

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**YEAR END REPORT**  
for the year ended June 30, 2005

Management Discussion & Analysis

**Description of Business**

International Barrier Technology Inc. (the Company) manufactures and sells fire-rated building materials primarily in the U.S.A. Primary markets include: roof decks in multifamily residential construction; roof assemblies in commercial modular construction; structural insulative panel construction (SIP's); interior wall panels; and, fire rated wall assemblies.

**Sales** reported for the fiscal year ending June 30, 2005 were \$5,464,924 a 34% increase over the previous year and record high sales of Barrier's fire resistant Blazeguard panels. Gross profit was up to \$1,131,778, a 78% annual increase. The gross margin, increased from 15.6% to 20.7%.

Sales as measured by surface footage of product shipped increased to 5.16 million square feet from 3.4 million square feet, an increase of 52%. This year to year increase follows a year where sales volume had improved from 2.11 million square feet, resulting in a two year increase of 145%. A substantial year to year sales volume increase of 30% was experienced in Florida, Barrier's leading multifamily residential roof deck market geography. This follows a year where Florida sales had increased 68.9%.

The Mule Hide FR panel was first introduced by Barrier in January 2004. The MuleHide FR panel is an essential component of an Underwriters Laboratories, Inc. assembly listing for fire rated roofs manufactured for commercial modular buildings. Fire rated roof assemblies are required by building code for a large percentage of commercial modular buildings. For fiscal year ending June 30, 2005, the MuleHide FR panel accounted for 2,010,100 sq. ft., or 39%, of Barriers total annual sales volume. In the pervious fiscal year ending June 30, 2004, the panel accounted for 604,200 sq.ft., or 17.9%, of sales. Barrier expects this market to continue to grow significantly in the coming years.

**Cost of goods sold** increased to \$4,333,146 from \$3,445,976. This increase resulted predominantly from increased sales volume. Actual cost of production on a per sq.ft. basis fell from \$1.01 to \$0.84, a decrease of 20%. Operating efficiencies in producing the MuleHide panel and lower annual average sheathing prices contributed significantly to the decrease in cost of production per sq.ft. Manufacturing efficiencies, in general, are improving with increasing volume. This trend is expected to continue through the current fiscal year.

Gross margins improved as a result of the decrease in cost of goods sold. Gross profit for the year was \$1,131,778, a 78% increase over the previous fiscal year when the gross profit was reported at \$636,535. Gross margin improved to 20.7% of total sales, a significant improvement from the previous year's gross margin of 15.6%.

**Operating expenses**, which include license fees/revenues, amortization, and R&D, increased to \$401,816 from \$203,027 the previous year. Research and development expenses of \$99,479 were a continuation of the expenses for tests and product development instigated the previous year in support of the MuleHide FR panel program and its required UL certification and listing program. Amortization was up year to year (to \$116,121 from \$85,950) based on the capital equipment and building expansion project underway at the Watkins, Minnesota facility. A 15,000 sq.ft. addition to the building and new equipment has been purchased in support of the new production line currently being constructed. The new production line is scheduled to be complete prior to the end of calendar year 2005.

Amortization of the worldwide Pyrotite technology and trademarks, which was completed in 2004 at a cost of \$1,000,000 US, was also amortized for a full year for the first time. The amortization expenses associated with the Pyrotite Technology to date, \$186,216, were booked entirely in this fiscal year (See Note 6).

**General and administrative expenses** increased to \$2,058,894 from \$847,054 last year, an increase of \$1,211,840. The largest single line item reported in G & A expenses was stock-based compensation, a “non-cash” category. New accounting procedures require that stock based compensation (issuance of stock options) be reported as a cost to the company with the value of the cost based on a prescribed formula (see Note 9). For fiscal year ending June 30, 2005, the amount charged to the company for stock based compensation was \$938,600. This represented an increase from last year’s total of \$95,763. Fiscal year ending June 30, 2004 was the first year Barrier was required to report charges in this category.

Consulting fees, management fees, and wages were up significantly as new professional services were brought to bear on Barrier’s expanding business. The reported increase in expense includes the hiring of a General Operations Manager at the Watkins, Minnesota location. Continued and expanding rates of growth will be dependent upon bringing new and increased professional talent into the company to help lead the process of growth. Other G & A costs were up proportionately with the increase in sales for the company. Sales, marketing, and investor relations expenses, for instance grew to \$309,932 from \$251,928 the previous year. As a percentage of sales revenue, however, there was actually a small decrease in rate to 5.7% from 6.2% the previous year. Barrier expects the rates of G & A expense, as a percentage of sales, to continue to diminish as sales volume continues to grow.

Included within the sales and marketing expenses for fiscal year ending June 30, 2005, was participation in three major trade shows, including: the International Builders Show in Orlando, FL; the Modular Builders Association Show in Las Vegas, NV; and, the Money Show in Las Vegas, NV. Promotional sales literature was improved as well as the initiation of a process to improve Barrier’s corporate image (logo) and website.

Barrier was selected to be a featured company in a television program entitled *Business and Beyond, Models of Excellence*, which is produced by Platinum Television and aired on CNBC. As a part of this program, Barrier was asked to help contribute to the costs of production and airing the show on CNBC with 100 rebroadcasts on cable television throughout the US. The cost to Barrier to be included in this program was \$28,700 US. The program is scheduled to begin airing in November 2005.

Barrier intends to continue to focus on timely communication with customers and shareholders. Barrier’s goal is to ensure that interested parties are informed about business opportunities, emerging developments, and the attainment of significant milestones as they happen.

**Other items** include non-cash categories of expense such as foreign exchange gain (loss), as well as interest income, and the forgiveness of debt. Barrier realized a foreign exchange loss of \$93,125 versus a gain of \$6,277 in the previous year. The reflection of foreign exchange gain or loss results from the need to consolidate US and Canadian expenses/revenues into a single financial statement for reporting purposes.

Interest income rose to \$28,297 from \$4,303 the previous fiscal year. Cash reserves, whose purpose is to fund the Watkins, MN plant expansion project, were created from private placements of stock (see **material transactions** below). These funds were placed into interest bearing accounts until the cash is required for capital equipment purchase, hence the increase in interest earned.

**Operating and net income.** As a result of the cost and revenue categories reported above, Barrier experienced an operating loss of \$1,328,932 for fiscal year ending June 30, 2005 versus a loss of \$413,546 in fiscal 2004. If the comparison year to year, however, was made net of amortization and stock based compensation charges, the relative loss for fiscal year ending June 30, 2005 versus 2004 would be (\$87,995) in 2005 versus (\$231,833) in 2004. Barrier considers this improvement significant and expects that plans for further improvements in sales volumes and production efficiencies during the current fiscal year will bode well for the attainment and sustainability of future profits.

**Summary of Quarterly Results.** The following is a summary of the Company's financial results for the eight most recently completed quarters:

	June 30	Mar 31	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sept 30
	<u>2005</u>	<u>2005</u>	<u>2004</u>	<u>2004</u>	<u>2004</u>	<u>2004</u>	<u>2003</u>	<u>2003</u>
Volume shipped (MSF)	1,305.9	1,361.1	1,290.6	1,206.3	1,278.3	1,139.8	505.1	458.5
Total Revenues (000\$)	1,326.3	1,563.9	1,174.1	1,400.6	1,628.5	1,327.7	561.3	565.1
Operating Income	(233.6)	(127.2)	(133.7)	92.7	33.1	(58.8)	(133.9)	(72.2)
Net income (loss) before discontinued ops	(408.9)	(123.9)	(254.5)	(606.5)	(25.6)	(119.1)	(122.0)	(136.3)
Per Share	(0.01)	(0.00)	(0.01)	(0.03)	-	(0.01)	(0.01)	(0.01)
Per Share, fully diluted	(0.01)	(0.00)	(0.01)	(0.03)	-	(0.01)	(0.01)	(0.01)

Sales volumes continue at levels near the peak operating capacity of the current production line at Watkins, Minnesota. Increasing sales volumes have occurred in Barrier's primary, established multifamily residential roof deck market, but the most significant gains have resulted from the new Mule Hide FR panel. Increasing net income numbers are expected now that the new production techniques have been implemented for the MuleHide product and R&D expenses are substantially complete. Operating efficiencies will continue to provide increasingly significant net income numbers as the new, highly automated production line starts up by year end 2005

**New product and market development** initiatives continue to provide opportunities for sales expansion and growth. Progress was made in the effort to develop fire rated roof assemblies for traditional, non-modular, wood framed commercial buildings. It is anticipated that the success of roof deck applications in the modular industry will help define these systems for expanded commercial use as well as single family residential applications.

Interior wall panel markets, especially those requiring fire-rated, environmentally friendly ("green") products, are thought to represent a viable opportunity for Blazeguard in the coming year. Many "high-end" architecturally specified institutional and commercial buildings such as banks and professional office buildings are required to have Class A flame spread interior wall panels. Often, the use of gypsum wall board does not have the aesthetic appeal of wood veneer or high pressure laminate overlays. Barrier has been working with a producer of substrate panels to produce such a laminated interior wall panel utilizing the Pyrotite coating as an underlayment to the face veneer. Barrier and its potential partner in the business have great expectations for the emergence of a suitable product for market introductions in the coming year. This opportunity may well follow the MuleHide example both in organizational design and success.

Barrier added an independent sales representative in Virginia early in 2004. Business has been improving there, ever since. An additional sales manager was recently hired as a Barrier employee late in June 2005. The new sales manager will have a territory defined as the upper Midwest, including: Minnesota; Wisconsin; northern Illinois; North and South Dakota. Additional sales representatives are being recruited in Texas and Southern California. These additional sales positions are expected to be filled prior to the end of the current fiscal year.

Distribution remains a strong part and reason for Barrier's marketing success. The Contractor Yards (formerly a Division of the Lowe's Company) continues to inventory Blazeguard at nine of their mid-Atlantic stores. While they are now a part of the Strober network of building products distribution, sales continued to be a significant part of Barrier's business. Barrier continues to introduce Blazeguard to other stores in the growing Strober network.

ABC Supply, as a part of the MuleHide network, is helping Barrier introduce Blazeguard and MuleHide FR products into the southern California market place. Carloads of product are being shipped from Watkins to a "re-load" center in Riverside, California. Local ABC Yards access truckload quantities from this re-load center and ship to their customers in the area. Barrier, ABC Supply, and MuleHide expect calendar year 2006 to be one of significant growth for Pyrotite based products in southern California.

**Global licensing opportunities.** With the purchase of the world technology rights complete, including US patents, foreign patent filings, trademarks, know-how and trade secrets, Barrier is in a position to develop partners all over the globe in licensing arrangements (see Note 5). Interested parties in China, Saudi Arabia, Mexico, Ireland, Great Britain, and New Zealand have communicated their interest to Barrier. Barrier, in turn, is responding with information about the attributes of Blazeguard®, and the Pyrotite™ technology in an effort to assess their appropriateness in the construction of building communities (residential and commercial) in these countries.

### Selected Annual Information

The following financial data is for the three most recent years ended June 30:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total revenue	\$ 5,464,924	\$ 4,082,511	\$ 2,254,562
Net income (loss)	(1,393,760)	(402,966)	46,775
Per share	(0.05)	(0.02)	0.00
Per share, fully diluted	(0.05)	(0.02)	0.00
Total assets	6,141,070	3,744,694	1,305,794
Total long-term financial liabilities	698,353	844,345	948,447
Cash dividends declared per share	Nil	Nil	Nil

**Financial position & financings.** During fiscal 2005, Barrier issued a total of 4,795,500 common shares for proceeds totaling \$3,275,989 as follows:

- 1,470,000 common shares at \$1.11 (US\$0.85) per share and 2,400,000 shares at \$0.59 (US\$0.48) pursuant to private placements.
- 510,000, 225,000, 10,000 common shares at \$0.10, \$0.26, \$0.80 per share respectively pursuant to the exercise of share purchase options.
- 180,000 common shares at \$0.80 per share pursuant to the exercise of share purchase warrants.

These financings were necessary to enable Barrier to secure the resources needed to finance plant and equipment capital improvements. Plant improvements, which began during the reported period will be completed in fiscal year 2006. The end result will be a new, "state of the art" facility engineered to significantly increase efficiency as well as double current manufacturing capacity. The new line will serve as a "prototype" line for prospective licensees.

Barrier ended the period with a working capital surplus of \$1,831,928, a significant and noticeable improvement from the prior year's surplus of \$657,148.

**Material transactions.**

1. Barrier completed a private placement of 1,470,000 units at \$1.11 (US\$0.85) per unit for net proceeds of \$1,629,848 (US\$1,249,500). Each unit consists of one common share and one share purchase warrant. Each warrant allows the holder to purchase one common share of the Company for US\$0.92 per share on or before August 20, 2006.
2. Barrier completed another private placement of 2,400,000 units at \$0.59 (US\$0.48) for proceeds of \$1,416,000. Each unit consists of one common share and one share purchase warrant. Each warrant allows the holder to purchase one common share of the Company for \$0.74 per share on or before March 22, 2007.

In conjunction with the completion of this private placement Barrier agreed to re-price 750,000 warrants from \$1.31 to \$0.75 and if the closing price for the Company's shares is \$0.90 or greater for a period of 10 consecutive trading days, then the warrant holders will have 30 days to exercise their warrants; otherwise, the warrants will expire. Also, Barrier agreed to re-price 217,000 warrants from US\$0.92 to US\$0.60 and if the closing price for the Company's shares is US\$0.72 or greater for a period of 10 consecutive trading days, then the warrant holders will have 30 days to exercise their warrants; otherwise, the warrants will expire.

These private placements were necessary in order to enable Barrier to secure resources needed to complete the new plant and equipment capital improvements estimated to be completed September, 2005.

3. Barrier executed documents with the City of Watkins and local contractors for the beginning of the \$2.7MM capital improvement project which includes the construction of a new 15,000 square foot manufacturing building and a newly engineered manufacturing production equipment line which will enable Barrier to double current manufacturing capacity and significantly increase efficiency.
4. Barrier recorded and recognized a \$938,600 stock option compensation charge associated with the granting of 1,868,500 stock options to directors, employees, and consultants referred to in Notes 2 and 9 to the financial statements. This entry was required by Canadian and USA Generally Accepted Accounting Principles – see Critical Accounting Estimates note below.

**Change in Accounting Policy**

Stock-based Compensation Plan

On July 1, 2004 the Company adopted the amended CICA Handbook Section 3870 – “Stock-based Compensation and Other Stock-based Payments”. This change in accounting policy has been applied retroactively with no restatement of prior periods presented for the statements of operations and deficit and cash flows.

**Related Party Transactions**

During the fiscal year ended June 30, 2005 the Company incurred wages and management fees of \$269,516 with directors of the Company and companies with common directors. (See Note 12 of the financial statements.)

**Capitalization**

Authorized: 100,000,000 common shares without par value.

Issued:

		<u>Issued Shares</u>	<u>Amount</u>
Balance, June 30, 2004		22,974,855	\$ 14,388,228
Issued for cash pursuant to a private placement	– at \$0.59	2,400,000	1,416,000
	– at \$1.11	1,470,000	1,629,848
Less: issue costs		-	(31,360)
Issued for cash pursuant to the exercise of share purchase options			
	– at \$0.10	510,000	51,000
	– at \$0.26	225,000	58,500
	– at \$0.80	10,000	8,000
Issued for cash pursuant to the exercise of share purchase warrants	– at \$0.80	180,000	144,000
Cancellation of escrow shares		(124,580)	-
Stock-based compensation charges		-	-
Reclassification of stock-based compensation charges upon exercise of share purchase options		-	81,265
Reclassification as a result of a change in accounting policy		-	-
Net loss for the year		<u>-</u>	<u>-</u>
Balance, June 30, 2005		27,645,325	17,745,481
Issued for cash pursuant to the exercise of share purchase warrants			
	- at \$0.74	180,000	133,200
	- at \$0.75	625,000	468,200
Issued for cash pursuant to the exercise of common share purchase options	- at \$0.51	<u>25,000</u>	<u>12,750</u>
Balance, October 18, 2005		<u>28,475,325</u>	<u>\$ 18,360,181</u>

Options and warrants outstanding:

The following summarizes information about the stock options outstanding at June 30, 2005:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
110,000	\$0.80	January 13, 2006
50,000	\$1.05	April 29, 2006
110,000	\$0.51	May 2, 2007
20,000	\$0.58	February 23, 2008
428,500	\$0.10	March 5, 2008
<u>1,150,000</u>	\$0.76	August 24, 2009
<u>1,868,500</u>		

At June 30, 2005, the following share purchase warrants were outstanding entitling the holder to purchase one common share for each warrant held as follows:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
750,000	\$0.75 Cdn	June 1, 2006
1,253,000	\$0.92 U.S.	August 20, 2006
217,000	\$0.60 U.S.	August 20, 2006
<u>2,400,000</u>	\$0.74 Cdn	March 22, 2007
<u>4,620,000</u>		

### **Critical Accounting Estimates**

#### Stock-based Compensation Charge and Expense

As described in Notes 2 and 9 to the financial statements, the Company is required by the Canadian and USA Accounting Authorities (Canadian Institute of Chartered Accountants and American Institute of Certified Public Accountants) to put a fair market value on newly issued stock options. This fair market value of the stock options is the difference between an estimated fair market value common share trading price (52 week average) and the stock option exercise price (the Black-Scholes Option Pricing Formula).

### **Internal Control and Financial Reporting Procedures**

The board of directors evaluates and maintains internal control procedures and financial reporting procedures to ensure the safeguarding of Barrier's assets as well as to ensure full, true, accurate and timely disclosure of Barrier's financial position for quarterly period reporting purposes. Barrier's management, including the Chief Executive Officer and the Chief Financial Officer, identified no changes in Barrier's internal control procedures over financial reporting during the fiscal year ended June 30, 2005, that would materially affect the accuracy of this financial report.

**Other Matters and Subsequent Events**

As at June 30, 2005, the Company does not have any off-balance sheet arrangements to report.

As at June 30, 2005, the Company does not have any legal proceedings to report.

Subsequent to June 30, 2005, the Company granted 150,000 stock options at a price of US\$0.63 per share to employees of the Company and issued 650,000 and 180,000 common shares at a price of \$0.75 and \$0.74 per share, respectively, pursuant to the exercise of share purchase warrants for total proceeds of \$620,700 and issued 25,000 common shares at \$0.51 per share for total proceeds of \$12,750 pursuant to the exercise of share purchase options. See Note 16 of the Financial Statements.

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**REPORT AND CONSOLIDATED FINANCIAL STATEMENTS**  
June 30, 2005 and 2004  
(Stated in Canadian Dollars)

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders,  
International Barrier Technology Inc.

We have audited the consolidated balance sheets of International Barrier Technology Inc. as at June 30, 2005 and 2004 and the consolidated statements of operations, cash flows and shareholders' equity (deficiency) for the years ended June 30, 2005, 2004 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2005 and 2004 and the results of its operations and its cash flows for the years ended June 30, 2005, 2004 and 2003 in accordance with generally accepted accounting principles in Canada.

Vancouver, Canada  
September 20, 2005

**"AMISANO HANSON"**  
Chartered Accountants

**COMMENTS BY AUDITORS FOR U.S. READERS ON CANADA – U.S. REPORTING CONFLICT**

The Standards of the Public Company Accounting Oversight Board (United States of America) require the addition of an explanatory paragraph (following the opinion paragraph) when there are changes in accounting principles that have a material effect on the comparability of the Company's financial statements and changes in accounting principles that have been implemented in the financial statements. As discussed in Note 2 to the accompanying consolidated financial statements, the Company changed its method of accounting for stock-based Compensation (CICA Handbook Section 3870). Our report to the shareholders dated September 20, 2005 is expressed in accordance with Canadian reporting standards, which do not permit a reference to such a change in accounting policy in the Auditors' Report when the change in accounting policy is properly accounted for and adequately disclosed in the financial statements.

Vancouver, Canada  
September 20, 2005

**"AMISANO HANSON"**  
Chartered Accountants

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED BALANCE SHEETS**  
June 30, 2005 and 2004  
(Stated in Canadian Dollars)

	<u>ASSETS</u>	<u>2005</u>	<u>2004</u>
Current			
Cash and term deposits		\$ 1,561,117	\$ 648,407
Accounts receivable		308,352	588,662
Inventory – Note 4		378,800	123,823
Prepaid expenses and deposits		<u>20,689</u>	<u>11,746</u>
		2,268,958	1,372,638
Plant and equipment – Note 5		2,580,415	894,143
Trademark and technology rights– Notes 6 and 12		<u>1,291,697</u>	<u>1,477,913</u>
		<u>\$ 6,141,070</u>	<u>\$ 3,744,694</u>
 <b><u>LIABILITIES</u></b> 			
Current			
Revolving operating loan		\$ -	\$ 134,047
Accounts payable and accrued liabilities – Note 12		355,220	487,244
Current portion of long-term debt – Note 7		23,777	26,147
Current portion of obligation under capital leases – Note 8		<u>58,033</u>	<u>68,052</u>
		437,030	715,490
Long-term debt – Note 7		17,971	51,585
Obligation under capital leases – Note 8		<u>680,382</u>	<u>792,760</u>
		<u>1,135,383</u>	<u>1,559,835</u>
 <b><u>SHAREHOLDERS' EQUITY</u></b> 			
Share capital – Notes 9 and 16		17,745,481	14,388,228
Contributed surplus		958,515	56,840
Deficit		<u>(13,698,309)</u>	<u>(12,260,209)</u>
		<u>5,005,687</u>	<u>2,184,859</u>
		<u>\$ 6,141,070</u>	<u>\$ 3,744,694</u>
Commitments – Notes 7, 8, 9 and 15			
Subsequent Events – Note 16			

APPROVED BY THE DIRECTORS:

“David Corcoran” Director  
David Corcoran

“Victor Yates” Director  
Victor Yates

SEE ACCOMPANYING NOTES

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
for the years ended June 30, 2005, 2004 and 2003  
(Stated in Canadian Dollars)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Sales	\$ 5,464,924	\$ 4,082,511	\$ 2,254,562
Cost of sales	<u>(4,333,146)</u>	<u>(3,445,976)</u>	<u>(1,766,992)</u>
Gross profit	<u>1,131,778</u>	<u>636,535</u>	<u>487,570</u>
Licence fee revenue	-	-	36,259
Amortization – plant and equipment	(116,121)	(85,950)	(98,300)
– trademark and technology rights	(186,216)	-	-
Research and development costs – Note 10	(99,479)	(55,432)	(25,850)
License fee expense – Note 11	<u>-</u>	<u>(61,645)</u>	<u>(75,540)</u>
	<u>(401,816)</u>	<u>(203,027)</u>	<u>(163,431)</u>
	<u>729,962</u>	<u>433,508</u>	<u>324,139</u>
General and administrative expenses			
Accounting and audit fees	42,488	40,910	36,095
Consulting fees – Note 12	120,154	-	35,420
Filing fees	37,004	31,275	10,274
Insurance	53,230	27,483	27,475
Interest and bank charges – Note 12	3,599	21,817	28,169
Interest on long-term debt – Note 8	39,795	57,404	62,944
Legal fees	65,037	29,536	18,955
Office and miscellaneous	69,811	38,775	23,377
Sales marketing and investor relations	309,932	251,928	53,790
Stock-based compensation – Note 9	938,600	95,763	-
Telephone	9,719	11,247	9,631
Transfer agent fees	18,822	10,730	6,986
Wages and management fees – Note 12	<u>350,703</u>	<u>230,186</u>	<u>205,855</u>
	<u>2,058,894</u>	<u>847,054</u>	<u>518,971</u>
Loss before other	(1,328,932)	(413,546)	(194,832)
Other			
Foreign exchange gain (loss)	(93,125)	6,277	153,202
Gain on forgiveness of debt	-	-	88,405
Interest income	<u>28,297</u>	<u>4,303</u>	<u>-</u>
Net income (loss) for the year	<u>\$ (1,393,760)</u>	<u>\$ (402,966)</u>	<u>\$ 46,775</u>
Basic and diluted loss per share	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>	<u>\$ 0.00</u>
Weighted average number of shares outstanding	<u>25,545,800</u>	<u>20,121,061</u>	<u>14,056,684</u>

SEE ACCOMPANYING NOTES

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
for the years ended June 30, 2005, 2004 and 2003  
(Stated in Canadian Dollars)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Operating Activities</b>			
Net income (loss) for the year	\$ (1,393,760)	\$ (402,966)	\$ 46,775
Items not involving cash:			
Gain on forgiveness of debt	-	-	(88,405)
Amortization – plant and equipment	(116,121)	85,950	98,300
– trademark and technology rights	(186,216)	-	-
Stock-based compensation	938,600	95,763	-
Changes in non-cash working capital balances related to operations:			
Accounts receivable	280,310	(456,529)	(6,604)
Inventory	(254,977)	(48,007)	8,842
Prepaid expenses and deposits	(8,943)	1,364	(3,983)
Accounts payable and accrued liabilities	(132,024)	131,466	(29,493)
Due to related parties	-	(18,225)	18,225
	<u>(268,457)</u>	<u>(611,184)</u>	<u>43,657</u>
<b>Investing Activities</b>			
Purchase of plant and equipment	(1,802,393)	(55,842)	(20,015)
Purchase of trademark and technology rights	-	(1,416,381)	(73,391)
	<u>(1,802,393)</u>	<u>(1,472,223)</u>	<u>(93,406)</u>
<b>Financing Activities</b>			
Decrease in unearned income	-	-	(4,798)
Decrease in long-term debt	(35,984)	(26,113)	(17,272)
Decrease in obligations under capital lease	(122,397)	(73,202)	(181,770)
Common shares issued for cash	3,275,988	2,700,029	320,000
Increase (decrease) in bank indebtedness	(134,047)	32,148	32,541
	<u>2,983,560</u>	<u>2,632,862</u>	<u>148,701</u>
Change in cash during the year	912,710	549,455	98,952
Cash and term deposits, beginning of the year	<u>648,407</u>	<u>98,952</u>	<u>-</u>
Cash and term deposits, end of the year	<u>\$ 1,561,117</u>	<u>\$ 648,407</u>	<u>\$ 98,952</u>
Cash and term deposits consist of:			
Cash	\$ 153,053	\$ 208,062	\$ 98,952
Term deposits	<u>1,408,064</u>	<u>440,345</u>	<u>-</u>
	<u>\$ 1,561,117</u>	<u>\$ 648,407</u>	<u>\$ 98,952</u>

.../cont'd

SEE ACCOMPANYING NOTES

Continued

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
for the years ended June 30, 2005, 2004 and 2003  
(Stated in Canadian Dollars)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Supplementary Cash Flow Information			
Cash paid for Interest	<u>\$ 42,308</u>	<u>\$ 75,801</u>	<u>\$ 76,425</u>
Cash paid for Income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Non-cash Transactions – Note 13			

SEE ACCOMPANYING NOTES

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (DEFICIENCY)**  
for the years ended June 30, 2005, 2004 and 2003  
(Stated in Canadian Dollars)

	Common Stock		Contributed <u>Surplus</u>	<u>Deficit</u>	<u>Total</u>
	<u>Issued Shares</u>	<u>Amount</u>			
Balance, June 30, 2002	13,138,355	\$ 11,029,276	\$ -	\$ (11,904,018)	\$ (874,742)
Issued for cash pursuant to a private placement	3,500,000	350,000	-	-	350,000
Less: finders fees	-	(30,000)	-	-	(30,000)
Issued pursuant to debt settlement agreements	2,000,000	300,000	-	-	300,000
Net income for the year	-	-	-	46,775	46,775
Balance, June 30, 2003	18,638,355	11,649,276	-	(11,857,243)	(207,967)
Issued for cash pursuant to a private placement	1,000,000	300,000	-	-	300,000
	- at \$0.64	1,200,000	768,000	-	768,000
	- at \$1.05	750,000	787,500	-	787,500
Finders' fee	- at \$0.35	100,000	35,000	-	35,000
Less: issue costs	-	(48,321)	-	-	(48,321)
Issued for cash pursuant to exercise of share purchase options	-	-	-	-	-
	- at \$0.10	171,500	17,150	-	17,150
	- at \$0.26	95,000	24,700	-	24,700
Issued for cash pursuant to exercise of share purchase warrants	-	-	-	-	-
	- at \$0.80	1,020,000	816,000	-	816,000
Stock-based compensation charges	-	-	95,763	-	95,763
Reclassification of stock-based compensation charges upon exercise of share purchase options	-	38,923	(38,923)	-	-
Net loss for the year	-	-	-	(402,966)	(402,966)
Balance, June 30, 2004	22,974,855	14,388,228	56,840	(12,260,209)	2,184,859

.../cont'd

SEE ACCOMPANYING NOTES

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (DEFICIENCY)**  
for the years ended June 30, 2005, 2004 and 2003  
(Stated in Canadian Dollars)

	Common Stock		Contributed Surplus	Deficit	Total
	Issued Shares	Amount			
Balance, June 30, 2004	22,974,855	14,388,228	56,840	(12,260,209)	2,184,859
Issued for cash pursuant to a private placement					
– at \$0.59	2,400,000	1,416,000	-	-	1,416,000
– at \$1.11	1,470,000	1,629,848	-	-	1,629,848
Less: issue costs	-	(31,360)	-	-	(31,360)
Issued for cash pursuant to the exercise of share purchase options					
– at \$0.10	510,000	51,000	-	-	51,000
– at \$0.26	225,000	58,500	-	-	58,500
– at \$0.80	10,000	8,000	-	-	8,000
Issued for cash pursuant to the exercise of share purchase warrants					
– at \$0.80	180,000	144,000	-	-	144,000
Cancellation of escrow shares	(124,580)	-	-	-	-
Stock-based compensation charges	-	-	938,600	-	938,600
Reclassification of stock-based compensation charges upon exercise of share purchase options	-	81,265	(81,265)	-	-
Reclassification as a result of a change in accounting policy	-	-	44,340	(44,340)	-
Net loss for the year	-	-	-	(1,393,760)	(1,393,760)
Balance, June 30, 2005	<u>27,645,325</u>	<u>\$ 17,745,481</u>	<u>\$ 958,515</u>	<u>\$ (13,698,309)</u>	<u>\$ 5,005,687</u>

SEE ACCOMPANYING NOTES

**INTERNATIONAL BARRIER TECHNOLOGY INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
June 30, 2005 and 2004  
(Stated in Canadian Dollars)

Note 1     Nature of Operations

The Company was incorporated under the British Columbia Company Act and is publicly traded on the TSX Venture Exchange in Canada (“TSX”) and the OTC Bulletin Board in the United States of America.

The Company operates in one business segment, the manufacture and sale of fire-rated building materials in the United States of America.

Note 2     Change in Accounting Policy

Stock-based Compensation Plan

On July 1, 2004 the Company adopted the amended CICA Handbook Section 3870 – “Stock-based Compensation and Other Stock-based Payments”. This change in accounting policy has been applied retroactively with no restatement of prior periods presented for the statements of operations and deficit and cash flows.

Under this amended standard, the Company must account for compensation expense based on the fair value of rights granted under its stock-based compensation plan. Under this method, compensation costs attributable to share options granted to employees or directors is measured at fair value at the grant date and expensed over the expected exercise time with a corresponding increase to contributed surplus. Upon exercise of stock options, consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

Previously, the Company accounted for stock-based compensation using the settlement method. No compensation costs were recorded in the financial statements for share purchase options granted to employees or directors provided that pro forma disclosure was made. Consideration paid by employees or directors on the exercise of stock options and purchase of stock was credited to share capital.

As a result of this change at July 1, 2004, contributed surplus and deficit increased by \$44,340, being the fair value of share purchase options granted to employees or directors during the period July 1, 2002 to June 30, 2004 which were previously shown in pro forma note disclosure.

Note 3 Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) in Canada and are stated in Canadian dollars. Differences with respect to accounting principles generally accepted in the United States of America are described in Note 17. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates which have been made using careful judgement. Actual results may differ from these estimates.

The financial statements have, in management’s opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

a) Principles of Consolidation

These consolidated financial statements include the accounts of International Barrier Technology Inc. and its wholly-owned subsidiaries, Pyrotite Coatings of Canada Inc., a British Columbia company and Barrier Technology Corporation, a US company. All inter-company transactions and balances have been eliminated.

b) Cash and Term Deposits

Cash and term deposits consist of cash and highly liquid, short-term term deposits.

c) Inventory

Inventory is valued by management at the lower of average cost and net realizable value.

d) Plant and Equipment, Trademark and Technology Rights and Amortization

Plant and equipment and trademark and technology rights are recorded at cost. Amortization is provided using the following methods and rates:

Manufacturing equipment	straight line over 5 years
Equipment and furniture	20% - declining balance
Computer equipment	30% - declining balance
Railway spur	4% - declining balance
Leasehold improvements	straight line over 5 years
Equipment under capital lease	20% - declining balance
Building under capital lease	straight line over 20 years
Trademark and technology rights	straight line over 8 years

Note 3      Significant Accounting Policies – (cont'd)

e) Impairment of Long-Lived Assets

The Company periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Company reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. An impairment loss is measured at the amount by which the carrying amount of the long-lived asset exceeds its fair value.

f) Leases

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of the lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred.

g) Foreign Currency Translation

Monetary assets and liabilities denominated in United States dollars are translated into Canadian dollars at the exchange rate prevailing at the end of the year. Non-monetary assets and liabilities and revenues and expenses are translated at the exchange rate prevailing at the respective transaction dates. Translation gains and losses are recognized in the current year.

h) Research and Development Costs

Research and development costs are expensed in the year in which they are incurred.

i) Basic and Diluted Loss Per Share

Basic earnings per share are computed by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Diluted earnings per share reflect the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method and the effect of convertible securities by the "if converted" method. Fully dilutive amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share.

Note 3      Significant Accounting Policies – (cont'd)

j) Financial Instruments

- Fair Value of Financial Instruments

The Company's financial instruments consist of cash and term deposits, accounts receivable, revolving operating loan, accounts payable and accrued liabilities, long-term debt and obligation under capital leases. Unless otherwise noted, the fair values of these financial instruments approximate their carrying values.

- Credit Risk

The Company grants credit to its customers in the normal course of business. Credit evaluations are performed on a regular basis and the financial statements take into account an allowance for bad debts. During the year ended June 30, 2005, four customers accounted for 82% of the Company's sales. The loss of any of these customers or the curtailment of purchases by such customers could have a material adverse effect on the Company's financial condition and results of operations.

- Currency Risk

The majority of the Company's operations are carried out in the United States of America. The Company's accounts receivable, accounts payable, long-term debt and obligation under capital leases are repayable in U.S. dollars. These factors expose the Company to foreign currency exchange rate risk, which could have a material adverse effect on the profitability of the Company.

k) Revenue Recognition

i) Building Supplies

Revenue is recognized upon shipment, when the rights of the ownership of the building supplies are transferred to the purchaser and collection is reasonably assured.

ii) Shipping and handling costs billed to customers have been included in revenue and shipping and handling costs expense have been included in cost of sales.

iii) License Fees

License fees revenue is recognized when the licensor records the sale of products from certain fire retardant technology known as IPOSB technology and collection is reasonably assured.

Note 3 Significant Accounting Policies – (cont'd)

l) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized in the current year for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes. Future income tax assets and liabilities are measured using tax rates and laws expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on future income tax assets and liabilities is recognized in operations in the year of change.

m) Comparative Figures

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

Note 4 Inventory

	<u>2005</u>	<u>2004</u>
Raw materials	\$ 104,635	\$ 89,981
Finished goods	<u>274,165</u>	<u>33,842</u>
	<u>\$ 378,800</u>	<u>\$ 123,823</u>

Note 5 Plant and Equipment

	<u>2005</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Manufacturing equipment	\$ 1,549,125	\$ 567,465	\$ 981,660
Equipment and furniture	17,031	13,421	3,610
Computer equipment	30,712	21,872	8,840
Railway spur	132,449	35,843	96,606
Leasehold improvements	<u>40,620</u>	<u>8,712</u>	<u>31,908</u>
	<u>1,769,937</u>	<u>647,313</u>	<u>1,122,624</u>

.../cont'd

Note 5 Plant and Equipment – (cont'd)

	2005		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Assets under capital lease			
Equipment	43,190	35,332	7,858
Land	74,434	-	74,434
Building	<u>1,915,596</u>	<u>540,097</u>	<u>1,375,499</u>
	<u>2,033,220</u>	<u>575,429</u>	<u>1,457,791</u>
	<u>\$ 3,803,157</u>	<u>\$ 1,222,742</u>	<u>\$ 2,580,415</u>
	2004		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Manufacturing equipment	\$ 572,523	\$ 546,559	\$ 25,964
Equipment and furniture	14,064	12,452	1,612
Computer equipment	25,195	19,265	5,930
Railway spur	132,449	31,818	100,631
Leasehold improvements	<u>36,234</u>	<u>1,026</u>	<u>35,208</u>
	<u>780,465</u>	<u>611,120</u>	<u>169,345</u>
Assets under capital lease			
Equipment	43,190	28,608	14,582
Land	74,434	-	74,434
Building	<u>1,102,673</u>	<u>466,891</u>	<u>635,782</u>
	<u>1,220,297</u>	<u>495,499</u>	<u>724,798</u>
	<u>\$ 2,000,762</u>	<u>\$ 1,106,619</u>	<u>\$ 894,143</u>

Amortization of assets under capital leases included in amortization expense for the year ended June 30, 2005 is \$65,643 (2004: \$61,952; 2003: \$66,438).

Manufacturing equipment includes \$834,161 of equipment acquired during the year ended June 30, 2005 for which no amortization has been taken due to the equipment not yet being available for use.

International Barrier Technology Inc.  
Notes to the Consolidated Financial Statements  
June 30, 2005 and 2004  
(Stated in Canadian Dollars) – Page 7

Note 6 Trademark and Technology Rights – Note 12

	<u>2005</u>	<u>2004</u>
Trademark and technology rights – at cost	\$ 1,489,771	\$ 1,489,771
Less: accumulated amortization	<u>(198,074)</u>	<u>(11,858)</u>
	<u>\$ 1,291,697</u>	<u>\$ 1,477,913</u>

Note 7 Long-term Debt

	<u>2005</u>	<u>2004</u>
Loan payable in US dollars (US\$15,921) is unsecured, repayable in monthly amounts of \$625 including interest at 4% per annum, due March 10, 2008	\$ 19,480	\$ 28,398
Loan payable in US dollars (US\$9,687) is secured by a director's guarantee and is repayable in monthly amounts of \$597 including interest at 10.5% per annum	-	12,921
Loan payable in US dollars (US\$18,200) is non-interest bearing, repayable in quarterly amounts of \$2,787 and is secured by a lien on the railway spur, due January 10, 2007	<u>22,268</u>	<u>36,413</u>
	41,748	77,732
Less: current portion	<u>(23,777)</u>	<u>(26,147)</u>
	<u>\$ 17,971</u>	<u>\$ 51,585</u>

Principal payments for the next three years are as follows:

2006	\$ 23,777
2007	12,444
2008	<u>5,527</u>
	<u>\$ 41,748</u>

Note 8 Obligation Under Capital Leases

Future minimum lease payments on the obligation under capital leases together with the obligation due under capital leases are as follows:

2006	\$ 100,045
2007	100,045
2008	100,045
2009	91,737
2010	90,076
Thereafter	<u>495,428</u>
	977,376
Less: amount representing interest	<u>(238,961)</u>
	738,415
Less: current portion	<u>(58,033)</u>
Long-term portion	<u>\$ 680,382</u>

The capital leases are repayable in U.S. dollars and bear interest at various rates from 6% to 13.5%.

Interest on capital leases included in interest on long-term debt for the year ended June 30, 2005 is \$39,504 (2004: \$54,469; 2003: \$53,989).

Note 9 Share Capital – Note 16

a) Authorized:

100,000,000 common shares without par value

b) Escrow:

At June 30, 2005, there are 48,922 common shares held in escrow by the Company's transfer agent, to be released every six months until 2011.

Note 9 Share Capital – Note 16 – (cont'd)

c) Commitments:

Share Purchase Warrants

At June 30, 2005, the following share purchase warrants were outstanding entitling the holder to purchase one common share for each warrant held as follows:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
750,000	\$0.75	June 1, 2006
1,253,000	US\$0.92	August 20, 2006
217,000	US\$0.60	August 20, 2006
<u>2,400,000</u>	\$0.74	March 22, 2007
<u>4,620,000</u>		

Stock-based Compensation Plan

The Company has a stock option plan for officers, directors, employees and consultants. Options are granted with an exercise price determined by the Board of Directors, which may not be less than the market price of the Company's stock on the date of the grant less applicable discounts permitted by the TSX, subject to a minimum price of \$0.10. All options granted under the plan vest in stages over 12 months with no more than 25% of the shares subject to the option vesting in any three-month period.

At June 30, 2005, the Company has granted share purchase options to purchase 1,868,500 common shares of the Company.

Note 9 Share Capital – Note 16 – (cont'd)

d) Commitments: – (cont'd)

Stock-based Compensation Plan – (cont'd)

A summary of the status of company's share purchase option plan as of June 30, 2005, 2004 and 2003 and changes during the years ending on those dates is presented below:

	<u>2005</u>	
	<u>Number Of Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at beginning of the year	1,333,500	\$0.23
Granted	1,280,000	\$0.74
Exercised	<u>(745,000)</u>	<u>\$0.16</u>
Options outstanding at end of the year	<u>1,868,500</u>	<u>\$0.60</u>
Options exercisable at end of the year	<u>1,675,999</u>	
	<u>2004</u>	
	<u>Number Of Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at beginning of the year	1,110,000	\$0.10
Granted	490,000	\$0.47
Exercised	<u>(266,500)</u>	<u>\$0.16</u>
Options outstanding at end of the year	<u>1,333,500</u>	<u>\$0.23</u>
Options exercisable at end of the year	<u>1,068,500</u>	

Note 9 Share Capital – Note 16 – (cont'd)

e) Commitments: – (cont'd)

Stock-based Compensation Plan – (cont'd)

	<u>2003</u>	
	<u>Number Of Shares</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at beginning of the year	1,310,000	\$0.10
Granted	600,000	\$0.10
Exercised	<u>(800,000)</u>	<u>\$0.10</u>
Options outstanding and exercisable at end of the year	<u>1,110,000</u>	<u>\$0.10</u>

The following summarizes information about share purchase options outstanding as at June 30, 2005:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
110,000	\$0.80	January 13, 2006
50,000	\$1.05	April 29, 2006
110,000	\$0.51	May 2, 2007
428,500	\$0.10	March 5, 2008
20,000	\$0.58	February 23, 2008
<u>1,150,000</u>	\$0.76	August 24, 2009
<u>1,868,500</u>		

During the year ended June 30, 2005, a compensation charge associated with stock options granted to consultants in the amount of \$938,600 (2004: \$95,763) was recognized in the financial statements.

Note 9 Share Capital – Note 16 – (cont'd)

c) Commitments: – (cont'd)

Stock-based Compensation Plan – (cont'd)

All stock-based compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	<u>2005</u>	<u>2004</u>
Expected dividend yield	0.0%	0.0%
Expected volatility	107.5%	137% to 140%
Risk-free interest rate	3.32% to 3.77%	1.58% to 2.68%
Expected term in years	2 years to 5 years	2 years

Note 10 Research and Development Costs

Research and development expense consists of the following for the years ended June 30, 2005, 2004 and 2003:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Testing services	\$ <u>99,479</u>	\$ <u>55,432</u>	\$ <u>25,850</u>

Note 11 Technology Royalty

Pursuant to a revised License Agreement dated January 1, 1996 with Pyrotite Corporation (“Licensor”) the Company is required to pay a royalty of 3% of USA fire retardant product gross sales, minimum US\$100,000 per annum from January 1, 1996 onward. The Company has granted to the Licensor the rights to the IPOSB Technology. The Licensor is required to pay the Company a royalty of 3% of USA gross sales from the IPOSB technology, minimum of US\$50,000 per annum from January 1, 1996 onward.

Pursuant to an agreement dated March 12, 2004, the Company acquired the rights to the fire retardant technology and trademarks from the Licensor. As a result, no further license fees are payable or receivable after May 31, 2004.

Note 11 Technology Royalty – (cont'd)

License fee expense consists of the following for the years ended June 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
License fee expense	\$ 123,290	\$ 151,080
License fee revenue	<u>(61,645)</u>	<u>(75,540)</u>
	<u>\$ 61,645</u>	<u>\$ 75,540</u>

Note 12 Related Party Transactions

The Company was charged the following by directors or private companies with common directors during the years ended June 30, 2005, 2004 and 2003:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Consulting fees	\$ 101,736	\$ -	\$ 5,000
Interest and bank charges	-	2,847	8,470
Wages and management fees	167,780	175,598	181,037
Trademark and technology rights:			
Consulting fee	<u>-</u>	<u>66,690</u>	<u>-</u>
	<u>\$ 269,516</u>	<u>\$ 245,135</u>	<u>\$ 194,507</u>

These charges were measured by the exchange amount, which is the amount agreed upon by the transacting parties.

Included in accounts payable and accrued liabilities is \$4,059 (2004: \$68,159) owing to directors of the Company.

Note 13 Non-cash Transactions

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows. The following transactions were excluded from the statements of cash flows:

During the year ended June 30, 2003, the Company issued 2,000,000 common shares at \$0.15 per share to settle accounts payable and amounts due to related parties totalling \$300,000.

Note 14 Income Taxes

The Company has accumulated non-capital losses in Canada and the United States totalling approximately \$2,000,000 which expire beginning in 2006. In addition, the Company has Scientific Research and Experimental Development Expenditures in Canada of \$1,087,818 which may be carried forward indefinitely to reduce taxable income in future years.

Significant components of the Company's future income tax assets are as follows:

	<u>2005</u>	<u>2004</u>
Non-capital losses carried forward	\$ 633,508	\$ 583,465
Scientific Research and Experimental Development expenses	402,493	402,493
Net carrying amount of capital assets	<u>2,267,458</u>	<u>2,050,998</u>
	3,303,459	3,036,956
Less valuation allowance	<u>(3,303,459)</u>	<u>(3,036,956)</u>
	<u>\$ -</u>	<u>\$ -</u>

The amount taken into income as a future tax asset must reflect that portion of the tax asset which are more likely-than-not to be realized from future operations. Considering the Company's cumulative losses in recent years, the Company has chosen to provide an allowance of 100% against all available tax assets, regardless of their terms of expiry.

Note 15 Commitment

The Company has a contractual commitment in the amount of \$951,720 in respect of the construction and installation of manufacturing equipment. As at June 30, 2005, the Company had incurred charges totalling \$476,475 in respect to this contract.

Note 16 Subsequent Events

Subsequent to June 30, 2005:

- i) the Company granted 150,000 common share purchase options entitling the holders thereof to purchase one common share for each option held at \$0.77 (US\$0.63) per share up to July 19, 2007.
- ii) the Company issued 25,000 common shares at \$0.51 per share for total proceeds of \$12,750 pursuant to the exercise of share purchase options.

Note 16 Subsequent Events – (cont'd)

iii) the Company issued 625,000 common shares at \$0.75 per share for total proceeds of \$468,750 and 180,000 common shares at \$0.74 per share for total proceeds of \$133,200 pursuant to the exercise of share purchase warrants.

Note 17 Differences Between Generally Accepted Accounting Principles in Canada and the United States of America

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada (“Canadian GAAP”) which differ in certain respects with those principles and practices that the Company would have followed had its financial statements been prepared in accordance with accounting principles and practices generally accepted in the United States of America (“US GAAP”).

The Company’s accounting principles generally accepted in Canada differ from accounting principles generally accepted in the United States of America as follows:

a) Stock-based Compensation

The Company grants stock options at exercise prices equal to the fair market value of the Company’s stock at the date of the grant. Pursuant to APB 25, the compensation charge associated with non-employees’ options is recorded in the reconciling items. The compensation charge for employees is not recognized in this circumstance. Under SFAS 123, it is required to present pro-forma information as to the effect on income and earnings per share as if the Company had accounted for its employee stock options under the fair value method of that statement. Had compensation cost been determined based on the fair value at the grant dates for those options issued to directors and employees, the Company’s net loss and loss per share for the year ended June 30, 2003 would have been increased to the pro-forma amount indicated below:

	<u>2003</u>
Net loss in accordance with US GAAP as reported (Note 17(d))	\$ (113,779)
Pro-forma adjustment for SFAS 123	<u>(12,000)</u>
Pro-forma net loss	<u>\$ (125,779)</u>
Pro-forma net loss per share	<u>\$ 0.00</u>

Note 17 Differences Between Generally Accepted Accounting Principles in Canada and the United States of America – (cont'd)

a) Stock-based Compensation – (cont'd)

The fair value of these options was estimated at the date of the grant using the following weighted average assumptions:

	June 30, <u>2003</u>
Expected volatility	94.6%
Dividend yield	0.0%
Weighted average expected life of stock options	5 years
Risk-free interest rate	3.5%

b) Comprehensive Loss

US GAAP requires disclosure of comprehensive loss which, for the Company, is net income (loss) under US GAAP plus the change in the cumulative foreign exchange translation adjustment.

Under Canadian GAAP, in accordance with recently issued CICA Handbook Section 1530, "Comprehensive Income", the Company is not required to report components of comprehensive income until fiscal periods that commence after October 1, 2006.

c) New Accounting Standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share Based Payment", that addresses the accounting transactions in which a company exchanges its equity instruments for goods or services. SFAS No. 123R requires that such transactions be accounted for using a fair value based method. Adoption of SFAS No. 123R is effective for periods beginning after June 15, 2005. The Company will adopt this statement as required and management does not believe the adoption will have a material effect on the Company's results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4," which requires that abnormal amounts of idle facility expense, freight, handling costs and wasted material be recognized as current-period charges. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this standard as required and management does not believe the adoption will have a material effect on the Company's results of operations or financial condition.

Note 17 Differences Between Generally Accepted Accounting Principles in Canada and the United States of America – (cont'd)

- d) The impact of the above on the financial statements for the fiscal years ended June 30 are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income (loss) for the year per Canadian GAAP and comprehensive income (loss) per US GAAP	\$ (1,393,760)	\$ (402,966)	\$ 46,775
Foreign currency translation adjustment	<u>22,684</u>	<u>(9,625)</u>	<u>(160,554)</u>
Net loss for the year under US GAAP	<u>\$ (1,371,076)</u>	<u>\$ (412,591)</u>	<u>\$ (113,779)</u>
Basic loss per share:			
Canadian GAAP	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>	<u>\$ (0.00)</u>
US GAAP	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>	<u>\$ (0.01)</u>

Had the Company followed US GAAP, the consolidated statement of shareholder's equity (deficiency) under US GAAP would have been reported as follows:

	<u>2005</u>	<u>2004</u>
Share capital		
Common shares	\$ 17,745,481	\$ 14,388,228
Additional capital-stock options	<u>958,515</u>	<u>56,840</u>
	<u>18,703,996</u>	<u>14,445,068</u>
Accumulated deficit		
Balance, beginning of year	(12,441,664)	(12,029,073)
Adoption of new accounting policy in respect of stock-based compensation	(44,340)	-
Net loss for the year	<u>(1,371,076)</u>	<u>(412,591)</u>
	<u>(13,857,080)</u>	<u>(12,441,664)</u>
Accumulated other comprehensive income	<u>158,771</u>	<u>181,455</u>
Shareholders' equity for US GAAP	<u>\$ 5,005,687</u>	<u>\$ 2,184,859</u>