INNOVATIVE MEDICAL SERVICES
Form 10KSB/A
August 07, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-KSB /A

ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended July 31, 2001

Commission file number 0-21019

INNOVATIVE MEDICAL SERVICES
(Exact name of registrant as specified in its charter)

California	33-0530289
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1725 Gillespie Way, El Cajon, California 92020
(Address of principal executive offices, including Zip Code)

(619) 596-8600
(Registrant's Telephone Number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None Securities registered pursuant to Section 12(g) of the Act:

Common Stock
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendments to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year: $2,409,700

Aggregate market value of the voting stock held by non-affiliates of the registrant: Approximately $3,107,000 as of October 25, 2002.

Indicate the number of shares outstanding of each of the issuer's classes of common stock: 8,780,899 shares of common stock as of October 25, 2002.

Documents incorporated by reference: Certain Exhibits

Explanatory note on amendment

The Registrant has filled this amendment to reflect changes made to its financial statements for the fiscal year ended July 31, 2002 with respect to the writing off of certain start up costs which had been previously capitalized. The Amendment revises and replaces the following sections:

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations ;

Item 7. Financial Statements and Notes to Financial Statements

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations Fiscal 2001 vs. Fiscal 2000

During the quarter, we began to realize revenues from multiple product lines in our different divisions. In order to be more informative regarding distribution of revenues, discussion of revenues will be in terms of our water treatment, silver ionization and pesticide divisions.

Revenues of $2,409,700 in the fiscal year ended July 31, 2001 were 45% higher than the $1,661,500 in revenues reported for the fiscal year ended July 31, 2000. The increase was due to increases in revenues in all of our company divisions. Water treatment division sales were $2,086,100, silver ionization division sales were $320,300 and pesticide division sales were $32,200.

Currently, water dealer program sales consist mostly of sales of other manufacturers' products to independent dealers. Revenue is recognized on sales to dealers as shipped since we currently do not sell to third party customers of the dealers. Revenues of silver ion and pesticide products are recognized on shipment where the sale is made F.O.B. shipping point.

Gross profit for the year ended July 31, 2001 was $1,047,100 versus $564, 000 in 2000. Gross profit percentage of 43% in 2001 was higher versus 34% in 2000. The increase in gross profit percentage was largely due to higher margins associated with our pesticide and silver ion technology product lines.

Net loss for the year ended July 31, 2001 was $2,011,500 versus net loss of $2,389,400 for the same period in 2000. During the year, General and Administrative expenses increased 1% or $11,800 from $1,789,800 in fiscal 2000 to $1,778,000 in fiscal 2001. Selling expense increased approximately $186,700, or 31%, from $595,100 in 2000 to $781,800 in 2001 because of increased costs associated with development of marketing materials, hiring of additional sales personnel, trade shows and product launches for the Nutripure dealer program, and the silver ion and pesticide divisions.

During the year ended July 31, 2001 the Company expended $230,000 in an effort to acquire and setup a Korean corporation. The Company originally capitalized these costs as Deferred Acquisition costs. The Company later determined the venture was not feasible and decided not to go forward with the project. The total costs were written-off as Abandoned Projects at July 31, 2002. As discussed in Note 2 of our financial statements, we now believe the treatment of these costs was not correct. The accompanying financial statements now show

these costs as expensed when incurred as Start-up Costs. The income statement effect of this restatement is to increase the net loss at July 31, 2001 by $230,000 and to decrease the net loss at July 31, 2002 by $230,000. The balance sheet effect is to show a decrease in Deferred Acquisition Costs in 2001 of $230,000.

In addition to the ongoing expansion of the water dealer program, distribution of our other products in the Water Treatment Division continues to grow. A competitor in the industry, Freshwater Systems, had a significant effect on our revenues in fiscal year 2000, but our sales have begun to recover. Fillmaster system sales increased 6% from fiscal year 2000 to 2001, and Fillmaster replacement filter sales increased 24% from fiscal year 2000 to 2001. Although the market for our pharmacy products is maturing in that there is a decreasing number of pharmacy chains that do not have water filtration products, and that we have sold systems to most major chains, Fillmaster sales to additional chain pharmacies are steady, as are replacement filter sales to existing customers. The focus for further Fillmaster sales will be on incremental and upgrade sales to individual pharmacies within current chain accounts, although we are still actively pursuing Fillmaster sales to remaining chains. We work to retain Fillmaster customers with our Customer Service Plan 2000, a multi-year service and warranty contract. Fillmaster customers that subscribe to our Customer Service Plan have contracted to continue purchasing; otherwise, customers do not have an obligation to continue historic purchasing patterns.

Although retail sales of Nutripure 2000 and Nutripure Sport Bottles comprise only 11% of Water Treatment Division Sales, we continue to receive and fulfill reorders and new orders.. . In addition to retail sales, we are conducting a direct mail program with these products.

In October 2000, we launched our Nutripure Dealer Program. Revenues from the program began in the third quarter and continue to ramp up as we work to sign up new dealers to the program. We partnered with Automated Payment Services ("APS"), and MBNA to strengthen and streamline the financing program and administration of the Nutripure dealer program. Under the unique Nutripure program, independent water treatment dealers may now offer credit to all prospective customers because the Nutripure program offers competitive, risk-based interest rates. In addition, through APS, dealers can obtain real-time processing and approval information online for their customers.

In January 2001, we announced the acquisition of a new, non-toxic pesticide technology. The acquisition was completed in April 2001 for approximately $160,000. RoachX is the first product to launch, and during the second half of the year, we focused on gaining distribution to more than 40,000 commercial pest control companies through national wholesalers. The commercial industry provides larger dollar volume potential and select and controlled distribution. During the second half of the year, we began receiving purchase orders and shipping RoachX across the United States. The national kickoff will take place at the National Pest Management Association meeting in New Orleans in October 2001.

In March 2001, we signed a five-year contract to provide Axenohl to Dodo & Company, a Korean cosmetics manufacturer and marketer. Under the contract, Dodo & Company will purchase approximately $1.2 million dollars of product from us over five years. In addition to the purchase price, we will receive a royalty on sales of the Axen-containing products. We anticipate that, over the five years, the revenues from Dodo & Company cosmetics royalties will exceed $5 Million. In addition to sales to Dodo cosmetics, other recent sales of Axenohl have been to companies in South Korea for testing purposes. Regulatory clearances have not yet been issued in South Korea.

Liquidity and Capital Resources Fiscal 2001 vs. 2000

From inception through July 31, 2001, we have financed our operations primarily through our initial public offering in August of 1996, by a subsequent private placement in March of 2000, and by other smaller private placement stock sales. We have operated without long-term debt and have no plans to obtain long-term financing in the next twelve months. We believe that sales from our new product lines will not provide sufficient capital resources to sustain operations and fund product development until fiscal year 2001/2002. In the short term, we expect to raise capital through equity sales as necessary to fund future growth until we operate above the break-even point. We continually evaluate opportunities to sell additional equity or debt securities, or obtain credit facilities from lenders to strengthen our financial position. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders.

During the fiscal year ended July 31, 2001, our current assets to liabilities ratio decreased from 5.02 to 3.15. Current assets decreased $883,000 from $2,794,400 to $1,911,400. Current assets at July 31, 2001 include a decrease of $914,200 in cash and cash equivalents and a decrease in restricted cash of $204,900 which was pledged against a line of credit which was paid off during the year. Accounts receivable increased $159,400 on increased sales volume. Inventories decreased $85,100 from $796,100 in fiscal 2000 to $711,000 in fiscal 2001 which reflects a changing product mix and more efficient purchasing. Noncurrent assets increased by $734,900 during the year mainly due to an increase in Patents and Licenses of $713,400. Current liabilities increased $50,600 from $556,300 to $606,900. The increase in current liabilities was the net result of an increase in accounts payable and accrued liabilities of $261,200 and a payoff of a line of credit of $210,600.

Our liquidity is unaffected by the financing program offered to participating dealers in the Nutripure water dealer program. We receive funds from our primary lender and disperse the funds to the dealer, less a commission charged by us, upon completion of the contract. The primary lender disperses funds to us. We record a liability when the funds are received and relief of liability when funds are dispersed, and we do not retain liability on the credit extended.

Cash flows used from operations were $1,338,500 in fiscal year 2001 and $1,311,900 in 2000. For fiscal year 2001 cash flows used in investing activities included $40,300 for the purchase of machinery and equipment and $621,100 for the purchase of patents and licenses. In fiscal 2000 cash flows used in investing activities included $503,100 for the purchase of machinery and equipment and for website development and $57,100 for the purchase of patents and licenses. Also, we incurred $148,700 in deferred acquisition costs during fiscal 2000. Cash flows from financing activities were $1,085,700 in fiscal 2001 and $3,120,100 in fiscal 2000. Financing activities for the current year included a decrease of $210,600 in notes payable. Cash flows from financing activities during the year included the following common stock transactions:

1. A $250,000 private placement in October 2000 in which we issued 94,340 shares of common stock to six investors at $2.65 per Unit.

2. A $250,002 private placement in January 2001 in which we issued 83,334 shares of common stock to six investors at $3.00 per Unit. Each Unit contained one share of common stock and a warrant to acquire an additional share of common stock for $4.00 per share up to January 28, 2003.

3. A $225,000 private placement in April 2001 in which we issued 150,000 shares of common stock to four investors at $1.50 per Unit. As part of this registration we also issued $200,000 of convertible debentures at 10% interest due July 31, 2001. The holders of this debenture are entitled to convert all or any amount over $10,000 of principal face amount and accrued interest into Units each consisting of one share of

Common Stock and a Common Stock Purchase Warrant. The conversion price for each Unit shall equal 80% of the average closing bid price for the five trading days immediately preceding the receipt of Notice of Conversion. The debentures were converted to common stock on July 31, 2001.

4. In addition, approximately $245,135 was received from exercise of outstanding stock options.

In the prior year, cash flows from financing activities were $3,120,100, which included $3,355,600 received through private placements of IMS and Nutripure.com. The total decrease in cash and cash equivalents for 2001 was $914,200 as compared to an increase of $1,099,300 during the same period in 2000.

Future Outlook

We believe that, during fiscal year 2001, we successfully transitioned from our niche pharmacy market into other, broader markets with our expanded water treatment division and our new bioscience division. Although our Fillmaster products still comprised the majority of our sales in 2001, we believe that will change in the coming fiscal year.

Looking ahead, we see a year of continued growth in the water treatment division as the Nutripure Dealer program fully develops and sales of our retail water filtration products continue to grow.

We also see the bioscience division growing in the coming year. We have focused the sales efforts of our pesticide technologies on the commercial pesticide industry to take advantage of key market opportunities. We have earned the support of and are selling RoachX through Vopak (formerly Van, Waters & Rogers) and members of the Speckoz group of nine regional independent wholesalers. Based upon these distributors' representations to us and upon their own websites and promotional materials, we believe them to be the largest distributors of pesticide products in the United States.

Other than purchase orders, we do not have written agreements with the distributors. We believe in the coming year RoachX will become an industry leading technology in cockroach control.

This fall we plan to formally launch three new products from this division: AntX(TM), our latest development in pesticide technology, CleanKill(TM), the Axen-based hard surface disinfectant for the pest control industry, and ProChoice(TM) caulk for pest control operators. We have submitted for and anticipate receiving EPA approval for AntX. CleanKill is approved by the EPA as an additional brand name of Axen. We repackage an NSF, USDA and FDA approved food-grade silicone caulk as our ProChoice product. We believe adding sales of these products to the already climbing RoachX revenues will have a very material positive effect on revenues in the coming fiscal year.

Although we think that the pesticide technologies will have the most immediate material impact on revenues in the coming year, we believe that the silver ion technologies will ultimately become the largest revenue generator for Innovative Medical Services. We intend not only to sell our own Axen-based products, like CleanKill, but also to sell Axen as an additive to other manufacture's products, like Dodo Cosmetics' acne-fighting product line. We believe that the innumerable applications for a non-toxic, tasteless, odorless, highly effective antimicrobial agent present an outstanding market opportunity for our Axenohl products.

The investment necessary to pursue regulatory approval for Axenohl will be

significant, but as additional US and international approvals for Axenohl uses are received, we expect revenues to develop quickly.

Item 7. Financial Statements

INNOVATIVE MEDICAL SERVICES

CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended July 31, 2001 and July 31, 2000

Independent Accountants' Report

Board of Directors
Innovative Medical Services

We have audited the accompanying consolidated balance sheets for Innovative Medical Services and Consolidated Subsidiaries as of July 31, 2001 and 2000, and the related consolidated statements of operations, statement of accumulated deficits and cash flows for the years ended July 31, 2001 and July 31, 2000. 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 generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying financial statements as of July 31, 2001 and 2000 and for the years then ended have been restated to correct errors as described in Note 2.

In our opinion, the consolidated financial statements, referred to above, present fairly, in all material respects, the financial position of Innovative Medical Services and Consolidate Subsidiaries as of July 31, 2001 and July 31, 2000, and the results of its operations and its cash flows for the years ended July 31, 2001 and July 31, 2000, in conformity with generally accepted accounting principles in the United States of America.

/s/ Miller and McCollom

MILLER AND MCCOLLOM
4350 Wadsworth Boulevard, Suite 300
Wheat Ridge, Colorado

October 19, 2001 except for the third paragraph above and Note 2, which is as of June 13, 2003.

CONSOLIDATED BALANCE SHEETS

	July 31 2001 Restated (Note 2)	July 31 2000 Restated (Note 2)
Cash and cash equivalents	$ 207,092	$ 1,121,316
Restricted cash	--	204,887
Accounts receivable, net of allowance for doubtful accounts of $ 115,000 at July 2001 and $225,000 at July 31, 2000	570,733	411,323
Due from officers and employees	240,001	226,729
Inventories	711,018	796,136
Prepaid expenses	182,556	33,975
Total current assets	1,911,400	2,794,366
Property, plant and equipment	903,072	1,056,252
Total property, plant and equipment	903,072	1,056,252
Deposits	8,127	14,083
Patents and licenses	1,014,282	300,910
Deferred acquisition costs	--	202,542
Total noncurrent assets	1,022,409	517,535
Total assets	$ 3,836,881	$ 4,368,153
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	$ 543,992	$ 308,812
Accrued liabilities	96,691	71,400
Notes payable	--	210,592

Total current liabilities	640,683	590,804
Minority interest payable	--	61,697
Common stock, no par value: authorized 20,000,000 shares, issued and outstanding 6,954,699 at July 31, 2001 and 5,942,902 at July 31, 2000	11,510,915	10,018,873
Class A warrants: issued and outstanding 3,686,000 warrants	108,750	108,750
Accumulated deficit	(8,423,467)	(6,411,971)
Total stockholders' equity	3,196,198	3,715,652
Total liabilities and stockholders' equity	$ 3,836,881	$ 4,368,153

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF INCOME

	For Year Ended July 31 2001	
	2001 Restated (Note 2)	200 Resta (Note
Net sales	$ 2,409,721	$ 1,6
Cost of sales	1,362,670	1,0
Gross profit	1,047,051	5
Selling expenses	781,810	5
General and administrative expenses	1,789,783	1,7
Research and development	292,964	1
Start-up costs	230,000	
Impairment of long lived assets	--	5
Total operating costs	3,094,557	2,9

Operating income (loss)	(2,047,506)	(2,4
Other income and (expense):		
Interest income	33,738	
Interest Expense	(11,100)	(
Loss on abandoned assets	--	(
Total other income (expense)	22,638	(
Income (loss) before income taxes, minority Interest in subsidiary operations and change in accounting principle	(2,024,868)	(2,5
Federal and state income taxes	1,600	
Income (loss) before minority interest in subsidiary operations and change in accounting principle	(2,026,468)	(2,5
Minority interest in subsidiary operations	14,972	
Net income (loss) before cumulative change in accounting principle	(2,011,496)	(2,4
Cumulative effect of change in accounting principle	--	
Net income (loss)	$ (2,011,496)	$ (2,3
Net income (loss) per common share before change in accounting principle (basic)	$ (0.31)	
Cumulative effect of change in accounting principle	--	
Net income (loss) per common share (basic)	$ (0.31)	$
Net income (loss) per common share before change in accounting principal (diluted)	$ (0.31)	
Cumulative effect of change in accounting principle	--	
Net income (loss) per common share (diluted)	$ (0.31)	$

CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICITS

Balance, beginning of period	$ (6,411,971)	$ (3,9

Prior period adjustment (see note 12)		(
Net income (loss)	(2,011,496)	(2,3
Balance, end of period	$ (8,423,467	$ (6,4

The accompanying notes are an integral part of these financal statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year End July 31	
	2001 Restated (Note 2)	2 Res (No
Cash flows from operating activities		
Net income (loss)	$ (2,011,496)	$ (2,3
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	96,961	1
Depreciation	193,477	1
Minority interest in subsidiary operations	(61,697)	
Impairment of long lived assets	-	5
Loss on abandoned assets	-	
Changes in assets and liabilities:		
(Increase) decrease in restricted cash	204,887	
(Increase) decrease in accounts receivable	(159,409)	3
(Increase) decrease in due from officers and employees	(13,272)	1
(Increase) decrease in prepaid expense	60,489	
(Increase) decrease in inventory	85,118	(
(Increase) decrease in deposits	5,956	
Increase (decrease) in accounts payable	235,180	(2
Increase (decrease) in accrued liabilities	25,292	
Net cash provided (used) by operating activities	(1,338,514)	(1,3
Cash flows from investing activities		
Purchase of property, plant and equipment	(40,297)	(5

Purchase of patents and licenses	(621,114)	(
Deferred acquisition costs	-	(1
Net cash (used) in investing activities	(661,411)	(7
Cash flows from financing activities		
Proceeds from debt obligations	200,000	2
Payments on debt obligations	(210,592)	(5
Proceeds from sale of common stock	1,096,293	3,3
Net cash provided by financing activities	1,085,701	3,1
Net increase (decrease) in cash and cash equivalents	(914,224)	1,0
Cash at beginning of period	1,121,316	
Cash at end of period	$ 207,092	$ 1,1
Supplemental disclosures of cash flow information		
Cash paid for interest paid	$ 11,100	$
Cash paid for taxes paid	$ 1,600	$
Noncash investing and financing activities:		
Value of shares issued in exchange for Nutripure.com minority interest	$ 550,011	$
Value of shares issued in exchange for ETI H2O	$ 140,953	$

The accompanying notes are an integral part of these financial statements.

Innovative Medical Services
Notes to Consolidated Financial Statements
See Independent Accountants' Report

Note 1. Organization and Summary of Significant Accounting Policies
Organization and Business Activity

Innovative Medical Services was incorporated in San Diego, California on August 24, 1992. The Company was organized with the purpose of manufacturing, marketing, and selling the Fillmaster, a unique and proprietary pharmaceutical water purification and dispensing product. The Company is fully operational, with more than 15,000 customers in all fifty states, Puerto Rico, the United Kingdom, Australia, Canada, and Europe. The Company has expanded research and development efforts in order to further develop its product line to include an additional 8 proprietary pharmacy-related efficiency tools.

In October of 1998, the Company purchased the assets of Export Company of America, Inc. (EXCOA), a privately held Fort Lauderdale, Florida-based distributor of disposable medical, dental and veterinary supplies. The major asset of this company was its 45% interest in Ampromed Comercio Importacao E Exportacao Ltda (AMPROMED), a Rio de Janeiro-based import company that sells medical, dental and veterinary supplies and water filtration products to practitioners, retail outlets and government agencies. The Company acquired the remaining 55% interest in AMPROMED from a private individual. To facilitate this transaction the Company has formed EXCOA Nevada, a 100% owned subsidiary of Innovative Medical Services. This company was incorporated in Nevada. A 99% interest in AMPROMED is held by EXCOA Nevada, with the remaining 1% of AMPROMED being owned by Innovative Medical Services. These business combinations were accounted for using the purchase method. The Company incurred $1,091,393 of acquisition costs for these two entities all of which was paid in cash. The majority of the purchase price was advanced to the previous owners in fiscal year 1998 and recorded as deferred acquisition costs until the purchase was concluded. The assets acquired and liabilities assumed are as follows:

Assets:	
Accounts Receivable	$ 32,500
Inventory	58,217
Fixed Assets	49,083
Customer List	360,000
Licenses	354,961
Goodwill	261,322
Total Assets	1,116,083
Liabilities	
Accounts Payable	24,690
Equity	$ 1,091,393

The above listed goodwill of $261,322 and customer list of $360,000 were being amortized over a period of forty (40) years. The licenses are being amortized over fifteen (15) years. The value of these assets and the amortization periods were reassessed at July 31, 2000 and adjusted as described in Note 16.

In December 1999, the Company formed NUTRIPURE.COM as a wholly owned subsidiary, incorporated in the state of Nevada. NUTRIPURE.COM is an e-commerce web supersite providing consumers a wide variety of vitamins, minerals, nutritional supplements, homeopathic remedies and natural products. In addition to products, the website offers comprehensive health and wellness information in an easy-to-access, intuitive reference format. The website will also present the Nutripure line of water filtration systems.

In November 2000, Innovative Medical Services acquired 100% of the stock of ETIH2O, Inc., a Florida corporation, for 56,381 shares of IMS stock valued at $140,953 ($2.50 per share). The transaction was recorded using the purchase method of accounting. The assets acquired and liabilities assumed are as follows:

Assets:		
	Notes Receivable	$ 33,655
	Inventories	32,077
	Equipment	16,932
	Licensing & Distribution Rights	118,324
Total Assets		200,988
Liabilities:		
	Notes Payable - IMS	60,035
Equity		$ 140,953

Assets and liabilities were valued at historical cost and no goodwill was recorded in the transaction. Results of operations of ETIH2O Inc. are included in the current period. The acquired entity was a startup company, if results of operations were included in prior periods and shown as though the companies had been combined at the beginning of the period, it would not have a material affect on the consolidated financial statements of Innovative Medical Services.

The Company merged ETI-H2O with a newly formed Nevada corporation of similar name and dissolved the Florida corporation. ETI-H2O, a privately held technology corporation, developed Axenohl and is responsible for processing, and production of Axenohl and Axen. ETI-H2O is also responsible for all supervision of all research, studies, data and quality control of the Axenohl/Axen product line.

In April 2001, the Company completed the purchase of the entire right, title and interest in and to specific patent-pending boric acid pesticide technologies and all rights, title and interest in and to all patents for RoachX from a private individual, for approximately $160,000 in cash. The owner/inventor accepted a position with the Company to serve as Senior Scientist and to head the Company's new Pest Management Division. The employment agreement included bonuses at certain revenue thresholds of RoachX sales. The owner/inventor of RoachX died unexpectedly in June of 2001. Because the initial payment was primarily for the patents and for the EPA licenses, it is included in Patents and Licenses and is amortized over a period of 17 years. RoachX is a pesticide technology containing a familiar active ingredient, boric acid, bound to a masking agent and combined with an attractant fragrance and proteins in a colloidal suspension. The patent-pending time-released formulation protects the boric acid from dissolving in water and maintains the integrity of the pesticide to obtain maximum killing effect.

Basis of Presentation and Principles of Consolidation

The accompanying financial statements include the consolidated accounts of Innovative Medical Services and its subsidiaries. All inter-company balances and transactions have been eliminated.

Previously published financial statements have been restated to write down certain intangible assets by $505,433. The net loss for the year ended July 31, 2000 increased to $2,384,052 from $1,745,430 that was previously reported. An explanation of the detail of the adjustment is included in Note 16.

Innovative Medical Services
Notes to Consolidated Financial Statements
See Independent Accountants' Report

Revenue Recognition
Generally, the company recognizes income based upon concluded arrangements with customers and all events have occurred by delivery or performance. Certain income is recognized upon shipment where the sale is made f.o.b. shipping point. Customer acceptance provisions and installation procedures accompanying delivery are minor in nature, and the Company has not experienced any material expense in satisfying customer satisfaction. Revenue is recognized on sales to dealers and to pharmacists as shipped, since the Company does not sell to third party customers of the dealers and pharmacies. Software upgrades are provided free to customers resulting from implants included in products which they purchase. In a minor amount of e-commerce business conducted to date, sales are recorded on a gross basis resulting from credit card sales, the Company does not charge the customer until the product is shipped and the Company has been billed.

The Company began its program of providing financing to independent dealers in fiscal year ending July 31, 2001. Currently the financing is for equipment of other manufacturers and not the Company's products. The Company receives funds from its primary lender and disperses the funds to the dealer, less a commission charged by the Company, upon completion of the contract. The Company records a liability when the funds are received and relief of liability when funds are dispersed. The Company is recording only the commissions earned as revenues.

Software Development Costs
The Company capitalizes software development costs incurred to develop certain assets in accordance with Statement of Position ("SOP") 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Certain costs of computer software developed or obtained for internal use are capitalized and amortized on a straight-line basis over the estimated useful life of the software. Costs for general and administrative, overhead, maintenance and training, are expensed as incurred. To date $207,707 of costs related to the Nutripure.com website have been capitalized under SOP 98-1 and are being amortized over a period of 3 years.

Stock-Based Compensation
The Company follows FASB Statement No. 123, 'Accounting for Stock-Based Compensation' ('FAS 123'). The provisions of FAS 123 allow companies to either expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in APB Opinion 25, 'Accounting for Stock Issued to Employees' ('APB 25') but disclose the pro forma effects on net income (loss) had the fair value of the options been expensed. The Company has elected to continue to apply APB 25 in accounting for its stock option plans (Note 10). For awards that generate compensation expense as defined under APB 25, the Company calculates the amount of expenses and recognizes the expense over the vesting period of the award.

In March 2000, the FASB issued FASB Interpretation No. 44, 'Accounting for Certain Transactions involving Stock Compensation' ('FIN 44'),

which contains rules designed to clarify the application of APB 25. FIN 44 became effective on July 1, 2000 at which time the Company adopted it. The impact of the adoption of FIN 44 was not material to the earnings or financial position of the Company.

Research and Development

Research and development costs that have no alternative future uses are charged to operations when incurred and are included in operating expenses. The total amount charged to Research and Development expense was $292,964 and $114,756 in the fiscal years ended July 31, 2001 and 2000, respectively.

Depreciation Method

The cost of property, plant and equipment is depreciated on a straight-line basis over the estimated useful lives of the related assets. The useful lives of property, plant, and equipment for purposes of computing depreciation are:

Computers and equipment	7.0 years
Furniture and fixtures	10.0 years
Website	3.0 years
Vehicle	5.0 years to 7.0 years

Leasehold improvements are being depreciated over the life of the lease, which is equal to 120 months.

Depreciation is computed on the Modified Accelerated Cost Recovery System for tax purposes.

Amortization

The cost of patents acquired is being amortized on a straight-line basis over the remaining lives of 17 years. Licenses which include the Ampromed Limitada, the right of Nutripure to distribute and disseminate certain information through its website, and costs to acquire EPA approval on Axen and Axenohl, are being amortized on a straight line basis over periods ranging from 15 to 20 years. Website development costs are being amortized on the straight-line basis over 3 years.

Amortization expense for the years ended July 31, 2001 and July 31, 2000 was $97,000 and $185,700, respectively.

Long-Lived Assets

In accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 121, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, the carrying value of intangible assets and other long-lived assets will be reviewed on a regular basis for the existence of facts or circumstances, both internally and externally, that may suggest impairment. The Company has recognized impairment of the assets purchased with the Ampromed acquisition and has reassessed the value of certain assets as described in Note 16. Should there be additional impairment in the future, the Company will measure the amount of the impairment based on undiscounted expected future cash

flows from the impaired assets. The cash flow estimates that will be used will contain management's best estimates, using appropriate and customary assumptions and projections at the time.

Inventory Cost Method
Inventories are stated at the lower of cost or market determined by the Average Cost method and net realizable value. Inventories at July 31 consisted of:

	2001	2000
Finished Goods	$ 246,374	$ 108,528
Work in Progress	150,815	180,770
Raw Materials	313,829	507,410
	$ 711,018	$ 796,708

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Use of Estimates
The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments
The fair value of financial instruments, consisting primarily of the line of credit, is based on interest rates available to the Company and comparison to quoted prices. The fair value of these financial instruments approximates carrying value.

Advertising and Promotional Costs
Cost of advertising and promotion are expensed as incurred or at the first-time advertising and promotion takes place. Such costs were $276,492 and $197,908 for the years ended July 31, 2001 and July 31, 2000, respectively.

Deferred Acquisition Costs
During the process of evaluating certain companies for acquisition, the Company expended $230,000 and $202,542 in fiscal years ended July 31, 2001 and July 31, 2000, respectively. These costs were capitalized and will be reclassified if the acquisitions are successful as a cost of the investment or expensed in the future if the acquisitions are not successful.

Net Income (Loss) Per Common Share
The Company adopted FASB Statement No. 128, Earnings Per Share ("SFAS 128"), which is effective for periods ending after December 15, 1997.

Entities that have only common stock outstanding are required to present basic earnings per share amounts. All other entities are required to present basic and diluted per share amounts. Diluted per share amounts assume the conversion, exercise or issuance of all potential common stock instruments unless the effect is to reduce a loss or increase the income per common share from continuing operations.

As required by SFAS 128, earnings per share is computed based upon the weighted average common shares outstanding for the year.

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Following is a reconciliation of the weighted average number of shares actually outstanding with the number of shares used in the computations of loss per common share:

	For the Years Ended July 31, 2001	July 31, 2000
Shares outstanding	6,954,699	5,942,903
Weighted average number of shares actually outstanding	6,420,926	5,056,141
Stock Options	1,815,625	1,214,309
Warrants	1,797,500	1,798,125
Total weighted average shares	10,034,051	8,068,575
Net income (loss) before cumulative Change in accounting principle	$ (2,011,496)	$(2,469,315)
Cumulative change in accounting principle	--	79,896
Net income (loss)	$ (2,011,496)	$(2,389,419)
Basic net earnings (loss) per share		
Net income (loss) per common share before change in accounting principle	$ (0.31)	$ (0.49)
Cumulative effect of change in accounting principle	--	0.02
Net income (loss) per common share	$ (0.31)	$ (0.47)
Diluted net earnings (loss) per share		
Net income (loss) per common share		

before change in accounting principle	$ (0.31)	$ (0.49)
Cumulative effect of change in accounting principle	--	0.02
Net income (loss) per common share	$ (0.31)	$ (0.47)

Potential common stock instruments at July 31, 2001, which include 1,815,625 stock options and 1,797,500 warrants, are included in the loss per share calculation for fiscal year ended July 31, 2001. Potential common stock instruments at July 31, 2000, which include 1,214,309 stock options and 1,798,125 warrants, are included in the loss per share calculation for fiscal year ended July 31, 2000.

On August 8, 2001, the warrants expired without exercise.

Recent Accounting Pronouncements

In June of 1998, the FASB issued Statement of Accounting Standards No. 133 ("SFAS 133") "Accounting for Derivative Instruments and Hedging Activities". SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities on the balance sheet at their value. This statement, as amended by SFAS 137, is effective for financial statements for all fiscal quarters to all fiscal years beginning after June 15, 2000. The Company does not expect the adoption of this standard to have a material impact on its results of operation, financial position, or cash flows as the Company currently does not engage in any derivative or hedging activities.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 requires all business combinations to be accounted for using the purchase method of accounting and is effective for all business combinations initiated after June 30, 2001. SFAS 142 requires goodwill to be tested for impairment under certain circumstances, and written off when impaired, rather than being amortized as previous standards required. SFAS 142 is effective for fiscal years beginning after December 15, 2001. Early application is permitted for entities with fiscal years beginning after March 15, 2001 provided that the first interim period financial statements have not been previously issued. The adoption of SFAS 141 did not have a material effect on the Company's operating results or financial condition. The Company is currently assessing the impact of SFAS 142 on its operating results and financial condition.

Income Taxes

The current provisions for income taxes of $1,600 for fiscal year ended July 31, 2001 and $800 for July 31, 2000 is the minimum franchise tax paid to the State of California regardless of income or loss.

At July 31, 2001, the Company has financial, federal, and California tax net operating loss carryforwards of approximately $7,146,000, and $6,523,000, and $3,073,000, respectively. At July 31, 2000, the Company has financial, federal, and California tax net operating loss carryforwards of approximately $5,594,000. $5,076,000, and $2,377,000, respectively. The difference between the financial reporting and the federal tax loss carryforward is primarily due to accrued expenses and valuation allowances reported in the financials but not deductible for tax purposes. The difference between federal and California tax loss carryforwards is primarily due to the fifty percent limitation on California loss carryforwards. The federal tax loss carryforwards will begin expiring in the fiscal year ended July 31, 2011, unless previously utilized and will completely expire in fiscal year ended July 31, 2020. The California tax loss carryforwards will begin expiring in fiscal year ended July 31, 2001, unless previously utilized and will completely expire in fiscal year ended July 31. 2010.

The Company adopted Financial Accounting Standards Board Statement No. 109, Accounting for Income Taxes, beginning in fiscal year ended July 31, 1993. The adoption had no impact on 1993 results. In accordance with this new standard, the Company has recorded total deferred tax assets of $ 1,304,000 and $ 1,181,000 for the fiscal years ended July 31, 2001 and 2000, respectively. Realization of these deferred tax assets, which relate to operating loss carryforwards and timing differences, is dependant on future earnings. The timing and amount of future earnings are uncertain and therefore, the valuation allowance had been established. The increase in the valuation allowance on the deferred tax asset during the fiscal year ended July 31, 2001 was $123,000.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	July 31 2001	July 31 2000
Net operating loss carryforward	$ 1,263,000	$ 1,108,000
Depreciation and amortization	0	0
Accrued expenses and calculation allowances	36,000	71,000
Other	5,000	2000
Total deferred tax assets	1,304,000	1,181,000
Valuation allowance for deferred tax assets	(1,304,000)	(1,181,000
Net deferred tax assets	$ 0	$ 0

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Note 2. Restatement of Financial Statements

Year Ended July 31, 2001 - Start-up Costs and Warranty Liability
The accompanying financial statements have been restated to correct an error in the recording and reporting of Start-up Costs and the Warranty Liability of the Company.

The Company expended $230,000 during the year ended July 31, 2001 and an additional $47,831 during the July 31, 2002 fiscal year in an effort to acquire and setup a Korean corporation. The Company capitalized these costs as Deferred Acquisition costs as incurred. The Company later determined the venture was not feasible and decided not to go forward with the project. The total costs of $277,831 were written-off as Abandoned Projects at July 31, 2002. We now believe the treatment of these costs was not correct. The accompanying financial statements now show these costs as expensed when incurred as Start-up Costs. The income statement effect of this restatement is to increase the net loss at July 31, 2001 by $230,000 and to decrease the net loss at July 31, 2002 by $230,000. The balance sheet effect is to show a decrease in Deferred Acquisition Costs in 2001 of $230,000.

In previous years the Company had not recorded a liability for its future warranty obligation. Because the Company has now computed and booked this liability the accompanying financial statements have been restated to include this obligation. The warranty liability was $29,153 at July 31, 1999 and is shown as a prior period adjustment on the Consolidated Statements of Accumulated Deficits. A liability of $33,791 at July 31, 2001 and $34,520 at July 31, 2000 are now included in Accrued Liabilities. The income statement effect of theses items was to reduce net loss at July 31, 2001 in $729 and to increase net loss at July 31, 2000 of $5,367.

Year Ended July 31, 2000 - Write Down of Impaired Assets And Change in Asset Lives
Ampromed was purchased in October 1998 to enable the Company to take advantage of the lucrative markets for medical and dental supplies in Brazil and other South American countries and to later introduce and distribute its water purification products to these markets. Since the acquisition the economic conditions in the region have declined and implementation of the project has been delayed. The Company no longer has immediate plans to import medical and dental supplies into Brazil but believes, however, that Ampromed is a vital part of its plan to market and sell "Axenohl", RoachX and the Nutripure line of water treatment products. The Company believes there is considerable value in owning a Brazilian Limitada but has reassessed the value of the goodwill and the customer list it purchased. Statement of Financial Accounting Standards No. 121 (Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of) requires an entity to review long-lived assets and identifiable intangible assets when, among other factors, there is a change in the extent or manner in which an asset is to be used or when there is a significant change in the business climate that could affect the value of an asset. Because the Company suspended its plans to market medical and dental supplies in Brazil in May of 2000 it believes the Goodwill and Customer List assets should be written off, and the value of the Limitada license to do business in Brazil should be written down to what it would cost to acquire in today's market. This is estimated to be

approximately $150,000 and is being amortized over its expected useful life of 15 years.

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At the date of acquisition of Ampromed the Company established amortization periods for the assets purchased at the maximum allowable life of 40 years. We now believe these estimated lives were too long and the life of the goodwill should have been set at 5 years to reflect a more reasonable amortization expense under the circumstances and the uncertainty involved in commitments from a foreign government. Also, an analysis of the customer list based on original estimates indicates that a 6 year life is a more appropriate amortization period for this intangible asset. In addition, instead of the straight-line method, the Company has computed an accelerated method of amortization for the customer list based on an analysis of expected future cash flows at July 31, 1999 and July 31, 2000. The effect of this restatement is to increase General and Administrative Expense by an increase to amortization cost of $152,800 in the year ended July 31,1999. The effect of the restatement in the year ended July 31, 2000 is a write down of impaired asset charge of $505,400 and an increase in General and Administrative Expense by an increase to amortization cost of $133,20

Note 3. Cash and Cash Equivalents

The carrying amounts for cash and cash equivalents approximate fair value because of the short maturity of these instruments. The Company maintains cash balances at several financial institutions. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to $100,000.

At July 31, 2001 and July 31, 2000, the Company's cash and cash equivalents is represented by $207,092 and $1,121,316, respectively, in cash or checking accounts.

Note 4. Restricted Cash

At July 31, 2001, the Company had no restricted cash. At July 31, 2000, the Company's restricted cash consisted of a certificate of deposit of $205,574. These certificates of deposit were held by a bank, as security for a line of credit with the same bank (Note 6).

Note 5. Due from Officers and Employees

At July 31, 2001, notes receivable of $66,561 represents amounts due from officers and $173,440 represents amounts due from employees. At July 31, 2000, notes receivable of $162,793 represents amounts due from officers and $63,936 represent amounts due from employees. Due from officers at July 31, 2001 consisted of a loan to the president of $18,379 and a loan to the chief financial officer of $48,182 due and payable at July 31, 2002. These were renewals and changes of prior year notes to $117,339 and $45,454, respectively, that were due at July 31, 2001. All notes receivable are due and payable within one year. The carrying value of the notes, based on the terms at which those same

loans would be made currently, approximate their fair value. All notes in excess of $10,000 have interest accrued at 6%

Note 6. Property, Plant and Equipment

The following is a summary of property, plant, and equipment - at cost, less accumulated depreciation:

	July 31, 2001	July 31, 2
Computers and equipment	$ 1,061,197	$ 927,
Furniture and fixtures	103,855	100,
Website	207,916	207,
Vehicle	50,985	50,
Leasehold improvements	307,606	304,
	1,731,559	1,591,
Less: accumulated depreciation		
and amortization	828,487	535,
Total	$ 903,072	$ 1,056,

Depreciation expense charged to general and administrative expense for the years ended July 31, 2001 and July 31, 2000 was $193,477and $159,624, respectively.

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Note 7. Debt

The details relating to debt are as follows:

	July 31, 2001	July 31
Line of Credit Community 1st Bank $200,000 line of credit, interest at 8.35% Due and payable February 25, 2001		

Secured by certificate of deposit of $205,574	$ -	$ 19
Line of Credit Flagship Capital, Inc. for financing of accounts payable, interest at 9% payable at $15,823 monthly beginning March 17, 2000.	-	
Total notes payable	-	2
Current maturities of notes payable included in current liabilities	-	2
Total long term debt	$ -	$

Note 8. Commitments

The company leased office and warehouse facilities under an operating lease that expired on December 31, 1996. On May 14, 1996, the Company entered into a new operating lease agreement for sixty-five months commencing on July 1, 1996. The rent payment portion of the lease is for sixty-three months, which allows for an initial building improvement period of two months. The monthly rental for the 11,255 square foot facility is $0.69 per square foot plus $0.14 per square foot for maintenance of common areas. There is also a fixed yearly increase of 4%. The company has also signed an amendment to the lease to allow for an option to lease the building for an additional five years. The company made improvements to the new building in the amount of approximately $307,000.

The rental expense recorded in general and administrative expenses for the years ended July 31, 2001 and July 31, 2000 was $133,968 and $98,835, respectively. Future minimum rental payments required for each of the 5 succeeding years assuming exercise of the option are as follows:

Year Ended July 31	Amount
2002	$139,327
2003	$144,900
2004	$150,696
2005	$156,724
2006	$162,993

Note 9. Capital Stock

The following schedule summarizes the change in capital stock:

	Common Stock Shares	Common Stock $	A Warrants Issued	A Warrant $
Balance, July 31, 1999	4,392,242	6,663,318	3,687,500	108,7
Sale of stock	783,250	759,055	-	
Private placement	767,411	2,596,500	-	
Balance, July 31, 2000	5,942,903	10,018,873	3,687,500	108,7
Sale of stock	245,467	640,884		
Private placement	421,314	851,158		
Stock Dividends	121,961	-		
Acquisitions	223,054	-		
Balance, July 31, 2001	6,954,699	$11,510,915	3,687,500	$108,7

Each Class A warrant entitles the holder to acquire an additional common share for $5.25 per common share beginning August 8, 1997 and expiring August 8, 2001. The Class A Warrants are redeemable by the Company for $0.05 per warrant, at the Company's option, commencing one year after the effective date of the offering provided the closing bid price for the Company's common shares shall have averaged in excess of $9.00 per share for thirty consecutive business days ending within five days of the date of notice of redemption.

Each Class Z warrant entitles the holder to acquire an additional common share for $10.00 per common share beginning August 8, 1998 and expiring August 8, 2001. The Class Z Warrants are redeemable by the Company for $0.10 per warrant, at the Company's option, commencing one year after the effective date of the offering provided the closing bid price for the Company's common shares shall have averaged in excess of $15.00 per share for thirty consecutive business days ending within five days of the date of notice of redemption.

On August 8, 2001 the total 3,687,500 Class A warrants and the total 785,000 Class Z warrants expired without exercise.

Note 10. Related Party Transactions

See Note 4 and Note 10.

Note 11. Stock Option Plans

The Company has the following stock option plans (the Plans) pursuant to which options to acquire common stock have been granted.

1996 Incentive Stock Option Plan: Approved by Shareholders in April, 1996 with 1,000,000 shares authorized under this Plan. The maximum number of shares subject to options granted under this Plan to any one Key Employee is 100,000 shares. The Options granted are "Incentive Stock Options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, for certain key employees. All Key Employees of the Company and its subsidiaries are eligible to participate in the 1996 Incentive Plan. A Key Employee is defined in the Plan as a Company employee who in the judgment of the Administrative Committee has the ability to positively affect the profitability and economic well-being of the Company. Part time employees, independent contractors, consultants and advisors performing bona fide services to the Company shall be considered employees for purposes of participation in the Plan. No Executive Officer or Director of the Company has received options pursuant to this Plan. Options to acquire 350,125 shares under the 1996 Incentive Plan were outstanding as of July 31, 2001 with 356,125 shares remaining under this Incentive Plan for which options may be granted.

1996 Directors and Officers Stock Option Plan: Adopted by the Board in April, 1996 with 1,000,000 shares authorized under this Plan. The maximum number of shares subject to options granted under this Plan to any one Director or Officer shall not exceed 200,000 shares in any 12-month period. Options to acquire 549,625 shares under the 1996 D&O Plan were outstanding as of July 31, 2001 and there are no shares remaining under this Plan for which options may be granted.

Amended 1998 Directors and Officers Stock Option Plan: Approved by Shareholders in December, 1998 with 2,000,000 shares authorized under this Plan. The maximum number of shares subject to options granted under this Plan to any one Director or Officer shall not exceed 200,000 shares in any 12-month period. Upon the election of a continuing director or the further appointment of a continuing executive officer, the continuing director or officer will receive an additional option for 50,000 shares. A newly elected director or newly appointed executive officer is entitled to receive an option for 100,000 shares. Options to acquire 1,281,250 shares under this Plan were outstanding as of July 31, 2001 and there are no shares remaining under this Plan for which options may be granted.

2001 Directors and Officers Stock Option Plan: Approved by Shareholders in January 2001 with 1,000,000 shares authorized under this Plan. The maximum number of shares subject to options granted under this Plan to any one Director or Officer shall not exceed 200,000 shares in any 12-month period. Upon the election of a continuing director or the further appointment of a continuing executive officer, the continuing director or officer will receive an additional option for 50,000 shares. A newly elected director or newly appointed executive officer is entitled to receive an option for 100,000 shares. Options to acquire 44,790 shares under this Plan were outstanding as of July 31, 2001 and there are 955,210 shares remaining under this Plan for which options may be granted.

2001 ETIH2O Stock Option Plan: Adopted by the Board in January 2001 with 1,000,000 shares authorized under this Plan. Options to acquire 550,000 shares under this Plan were outstanding as of July 31, 2001 and there are 450,000 shares remaining under this Plan for which options may be granted.

2001 Consultants and Advisors Stock Option Plan: Adopted by the Board in January 2001 with 500,000 shares authorized under this Plan. The maximum number of shares subject to options granted under this Plan to any one participant shall not exceed 50,000 shares in any 12-month period. No options to acquire shares under this Plan were outstanding as of July 31, 2001 and there are 500,000 shares remaining under this Plan for which options may be granted.

The Plans are administered by a Committee of the Board of Directors or the entire Board. The exercise price of options granted under any of the Plans must be at or above the fair market value for the common stock at the date of grant.

The Company estimates a fair value method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). In accordance with SFAS 123, the Company has chosen to continue to account for employee stock-based compensation utilizing the intrinsic value method. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

Also, in accordance with SFAS 123, the Company has provided footnote disclosure with respect to stock-based employee compensation. The cost of stock-based employee compensation is measured at the grant date based on the value of the award and is recognized over the service period. The value of the stock based award is determined using a pricing model whereby compensation cost is the excess of the fair value of the stock as determined by the model at grant date or other measurement date over the amount an employee must pay to acquire the stock.

The Company accounts for non-employee stock based compensation by establishing a fair value for stock options granted. Compensation cost is measured as the excess, if any, of the fair value of the Company's stock over the amount the non-employee must pay to acquire the stock and is recognized over the anticipated service period.

The effect of applying FAS 123 on the years ended July 31, 2001 and 2000 pro forma net loss as stated below is not necessarily representative of the effects on reported net loss for future years due to, among other things, the vesting period of the stock options and the fair value of additional stock options in future years. Had compensation cost for the Company's stock option plans been determined based upon the fair value at the grant date for awards under the plans consistent with the methodology prescribed under FAS 123, the Company's net loss in the years ended July 31, 2001 and 2000 would have been approximately $2,420,628 and $3,292,510 or $(0.38) per share and $(0.66) per share, respectively, on a diluted basis. The fair value of the options granted during the years ended July 31, 2001 and 2000 are estimated at $1.22 per share and $1.84 per share, respectively, on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for grants in 2001 and 2000; no

dividend yield, volatility of 98.79% and 124%, respectively; a risk-free interest rate of 5.50% and 5.50%, respectively and an expected life of 3.51 year from date of vesting. A summary of stock option activity is as follows:

	Number of Shares	Weighted-Average Exercise Price ($)
Balance at July 31, 1999	1,615,000	1.17
Granted	1,246,540	1.81
Exercised	(781,750)	1.78
Forfeited	(44,250)	1.34
Balance at July 31, 2000	2,035,540	1.55
Granted	997,000	2.21
Exercised	(203,824)	1.78
Forfeited	(93,750)	1.50
Balance at July 31, 2001	2,734,966	1.72

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	Outstanding			Exerc
Range of Exercise Prices	Number Shares Outstanding	Weighted Average Life (in years)	Weighted Average Exercise Price	Number Exercisable
$0.56	285,000	2.0	$ 0.56	235,000
$1.00	553,750	1.9	$ 1.00	352,500
$1.31 to $1.50	274,966	3.7	$ 1.45	176,875
$1.63 to $1.90	315,000	3.6	$ 1.71	165,000
$2.00 to $2.50	900,000	3.0	$ 3.01	480,000
$2.93 to $3.20	406,250	3.3	$ 3.01	406,250
	2,734,966	2.9	$ 1.72	1,815,625

Note 12. Pension Plan

The Company participates in a Small SEP program under which the employer makes contributions to a SEP, which includes a salary reduction arrangement (SARSEP). Employees who participate in the SARSEP may elect to have the employer: (a) make contributions to the SEP on their behalf, or (b) pay them cash. A salary reduction arrangement may be used only in years in which the SEP meets requirements that the IRS may impose to ensure distribution of excess contributions. Annual contributions of an employer under a SEP are excluded from the participant's gross income. No employer contributions were made during the fiscal years ending July 31, 2000 and July 31, 2001.

Note 13. Credit Risk and Fair Value of Financial Instruments

The Company markets its products to numerous customers in various geographic regions, thereby spreading its credit risk related to receivables. See Note 2 Cash and Cash Equivalents as to the discussion of credit risks concerning cash equivalents.

The carrying amounts for cash and cash equivalents, receivables, and payables approximate fair value because of the short maturity, generally less than three months, of these instruments. The carrying value of the Company's long-term debt approximates fair value since the current borrowing rates available for financing are similar in terms.

Note 14. Cumulative Change in Accounting Principle

During fiscal years 1999 and 2000, the Company incurred approximately $208,000 in development costs related to construction of the Nutripure.com website. These costs were originally expensed as incurred. In the accompanying financial statements, these costs have been retroactively capitalized and included in fixed assets at July 31, 2000 in compliance with SOP 98-1 (Statement of Position issued by the Accounting Standards Executive Committee). Of these costs, $79,900 were incurred in prior years and are shown as a change in accounting principle consistent with EITF Issue No. 00-2 - Emerging Issues Task Force Issue titled: Accounting for Web Site Development Costs dated March 16, 2000.

Note 15. Business Segment and Sales Concentrations

In accordance with the provisions of SFAS No. 131, certain information is disclosed based on the way management organizes financial information for making operating decisions and assessing performance. In determining operating segments, the Company reviewed the current management structure reporting to the chief operating decision-maker ('CODM') and analyzed the reporting the CODM receives to allocate resources and measure performance.

The Company's business activities are divided, managed and conducted in two basic business segments, the Water Treatment segment and the Bioscience segment. These two segments were determined by management based upon the inherent differences in the end use of the products, the

inherent differences in the value added processes made by the Company, the differences in the regulatory requirements and the inherent differences in the strategies required to successfully market finished products. The Water Treatment segment includes Commercial Water treatment, Residential Retail products and the Nutripure Water Dealer program. Bioscience includes two new products, Axenohl (Silver Ion Technology) and RoachX (Pest Management).

The Company plans to utilize multiple forms of analysis and control to evaluate the performance of the segments and to evaluate investment decisions. In general, gross margin and Earnings Before Interest Depreciation and Amortization (EBITDA) are deemed to be the most significant measurements of performance, although collection volumes and certain controllable costs also provide useful "early warning signs" of future performance. Because the Company has just recently changed to multiple segments, historical data on gross profit and income from operations is not available. However, the following is a summary of segment revenues at July 31, 2001:

	Fiscal Year End 2001	% Total Sales	Fiscal Year End 2000	%
Water Treatment Division				
Commercial Water Treatment	$1,698,900	71%	$1,597,500	
Residential Retail Water Treatment	$190,800	8%	$29,800	
Nutripure Dealer Program	$167,400	7%	$34,200	
Bioscience Division				
Silver Ion Technology	$320,300	13%	-	
Pest Management Technology	$32,300	1%	-	
Total Revenues	$2,409,700		$1,661,500	

Significant customers primarily consisted of domestic retail chain pharmacies. Sales concentrations to major chain stores were approximately $1,294,600 and export sales were $390,100 for the year ended July 31, 2001. No customer accounted for more than 10% of consolidated sales.

Note 16. Stock Dividend and Share Exchange

In December 1999, Innovative Medical Services formed a wholly owned subsidiary, Nutripure.com, to capitalize on internet commerce opportunities focusing on health and wellness. Total authorized capitalization of the corporation was 50,000,000 shares of common stock at $.001 par value. The Company purchased 8,000,000 shares and the newly formed board of directors of the subsidiary purchased 900,000 shares all at par value. In February of 2000 the corporation raised $550,000 in a private placement of 1,100,000 at $0.50 per share. At this point the minority interest represented 20% of the outstanding common stock of the corporation. Minority interest payable and income from operations were first recognized in the consolidated financial statements in the quarter ended April 30, 2000. On October 24, 2000, the Company issued 183,337 shares of common stock valued at $550,011 ($3.00 per share) in exchange of 1,100,000 shares of Nutripure.com stock representing the 10% minority interest outstanding shares of Nutripure.com, which were originally purchased for $.50 cents per

share. Management of Nutripure.com did not exchange shares. Shares held by Management were eliminated by a reverse split, effective March 16, 2001.

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In January 2000, Innovative Medical Services declared a dividend in kind of Nutripure.com common stock as the Company began the process to spin off Nutripure.com as a separate public company. The record date and distribution date were to be set following completion of the registration of Nutripure.com as a reporting issuer with the Securities and Exchange Commission. Following the announcement of the dividend, however, adverse market conditions for solely internet-based ventures eroded Management's confidence in the viability of a public market for Nutripure.com common stock. Therefore, the Board amended its declaration of a Nutripure.com dividend to a dividend of Innovative Medical Services' common stock and the Company purchased the minority interest in Nutripure.com through an exchange of shares. The Company retains Nutripure.com as an operating division of Innovative Medical Services in order to minimize the substantial administrative expense associated with launching and operating a public company.

On October 26, 2000, Innovative Medical Services announced that the Board of Directors voted to declare a dividend in kind of Innovative Medical Services' common stock. This common stock dividend was declared and distributed in lieu of the previously announced dividend of Nutripure.com shares. The Company distributed one share of Innovative Medical Services' common stock for every fifty shares held of record on November 6, 2000, with fractional shares rounded up to the nearest whole share, for a total of 121,961 shares.

Note 17. Subsequent Events

On August 14, 2001, 20,000 options were exercised bringing the total outstanding shares of common stock to 6,974,699 as of October 29, 2001, the date of the Form 10KSB filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INNOVATIVE MEDICAL SERVICES	DATE
/s/ MICHAEL L. KRALL	August 4, 2003

Michael L. Krall, Chairman/President/CEO

Pursuant to the requirements of the Securities Exchange Act of 1934, this report is signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

NAME	TITLE	DATE
/s/ DENNIS BROVARONE Dennis Brovarone	Director	August 4, 2003
/s/ GARY BROWNELL Gary Brownell	Chief Financial Officer and Director	August 4, 2003
/s/ PATRICK GALUSKA Patrick Galuska	Director	August 4, 2003
/s/ MICHAEL L. KRALL Michael L. Krall	President/CEO and Director	August 4, 2003
/s/ EUGENE PEISER Eugene Peiser	Director	August 4, 2003
/s/ GREGORY BARNHILL Gregory Barhill	Director	August 4, 2003