting date	20 December 2002	-
Expiry date	31 December 2004	-
Weighted average exercise price	60 cents	-

(c) Options exercised

No options exercised by employees during the years ended 30 June 2003 or 30 June 2002.

15. SUBSEQUENT EVENTS

The Company issued a Prospectus dated 26 August 2003 for a non-renounceable entitlements issue to Participating Shareholders of one ordinary share for every 17 ordinary shares held by Participating Shareholders. The Prospectus offered up to 5,311,442 ordinary shares at an issue price of 18 cents per share to raise a maximum of \$956,059 before costs of the issue.

The Prospectus closed on 15 September 2003 and a total of 3,681,937 ordinary shares were issued on 19 September 2003 raising \$662,749 before costs of the issue.

On 20 August 2003, 2,105,050 ordinary shares were issued to Capital Growth Corp Limited. Additional information regarding the shares issue are provided at Note 18.

The financial effect of each of the above has not been recognised in the financial statements.

Notes to the Financial Statements continued**16. REMUNERATION OF DIRECTORS**

	2003	2002
	\$	\$
Income paid or payable, or otherwise made available, to all Directors of the Company, in connection with the management of the affairs of the Company.	288,978	238,820

The number of Directors of the Company whose income (including superannuation) falls within the following bands is:

\$0 - \$9,999	2	5
\$10,000 - \$19,999	3	-
\$20,000 - \$29,999	1	-
\$40,000 - \$49,999	1	1
\$150,000 - \$159,999	1	1

17. AUDITORS REMUNERATION

Amounts receivable or due and receivable by the auditors

Auditing accounts	14,300	10,500
Other services	12,650	11,727
	26,950	22,227

18. RELATED PARTY DISCLOSURES**(a) Directors**

The Directors of Structural Monitoring Systems Limited during the financial year were:

Lennard Steve Brajkovich

Anthony Thomas Brennan (appointed 26 May 2003)

Kenneth Frank Clements (resigned 21 May 2003)

Robin John Dean

Professor Rhys Jones (resigned 27 June 2003)

Paul Ejnar Kristensen

Air Vice Marshal Alan Raymond Reed

Michael John Wynne (resigned 29 May 2003, appointed alternate for R.J. Dean 17 June 2003)

(b) Remuneration of Directors

Information on remuneration of Directors is disclosed in Note 16.

Notes to the Financial Statements continued**18. RELATED PARTY DISCLOSURES continued****(c) Transactions with Directors and Director-related entities****Services**

Management fees totalling \$145,834 (2002: \$350,000) were incurred pursuant to the terms and conditions of a management agreement with Seabay Corporation Pty Ltd, a company of which R J Dean and M J Wynne are directors. The management agreement ended on 1 December 2002 and no management fees have been be incurred under the agreement since that date.

A royalty expense of \$69,250 (2002: \$70,723) was incurred pursuant to the terms and conditions of a technology agreement with Tulip Bay Pty Ltd, a company of which L S Brajkovich is a director. Further details are contained in Note 13.

On 26 May 2003 the Company entered into a Consultancy Agreement with Wall Street Nominees Pty Ltd for the provision of Mr A T Brennan's services as an executive director of the Company. Under the agreement a consulting fee of \$20,000 plus GST per calendar month is payable to Wall Street Nominees Pty Ltd and the Company is required to make superannuation contributions at the rate of 9% of the consulting fees. The term of the agreement is for a period of two years from 26 May 2003 unless otherwise mutually agreed between Wall Street Nominees Pty Ltd and the Company.

Loans

The Company provided a loan of \$25,302 (2002: nil) to SMS plc. Mr A T Brennan and Mr R J Dean are on the board of SMS plc. The loan is non-interest bearing and is repayable on demand.

Private Placement

The Company successfully negotiated a private placement with Capital Growth Corp Limited ("CGC") to raise \$3,650,000. Under the Heads of Agreement entered into with CGC, the number to be issued to CGC was dependent on a valuation of the Company determined independently of CGC and the Company, CGC assisting with certain commercially sensitive negotiations and the Company meeting certain obligations. The terms of the Heads of Agreement were negotiated at arm's length prior to Mr Brennan's appointment to the board.

A total of 23,953,220 ordinary shares have been issued to CGC pursuant to the Heads of Agreement, of which 2,105,050 shares were issued after 30 June 2003.

Notes to the Financial Statements continued**18. RELATED PARTY DISCLOSURES continued****(d) Transactions of Directors and Director-related entities concerning shares and share options**

The aggregate number of shares and share options of the Company acquired or disposed of by Directors or their Director-related entities were:

	2003	2002
	Number	Number
Acquisitions		
Ordinary shares	24,728,170	19,647,620
Disposals		
Ordinary shares	2,030,000	3,495,450
Granted options	-	1,000,000
Exercised options	1,000,000	19,381,930
Lapsed options	-	1,810,000
Transferred options	-	75,550

The aggregate number of shares and share options of the Company held directly, indirectly or beneficially by Directors or their Director-related entities at balance date were:

Ordinary shares	96,971,260	55,529,800
Ordinary "A" class shares	-	25,001,200
Options	-	1,000,000

During the year, Mr A R Reed acquired 1,000,000 ordinary shares through the exercise of options at an exercise price of 15 cents. The options were issued on 23 August 2001 in accordance with a special resolution passed by shareholders at a general meeting held on 23 August 2001.

19. SEGMENT INFORMATION

The Company operates in one industry, the Non-destructive Testing and Condition Monitoring industry, and in one geographical area, Australia.

20. CORPORATE INFORMATION

The registered office of the Company is located at Unit 5, 15 Walters Drive, Osborne Park, Western Australia 6017

At 30 June 2003 the Company had 14 employees (2002: 14 employees).

Notes to the Financial Statements continued

21 FINANCIAL INSTRUMENTS

(a) Interest rate risk

The Company's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities at the reporting date are as follows:

	Floating Interest Rate		Non-interest bearing		Total carrying amount as per the statement of financial position		Weighted average effective interest rate	
	2003 \$	2002 \$	2003 \$	2002 \$	2003 \$	2002 \$	2003 %	2002 %
(i) Financial assets								
Cash	3,711,361	3,272,924	42,124	-	3,753,485	3,272,924	4.76	4.45
Loan – SMS plc	-	-	25,302	-	25,302	-	N/A	N/A
Deposit – Bond for Bassendean premises	-	-	-	6,909	-	6,909	N/A	N/A
GST receivable	48,405	-	-	51,978	48,405	51,978	N/A	N/A
Total financial assets	3,759,766	3,272,924	67,426	58,887	3,827,192	3,331,811		
(ii) Financial liabilities								
Trade creditors	-	-	195,945	194,817	195,945	194,817	N/A	N/A
Royalties	-	-	69,381	67,000	69,381	67,000	N/A	N/A
Superannuation	-	-	38,222	26,157	38,222	26,157	N/A	N/A
Total financial liabilities	-	-	303,548	287,974	303,548	287,974		

(b) Net fair values

All financial assets and liabilities have been recognised at the balance date at their net fair values.

The following methods and assumptions are used to determine the net fair values of financial assets and liabilities:

Cash, cash equivalents and short-term investments: The carrying amount approximates fair value because of their short-term to maturity.

Trade receivables, trade creditors and dividends receivable: The carrying amount approximates fair value.

(c) Interest rate risk

The Company's maximum exposure to credit risk at reporting date in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the statement of financial position.

DIRECTORS' DECLARATION

In accordance with a resolution of the Directors of Structural Monitoring Systems Limited, I state that:

In the opinion of the Directors:

- (a) the financial statements and notes of the Company are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Company's financial position as at 30 June 2003 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards and Corporations Regulations; 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.

On behalf of the Board



R.J. Dean
Director

Perth, Western Australia
30 September 2003

Independent audit report to members of Structural Monitoring Systems Limited

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for Structural Monitoring Systems Limited (the company) for the year ended 30 June 2003.

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

Audit approach

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

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

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

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

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

Independence

We are independent of the company, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Audit opinion

In our opinion, the financial report of Structural Monitoring Systems Limited is in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of Structural Monitoring Systems Limited at 30 June 2003 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.


Ernst & Young

J. Copp
Partner
Perth

30 September 2003

ADDITIONAL INFORMATION

Additional information not shown elsewhere in the Annual Report is set out below. The information is current as at 26 August 2003.

(a) Distribution of equity securities

The number of shareholders by size of holding are as follows:

			Number of holders	Number of shares	% of Total Issued Capital
1	-	1,000	-	-	-
1,001	-	5,000	36	160,670	0.11%
5,001	-	10,000	72	530,551	0.37%
10,001	-	100,000	160	5,900,961	4.11%
100,001	and over		87	136,893,920	95.41%
			355	139,804,165	100.00%

(b) Twenty largest shareholders

The names of the twenty largest holders of shares are as follows:

		Number of shares	% of Total Issued Capital
1	Sentry Holdings Pty Ltd	49,758,092	34.68%
2	Capital Growth Corp Limited	23,953,220	16.69%
3	Tulip Bay Pty Ltd	12,705,050	8.86%
4	Capital Technologies Pty Ltd	4,184,000	2.92%
5	Seabay Corporation Pty Ltd	4,000,000	2.78%
6	Kenneth Frank Clements:		
	Kenneth Frank Clements <Malloy Island Superfund A/C>	3,472,941	2.42%
	Kenneth Frank Clements <Edgewater Clements Fund A/C>	406,588	0.28%
7	Mary Ethel Ermoine Jones <The Wolf Fund A/C>	2,000,000	1.39%
8	Alan Raymond Reed	1,760,000	1.23%
9	LRW Nominees Pty Ltd <The Cooler Fund A/C>	1,733,278	1.21%
10	Gaffney Consultants Ltd	1,680,000	1.17%
11	Lindane Pty Ltd <Captech Super Fund A/C>	1,316,000	0.92%
12	Wiko Holdings Pty Ltd	1,200,000	0.84%
13	Poynton and Partners Pty Ltd	1,112,585	0.78%
14	Edmund Noel Monks	1,080,000	0.75%
15	Gunter Thiel	1,000,000	0.70%
16	Charnley Hall Pty Ltd	960,000	0.67%
17	Lamton Investments Inc	960,000	0.67%
18	Kostan Pty Ltd	888,000	0.62%
19	Frank Manford Pty Ltd <Fam Superannuation Fund A/C>	868,235	0.61%
20	Crystal Pines Pty Ltd	812,700	0.57%
		115,850,689	80.76%