

**STRUCTURAL MONITORING SYSTEMS LIMITED**  
(ABN 94 067 556 245)

**ANNUAL REPORT**

**30 JUNE 2002**



<b>CONTENTS</b>	<b>PAGE</b>
<b>Chairman's Report .....</b>	<b>2</b>
<b>Directors' Report .....</b>	<b>3</b>
<b>Statement of Financial Performance.....</b>	<b>6</b>
<b>Statement of Financial Position .....</b>	<b>7</b>
<b>Statement of Cash Flows .....</b>	<b>8</b>
<b>Notes to the Financial Statements.....</b>	<b>9</b>
<b>Directors' Declaration.....</b>	<b>22</b>
<b>Independent Audit Report .....</b>	<b>23</b>
<b>Additional Information.....</b>	<b>24</b>

---

## **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

At the last AGM in November 2001, I predicted a very interesting year ahead for your company. As it turned out, the activity and achievements for the year exceeded my expectations. I am pleased to make this report to you with a prediction for an even more vigorous year ahead.

There has been so much activity on so many fronts that it is difficult to select the highlights to include in my overview. I will begin with the agreement SMS reached with Airbus last year which included a significant payment by Airbus to retain exclusivity for commercial aviation applications of **CVM**<sup>TM</sup> until 31st March 2002. Airbus were seeking development of extremely sensitive lap joint sensors as part of the agreement and this was proving very difficult to achieve. As a result and also because of staff changes at Airbus, the exclusive agreement was not renewed and SMS broadened its horizons to include discussions with Boeing. SMS has now succeeded in developing reliable lap joint sensors which are being tested successfully by Airbus and Boeing. Boeing has been very receptive to our approaches and arranged a series of in company seminars to explain the technology. We now have a four phase contract with Boeing which includes flight testing of **CVM**<sup>TM</sup> technology.

For military aircraft, SMS is also planning the installation of **CVM**<sup>TM</sup> on Royal Singapore Air Force A4 and F5E Fighter Aircraft. With the successful completion of six months testing, fleet wide installation is planned to occur. Our product is still performing well on the US Navy CH 53 Helicopter but the crack on the demonstration aircraft has still not reached the sensor to trigger the alert so the testing continues. The US Air Force have identified **CVM**<sup>TM</sup> as a preferred solution for structural monitoring. Installation of sensors on a RAAF P3C for a demonstration has been delayed because of other commitments but will take place soon.

SMS is also in discussion with a US military maintenance contractor. This contractor is looking to make an investment in SMS to assist SMS establish operations in the US. SMS is planning to establish marketing and technical support in the US; this is vital to gaining broad access to US military contracts. As a result of these meetings and our recognition of the US being the major market place for **CVM**<sup>TM</sup> technology, it has been decided to establish a permanent SMS presence in the US. The Board is now assessing the best way to achieve this goal.

Patent protection of our product is critical and five new patents are currently under examination by the International Patents authority. We are confident of progressing these claims. A sixth new patent has been filed and is at the provisional stage. Further research includes an agreement reached this year with Defence Science and Technology Organisation to develop a suitable sensor for inclusion in composite structures.

While this has been a very busy and successful year, it has also been an expensive one. It is very difficult to run an international company from Perth and travel costs take up a great deal of resources. SMS has developed a business plan for the next financial year. This plan includes an investment by a significant partner and discussions are well under way to obtain these necessary funds to continue to further develop your company.

I want to commend the Managing Director and all members of the staff of your company on a very productive and exciting year of 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 2002 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 that 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.

**Michael John Wynne**, (Deputy Chairman)

Mr Wynne is a successful businessman and property developer. He is the managing director and major shareholder of the Marmion Group Pty Ltd a large contract plumbing business in Western Australia.

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

Mr Dean is an investment banker with over 30 years experience in finance, corporate advice to and the management of, public companies. He was the chief executive officer of a large public company, which had a market capitalisation in excess of \$250 million and 300 employees. Prior to that he was head of project finance with Bank of Western Australia Limited where he was involved in financing many major project developments throughout Australia.

**Lennard Steve Brajkovich**, OAM, JP.

Mr Brajkovich serves the West Australian and Australian chicken meat industry as president and member of several committees 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 the Company a wealth of business experience and corporate stewardship. He was a founding investor in the SMS Technology.

**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.

**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.

## DIRECTORS' REPORT continued

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

Mr Kristensen is a director of a number of organisations with a technology base and is well credentialed in research and development and international licensing. He was the founder and managing director of the Company from 1995 to 1999. He is currently Chairman of DDD Group Plc., listed on the London Stock Exchange AIM market. He was a founding director and shareholder in the Western Australian based smart card manufacturer, ERG Limited and a number of other technology companies.

## **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 \$1,702,637 (2001: \$2,648,319). No dividends were proposed or paid during the financial year.

## **SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS**

Shareholders' equity increased from \$3,260,948 to \$4,595,076, an increase of \$1,334,128. During the year losses of \$1,702,637 incurred in the ongoing development and commercialisation of the Company's **CVM**<sup>TM</sup> were more than offset by an increase in contributed equity of \$3,036,765. The Company issued 22,676,440 ordinary shares largely through the exercise of 31 October 2001 options to raise a net amount of \$3,036,765.

## **SIGNIFICANT EVENTS AFTER BALANCE DATE**

Other than as referred to elsewhere in this report, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly its operations, the results of those operations, or the state of affairs of the Company, in subsequent financial years.

## **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.

**DIRECTORS' REPORT continued****INDEMNIFICATION AND INSURANCE OF OFFICERS AND AUDITORS****Indemnification**

Shareholders approved the entry into an Officer Protection Deed with each of the Directors 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.

**Insurance premiums**

During the year ended 30 June 2002 the Company insured directors and officers against certain liabilities. The contract of insurance prohibits disclosure of the nature of liabilities insured against and the premium paid.

**MEETINGS OF DIRECTORS**

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

<b>Director</b>	<b>Meetings attended</b>	<b>Meetings held while a Director</b>
L S Brajkovich	6	6
K F Clements	6	6
R J Dean	6	6
R Jones	2	6
P E Kristensen	6	6
A R Reed	6	6
M J Wynne	4	6

**CORPORATE GOVERNANCE**

The Directors recognise the need to maintain the high standards of corporate behaviour and accountability. The Directors have established an audit committee 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.

Director  
Perth, Western Australia  
18 October 2002

**STATEMENT OF FINANCIAL PERFORMANCE**  
**For The Year Ended 30 June 2002**

	Note	2002 \$	2001 \$
<b>Revenue from ordinary activities</b>			
Equipment hire and service income		1,277,968	41,215
Government grants		144,989	60,505
Interest – other corporations		133,594	36,553
Other income		-	2,506
Total revenue from ordinary activities		1,556,551	140,779
<b>Operating expenses</b>			
Advertising, brochures and corporate image		59,003	53,832
Amortisation expenses		519,027	446,062
Deferred research and development costs written off		313,323	279,070
Depreciation		48,279	16,741
Directors fees		41,500	35,700
Executive management fees		350,000	266,668
Operating lease rental		67,927	60,000
Professional fees		796,720	597,082
Patent registration costs and fees		84,503	103,712
Provision – Employee entitlements		20,554	15,182
Royalty fees		70,723	65,600
Salaries and wages		286,145	337,071
Travel and accommodation		225,910	222,698
Other expenditure		375,574	289,680
Total operating expenses		3,259,188	2,789,098
<b>Loss from ordinary activities, before income tax</b>		1,702,637	2,648,319
Income tax attributable to operating loss	2	-	-
<b>Net loss</b>	9	1,702,637	2,648,319

*The accompanying notes form part of these financial statements.*

**STATEMENT OF FINANCIAL POSITION**

As At 30 June 2002

	Note	2002 \$	2001 \$
<b>Current assets</b>			
Cash	10(b)	3,272,924	1,709,765
Inventories, at cost		-	27,313
Receivables	3	58,887	50,099
Other - prepayments		14,781	8,500
Total current assets		<u>3,346,592</u>	<u>1,795,677</u>
<b>Non-current assets</b>			
Plant and equipment	4	214,928	201,772
Intangibles	5	881,140	1,245,763
Deferred research and development costs	6	498,826	288,404
Total non-current assets		<u>1,594,894</u>	<u>1,735,939</u>
<b>Total assets</b>		<u>4,941,486</u>	<u>3,531,616</u>
<b>Current liabilities</b>			
Payables	7	299,974	244,786
Provision – employee entitlements		46,436	25,882
Total current liabilities		<u>346,410</u>	<u>270,668</u>
<b>NET ASSETS</b>		<u>4,595,076</u>	<u>3,260,948</u>
<b>Equity</b>			
Contributed equity	8	11,419,991	8,383,226
Accumulated losses	9	(6,824,915)	(5,122,278)
<b>TOTAL EQUITY</b>		<u>4,595,076</u>	<u>3,260,948</u>

*The accompanying notes form part of these financial statements.*

**STATEMENT OF CASH FLOWS**  
**For The Year Ended 30 June 2002**

	Note	2002 \$	2001 \$
<b>Cash flows from operating activities</b>			
Receipts from customers		1,277,968	49,714
Payments to suppliers and employees		(2,783,672)	(2,786,718)
Royalty fee		(127,658)	-
Interest received		133,594	36,553
Government grants		144,989	60,505
Other receipts		-	2,496
<b>Net cash (outflows) from operating activities</b>	10(a)	(1,354,779)	(2,637,450)
<b>Cash flows from investing activities</b>			
Purchase of plant and equipment		(107,632)	(86,756)
Deposits and advances		-	(8,500)
<b>Net cash (outflows) from investing activities</b>		(107,632)	(95,256)
<b>Cash flows from financing activities</b>			
Proceeds from issue of shares		3,037,865	3,560,991
Payment of share issue costs		(12,295)	-
Other		-	11,195
<b>Net cash flow from financing activities</b>		3,025,570	3,572,186
<b>Net increase in cash held</b>		1,563,159	839,480
Cash at the beginning of the financial year		1,709,765	870,285
<b>Cash at the end of the financial year</b>	10(b)	<b>3,272,924</b>	<b>1,709,765</b>

*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.

The financial report has been prepared on a going concern basis which contemplates the realisation of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company has not yet attained commercial production and has incurred a significant deficit to 30 June 2002. The ability of the Company to continue as a going concern is dependent upon either reaching satisfactory commercial production levels in order to generate positive cash flows or raising additional funds through new or existing shareholders.

The outcome of these matters cannot be predicted at this time. This financial report does not give effect to any adjustment to the classifications and amounts of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

#### **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 their useful lives, 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 entitlements

Provision is made for employee entitlement 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 entitlements expected to be settled within twelve months of the reporting date are measured at their nominal amounts. All other employee entitlement 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 entitlements 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 entitlements; and
- other types of employee entitlements are charged 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**

	<b>2002</b>	<b>2001</b>
	<b>\$</b>	<b>\$</b>
<b>2. INCOME TAX</b>		
The income tax attributable to operating loss is reconciled to the prima facie tax payable as follows:		
Operating loss before income tax	1,702,639	2,648,319
Prima facie tax on operating loss at 30% (2001: 34%)	(510,792)	(900,428)
Tax effect of permanent differences		
Non-deductible items	28,754	14,449
R & D tax concession	(151,190)	(151,731)
Tax losses and timing differences not brought to account	633,228	734,248
<b>Income tax expense attributable to operating loss</b>	<b>-</b>	<b>-</b>
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.	2,468,287	1,741,998

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.

	<b>2002</b>	<b>2001</b>
	<b>\$</b>	<b>\$</b>
<b>3. RECEIVABLES (CURRENT)</b>		
Deposit – Bond for Bassendean premises	6,909	10,000
GST receivable	51,978	40,099
	58,887	50,099

**Notes to the Financial Statements continued**

	<b>2002</b>	<b>2001</b>
	\$	\$
<b>4. PLANT AND EQUIPMENT</b>		
Plant and equipment at cost	288,720	97,994
Accumulated depreciation	(75,726)	(27,449)
	<u>212,994</u>	<u>70,545</u>
Comparative vacuum monitoring units	-	129,293
Loose tools	1,934	1,934
	<u>214,928</u>	<u>201,772</u>
<b>(a) Reconciliation</b>		
Reconciliation of the carrying amount of plant and equipments is set out below:		
Carrying amount at beginning	201,772	130,350
Additions	107,633	88,163
Recoverable amount write-down	(46,198)	-
Depreciation expense	(48,279)	(16,741)
	<u>214,928</u>	<u>201,772</u>
<b>5. INTANGIBLES</b>		
Patents	1,760,616	1,760,616
Accumulated amortisation	(916,976)	(564,853)
	<u>843,640</u>	<u>1,195,763</u>
Technology licences	125,000	125,000
Accumulated amortisation	(87,500)	(75,000)
	<u>37,500</u>	<u>50,000</u>
	<u>881,140</u>	<u>1,245,763</u>
<b>6. DEFERRED RESEARCH AND DEVELOPMENT COSTS</b>		
Balance at beginning	407,195	130,124
Expenditure incurred during year	678,149	554,141
Costs written off	(313,323)	(277,070)
	<u>772,021</u>	<u>407,195</u>
Accumulated amortisation	(273,195)	(118,791)
	<u>498,826</u>	<u>288,404</u>

## Notes to the Financial Statements continued

	2002 \$	2001 \$
<b>7. PAYABLES (CURRENT)</b>		
Trade creditors	194,817	97,845
Royalties	67,000	123,935
Accruals	12,000	10,000
Superannuation	26,157	754
Other	-	12,252
	<u>299,974</u>	<u>244,786</u>

Aggregate amounts payable to related parties included in the above:

Directors and director-related entities  
- director-related entities

194,817	97,845
---------	--------

**8. CONTRIBUTED EQUITY****(a) Issued and paid up capital**

113,738,360 (2001: 91,061,920) ordinary shares.	<u>11,419,991</u>	<u>8,383,226</u>
---	-------------------	------------------

**(b) Movements in shares on issue**

	2002		2001	
	Number	\$	Number	\$
<b>A class ordinary shares</b>				
Beginning of the financial year	25,001,200	2,500,120	2,500,120	2,500,120
Issued during the year:				
- share split 10:1	-	-	22,501,080	-
End of the financial year	<u>25,001,200</u>	<u>2,500,120</u>	<u>25,001,200</u>	<u>2,500,120</u>
<b>Ordinary shares</b>				
Beginning of the financial year	66,060,720	5,883,106	4,947,500	2,335,940
Issued during the year:				
- share split 10:1	-	-	44,527,500	-
- public equity raising	614,960	307,480	4,303,000	2,151,500
- exercise options	22,061,480	2,730,385	12,282,720	1,409,491
- share issue costs	-	(1,100)	-	(13,825)
End of the financial year	<u>88,737,160</u>	<u>8,919,871</u>	<u>66,060,720</u>	<u>5,883,106</u>
Total issued and paid up capital at 30 June 2002	<u>113,738,360</u>	<u>11,419,991</u>	<u>91,061,920</u>	<u>8,383,226</u>

**Options**

At 30 June 2002 the following options over unissued ordinary shares were outstanding:

Latest exercise date	Price	Number
31 October 2002	15.0 cents	1,000,000
31 October 2002	50.0 cents	1,000,000
1 June 2003	60.0 cents	100,000

**Notes to the Financial Statements continued**

	<b>2002</b>	<b>2001</b>
	<b>\$</b>	<b>\$</b>
<b>9. ACCUMULATED LOSSES</b>		
Accumulated losses	6,824,915	5,122,278
Balance at beginning of year	5,122,278	2,473,959
Net loss	1,702,637	2,648,319
Balance at end of year	6,824,915	5,122,278
<b>10. STATEMENT OF CASH FLOWS</b>		
<b>(a) Reconciliation of the operating loss after tax to the net cash flows from operations:</b>		
Operating loss after tax	1,702,637	2,648,319
<b>Non-cash items</b>		
Depreciation of plant and equipment	(48,279)	(16,741)
Amortisation	(519,027)	(446,062)
Write-down of plant and equipment	(46,198)	-
<b>Changes in assets and liabilities</b>		
Increase/(decrease) in inventories	(27,313)	27,313
(Decrease) in deposit – Bond for Bassendean premises	(3,091)	-
(Decrease) in trade debtors	-	(8,499)
Increase/(decrease) prepayments	6,281	(20,985)
Increase in deferred research and development costs	364,826	277,071
Increase in goods and services tax receivable	11,879	35,020
Decrease/(increase) trade creditors	(96,972)	157,196
Decrease accrued royalty	56,935	-
(Increase) accrued charges	(2,000)	-
Decrease other payables	1,058	-
(Increase) accrued superannuation	(25,403)	-
(Increase) in provision for employee entitlements	(20,554)	(15,182)
<b>Net cash outflows from operating activities</b>	<b>1,354,779</b>	<b>2,637,450</b>
<b>(b) Reconciliation of cash</b>		
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	500	500
Cash at bank	164,875	(41,028)
Deposits at call	3,107,549	1,750,293
	<b>3,272,924</b>	<b>1,709,765</b>

**Notes to the Financial Statements continued****11. 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,
- however, payment of the annual royalty shall be deferred until the first to occur of:
- i. completion of the audit of the accounts of the Company with respect to the first accounting period after listing by the Company on a prescribed stock exchange; or
  - ii. if no such listing takes place prior to 31 October 2001 then the accrued payment shall be due and payable on 31 October 2001.

	<b>2002</b>	<b>2001</b>
	\$	\$
<i>Operating lease</i> (premises)		
Minimum lease payments		
- not later than one year	70,000	32,500
- later than one year and not later than five years	134,167	-
Aggregate lease rental expenditure contracted for at balance date	<u>204,167</u>	<u>32,500</u>

**12. EMPLOYEE ENTITLEMENTS**

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. The options cannot be transferred and will not be quoted on the ASX. Currently 1 director and 14 employees are eligible for this scheme.

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

	<b>2002</b>		<b>2001</b>	
	<b>Number of options</b>	<b>Weighted average exercise price</b>	<b>Number of options</b>	<b>Weighted average exercise price</b>
Balance at beginning of year	100,000	60 cents	-	N/A
- granted	-	N/A	100,000	60 cents
- forfeited	-	N/A	-	N/A
- exercised	-	N/A	-	N/A
Balance at end of year	<u>100,000</u>	<u>60 cents</u>	<u>100,000</u>	<u>60 cents</u>
Exercisable at end of year	<u>100,000</u>	<u>60 cents</u>	<u>100,000</u>	<u>60 cents</u>

**Notes to the Financial Statements continued****12. EMPLOYEE ENTITLEMENTS continued**

The following table summarises information about options outstanding and exercisable at 30 June 2002:

Option price	Options	Outstanding		Exercisable	
		Average option life	Average option price	Number of options	Average option price
\$0.55 - \$0.64	100,000	2.1	60 cents	100,000	60 cents

**13. SUBSEQUENT EVENTS**

No matters or circumstances have arisen in the interval between 30 June 2002 and the date of this report which significantly affected the operations of the Company, the results of those operations, or the state of affairs of the Company.

**14. REMUNERATION OF DIRECTORS**

	2002 \$	2001 \$
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.	238,820	204,556

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

\$0 - \$9,999	5	6
\$10,000 - \$19,999	-	1
\$40,000 - \$49,000	1	-
\$90,000 - \$99,999	-	-
\$150,000 - \$159,999	1	1

**15. AUDITORS REMUNERATION**

Amounts receivable or due and receivable by the auditors

Auditing accounts	10,500	7,500
Other services	11,727	11,743
	22,227	19,243

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

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

Lennard Steve Brajkovich  
 Kenneth Frank Clements  
 Robin John Dean  
 Professor Rhys Jones  
 Paul Ejnar Kristensen  
 Air Vice Marshal Alan Raymond Reed  
 Michael John Wynne

**Notes to the Financial Statements continued****16. RELATED PARTY DISCLOSURES continued****(b) Remuneration of Directors**

Information on remuneration of Directors is disclosed in Note 13.

**(c) Transactions with Directors and Director-related entities**

Management fees totalling \$350,000 (2001: \$266,668) 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 ends on 1 December 2002 and no management fees will be incurred under the agreement beyond that date.

A royalty expense of \$70,723 (2001: \$65,600) 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 11.

**(d) Parent entity**

The parent entity of Structural Monitoring Systems Limited is Sentry Holdings Pty Ltd, a company incorporated in Australia.

**(e) 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:

	<b>2002</b>	<b>2001</b>
	<b>Number</b>	<b>Number</b>
<b>Acquisitions</b>		
Ordinary shares	19,647,620	11,252,720
31 October 2001 options	-	80,000
<b>Disposals</b>		
Ordinary shares	3,495,450	-
Exercise of 31 October 2001 options	19,381,930	10,852,720
Lapsed 31 October 2001 options	1,810,000	-
Transfers of 31 October 2001 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	55,529,800	39,377,720
Ordinary "A" class shares	25,001,200	25,001,200
31 October 2001 options	-	21,267,480

**17. SEGMENT INFORMATION**

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

## Notes to the Financial Statements continued

## 18 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	
	2002 \$	2001 \$	2002 \$	2001 \$	2002 \$	2001 \$	2002 %	2001 %
<b>(i) Financial assets</b>								
Cash	3,272,924	1,709,765	-	-	3,272,924	1,709,765	4.23	4.45
Deposit – Bond for Bassendean premises	-	-	6,909	10,000	6,909	10,000	N/A	N/A
GST receivable	-	-	51,978	40,099	51,978	40,099	N/A	N/A
<b>Total financial assets</b>	<b>3,272,924</b>	<b>1,709,765</b>	<b>58,887</b>	<b>50,099</b>	<b>3,331,811</b>	<b>1,759,864</b>		
<b>(ii) Financial liabilities</b>								
Trade creditors	-	-	194,817	97,845	194,817	97,845	N/A	N/A
Royalties	-	-	67,000	123,935	67,000	123,935	N/A	N/A
Superannuation	-	-	26,157	754	26,157	754	N/A	N/A
Other	-	-	-	12,252	-	12,252	N/A	N/A
<b>Total financial liabilities</b>	<b>-</b>	<b>-</b>	<b>261,817</b>	<b>234,032</b>	<b>261,817</b>	<b>234,032</b>		

## (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.

**19. CORPORATE INFORMATION**

Structural Monitoring Systems Limited is a company limited by shares that is incorporated and domiciled in Australia. Its parent entity is Sentry Holdings Pty Ltd.

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

At 30 June 2002 the Company had 14 employees (2001: 9 employees).

**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 2002 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

Director  
Perth, Western Australia  
18 October 2002

**INDEPENDENT AUDIT REPORT**

**ADDITIONAL INFORMATION**

Additional information not shown elsewhere in the Annual Report is set out below. The information is current as at 1 October 2002.

**(a) Distribution of equity securities**

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

			<b>Number of holders</b>	<b>Number of shares</b>	<b>% of Total Issued Capital</b>
1	-	1,000	-	-	-
1,001	-	5,000	63	301,200	0.264%
5,001	-	10,000	74	631,508	0.555%
10,001	-	100,000	125	5,103,282	4.486%
100,001	and over		77	107,702,370	94.693
			339	113,738,360	99.998%

**(b) Twenty largest shareholders**

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

		<b>Number of shares</b>	<b>% of Total Issued Capital</b>
1	Sentry Holdings Pty Ltd	48,592,400	42.722%
2	Tulip Bay Pty Ltd	12,335,000	10.845%
3	Capital Technologies Pty Ltd	6,000,000	5.275%
4	Seabay Corporation Pty Ltd	4,000,000	3.516%
5	Group #2	3,664,000	3.221%
	Kenneth Frank Clements <Malloy Island Superfund A/C>	3,280,000	2.883%
	Kenneth Frank Clements <Edgewater Clements Fund A/C>	384,000	0.337%
6	Mary Ethel Ermoine Jones <the Wolf Fund A/C>	2,000,000	1.758%
7	LRW Nominees Pty Ltd <The Cooler Fund A/C>	1,733,278	1.523%
8	Gaffney Consultants Ltd	1,680,000	1.477%
9	Charnley Hall Pty Ltd	1,440,000	1.266%
10	Wiko Holdings Pty Ltd	1,200,000	1.055%
11	Edmund Noel Monks	1,080,000	0.949%
12	Gunter Thiel	1,000,000	0.879%
13	Lamton Investments Inc	960,000	0.844%
14	Kostan Pty Ltd	888,000	0.780%
15	Leonie Kristensen	865,690	0.761%
16	Frank Manford Pty Ltd <Fam Superannuation Fund A/C>	820,000	0.720%
17	Crystal Pines Pty Ltd	767,550	0.674%
18	Alan Raymond Reed	760,000	0.668%
19	Shoalwater Bay Investments Ltd	640,000	0.562%
20	Robert Slade & Elizabeth Loraine Forbes <Fund A/C>	600,000	0.527%
		91,025,918	80.021%