

Offshore Systems International Ltd.

Interim Consolidated Financial Statements (Unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

(Prepared in accordance with United States Generally Accepted Accounting Principles)

Offshore Systems International Ltd.

U.S. GAAP

Consolidated Balance Sheets (unaudited)

(Incorporated under the laws of the Province of British Columbia, Canada)

(expressed in Canadian dollars)

	As at	
	May 31, 2005	November 30, 2004
	\$	\$
Assets (note 10)		
Current assets		
Cash	13,580,479	251,037
Restricted cash (note 4)	220,000	-
Accounts receivable (note 5)	7,306,453	9,140,478
Inventory (note 6)	893,754	649,427
Prepaid expenses and deposits	325,229	142,752
Deferred income taxes	844,141	780,331
	<hr/>	<hr/>
	23,170,056	10,964,025
Deferred income taxes	31,366	-
Plant and equipment (note 7)	989,952	938,102
Intangible and other assets (note 8)	876,098	408,611
Goodwill (note 3)	397,139	-
	<hr/>	<hr/>
	25,464,611	12,310,738
Liabilities		
Current liabilities		
Bank indebtedness	193,301	-
Accounts payable and accrued liabilities (note 9)	3,139,283	2,596,362
Income taxes payable	209,650	-
Unearned revenue	98,088	79,865
Deferred income taxes	43,767	-
	<hr/>	<hr/>
	3,684,089	2,676,227
Deferred income taxes	77,887	-
	<hr/>	<hr/>
	3,761,976	2,676,227
Stockholders' Equity		
Capital stock		
Authorized (note 11(a))		
Issued and outstanding		
30,262 Class A preference shares – Series A (2004 – 30,262) (note 11(b))	30,262	30,262
390,000 Class B preference shares – Series 2 (2004 – nil) (note 11(c)(ii))	12,649,066	-
nil Class B preference shares – Series 1 (2004 – 57,711) (note 11(c)(i))	-	2,163,621
27,488,074 common shares (2004 - 27,488,074)	20,047,731	20,047,731
	<hr/>	<hr/>
	32,727,059	22,241,614
Warrants (note 11(c))	5,206,844	661,575
Additional Paid in Capital	5,071,694	928,169
Accumulated deficit	(21,330,012)	(14,196,847)
Accumulated other comprehensive income	27,050	-
	<hr/>	<hr/>
	21,702,635	9,634,511
	<hr/>	<hr/>
	25,464,611	12,310,738
Contingencies (note 14)		

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

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Consolidated Statement of Earnings (unaudited) (expressed in Canadian dollars)

	Three Months Ended May 31,		Six Months Ended May 31,	
	2005	2004	2005	2004
	\$	\$	\$	\$
Revenue				
Software	281,521	1,397,516	1,772,689	4,390,779
Geomatics	906,015	998,970	1,213,596	1,717,703
Systems and system components	555,079	227,344	960,808	414,238
Other	139,070	150,005	194,449	280,875
	<hr/>	<hr/>	<hr/>	<hr/>
	1,881,685	2,773,835	4,141,542	6,803,595
Cost of sales	<hr/>	<hr/>	<hr/>	<hr/>
	1,511,334	998,832	2,539,082	2,459,819
Gross profit	<hr/>	<hr/>	<hr/>	<hr/>
	370,351	1,775,003	1,602,460	4,343,776
Expenses				
General and administrative	999,877	925,044	2,035,961	1,655,117
Research and development	461,925	583,351	781,158	1,046,575
Sales and marketing	674,562	735,541	1,226,818	1,528,818
Depreciation and amortization	78,971	55,978	132,717	108,044
Interest	8,687	103	21,403	371
Foreign exchange loss (gain)	50,912	8,101	(22,232)	(16,640)
Technology Partnerships Canada royalty (note 12)	37,867	7,708	92,558	56,634
Technology Partnerships Canada contribution (note 12)	(470,628)	(851,542)	(736,145)	(851,542)
	<hr/>	<hr/>	<hr/>	<hr/>
	1,842,173	1,464,284	3,532,238	3,527,377
Net earnings (loss) before income taxes	<hr/>	<hr/>	<hr/>	<hr/>
	(1,471,822)	310,719	(1,929,778)	816,399
Income tax expense (recovery) (note 15)				
Deferred income tax expense (recovery)	143,189	(217,363)	(95,176)	(496,266)
Current income tax expense	82,756	147,994	82,756	380,786
	<hr/>	<hr/>	<hr/>	<hr/>
	225,945	(69,369)	(12,420)	(115,480)
Net earnings (loss)	<hr/>	<hr/>	<hr/>	<hr/>
	(1,697,767)	380,088	(1,917,358)	931,879
Foreign currency translation adjustment	27,050	-	27,050	-
Comprehensive income (loss)	<hr/>	<hr/>	<hr/>	<hr/>
	(1,670,717)	380,088	(1,890,308)	931,879
Net earnings (loss) available to common shareholders (note 11(e))	<hr/>	<hr/>	<hr/>	<hr/>
	(6,880,135)	303,366	(7,133,165)	778,435
Earnings per share (note 11(e))				
Basic earnings per share	(0.25)	0.01	(0.26)	0.03
Diluted earnings per share	(0.25)	(0.01)	(0.26)	0.01
Weighted average number of common shares outstanding (note 11(e))				
Basic	27,488,074	27,145,769	27,488,074	26,964,789
Diluted	27,488,074	29,771,620	27,488,074	32,525,826

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

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Consolidated Statements of Stockholders' Equity and Accumulated Deficit (unaudited)

For the six months ended May 31, 2005

(Incorporated under the laws of the Province of British Columbia)

(expressed in Canadian dollars)

	Class A Preference Shares		Class B Preference Shares		Common Shares		Warrants		Additional Paid In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Number	Amount \$	Number	Amount \$	Number	Amount \$	Number	Amount \$				
Balance - November 30, 2004	30,262	30,262	57,711	2,163,621	27,488,074	20,047,731	1,393,301	661,575	928,169	(14,196,847)	-	9,634,511
Accretion of discount on Class B preference shares Series 1	-	-	-	33,439	-	-	-	-	-	(33,439)	-	-
Stock-based compensation	-	-	-	-	-	-	-	-	2,524	-	-	2,524
	30,262	30,262	57,711	2,197,060	27,488,074	20,047,731	1,393,301	661,575	930,693	(14,230,286)	-	9,637,035
Net loss for the period	-	-	-	-	-	-	-	-	-	(219,591)	-	(219,591)
Balance - February 28, 2005	30,262	30,262	57,711	2,197,060	27,488,074	20,047,731	1,393,301	661,575	930,693	(14,449,877)	-	9,417,444
Accretion of discount on Class B preference shares Series 1	-	-	-	390,672	-	-	-	-	-	(390,672)	-	-
Repurchase of Class B preference shares Series 1	-	-	(57,711)	(2,587,732)	-	-	-	-	(668,785)	370,967	-	(2,885,550)
Issue of Class B preference shares Series 2 and warrants, net of issue costs	-	-	390,000	12,536,563	-	-	12,395,064	4,545,269	-	-	-	17,081,832
Beneficial conversion feature on Class B preference shares Series 2	-	-	-	(4,796,649)	-	-	-	-	4,796,649	-	-	-
Accretion of discount on Class B preference shares Series 2	-	-	-	112,503	-	-	-	-	-	(112,503)	-	-
Accretion of beneficial conversion feature on Class B preference shares Series 2	-	-	-	4,796,649	-	-	-	-	-	(4,796,649)	-	-
Foreign currency translation adjustment	-	-	-	-	-	-	-	-	-	-	27,050	27,050
Dividends on Class B preference shares series 1	-	-	-	-	-	-	-	-	-	(62,785)	-	(72,785)
Dividends on Class B preference shares series 2	-	-	-	-	-	-	-	-	-	(190,726)	-	(180,726)
Stock-based compensation	-	-	-	-	-	-	-	-	13,137	-	-	13,137
	30,262	30,262	390,000	12,649,066	27,488,074	20,047,731	13,788,365	5,206,844	5,071,694	(19,632,245)	27,050	23,400,402
Net loss for the period	-	-	-	-	-	-	-	-	-	(1,697,767)	-	(1,697,767)
Balance - May 31, 2005	30,262	30,262	390,000	12,649,066	27,488,074	20,047,731	13,788,365	5,206,844	5,071,694	(21,330,012)	27,050	21,702,635

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Consolidated Statement of Cash Flows (unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

	Three Months Ended May 31		Six Months Ended May 31	
	2005 \$	2004 \$	2005 \$	2004 \$
Cash flows from (used in) operating activities				
Net earnings (loss) for the period	(1,697,767)	380,088	(1,917,358)	931,879
Items not affecting cash				
Depreciation and amortization	118,184	83,802	202,854	161,849
Stock based compensation	13,137	33,006	15,661	33,006
Deferred income taxes	143,189	(64,470)	(95,176)	(115,480)
Other	4,420	-	4,420	-
	(1,418,837)	432,426	(1,789,599)	1,011,254
Changes in non-cash working capital items				
Accounts receivable	1,403,092	(1,359,153)	2,383,378	(3,983,827)
Inventory	(31,200)	(81,880)	(244,327)	(51,644)
Prepaid expenses and deposits	114,844	91,029	(182,477)	175,987
Accounts payable and accrued liabilities	1,258,425	312,017	493,011	253,801
Income taxes payable	87,366	-	87,366	-
Unearned revenue	(2,228)	43,993	(7,748)	42,471
Rent payable	-	(133,942)	-	(133,942)
Accrued long term royalties	-	(46,845)	-	(93,690)
	2,830,299	(1,174,781)	2,529,203	(3,790,844)
	1,411,462	(742,355)	739,604	(2,779,590)
Cash flows from (used in) financing activities				
Issue of Common shares	-	264,239	-	315,416
Share issue cost – Class B preference shares – Series 1	-	(20,115)	-	(20,115)
Issue of Class B preference shares – Series 2 and warrants, net of issue costs	17,081,832	-	17,081,832	-
Repurchase of Class B preference shares – Series 1	(2,885,550)	-	(2,885,550)	-
Class B preference share dividends declared and paid	(166,945)	-	(253,511)	(91,866)
	14,029,337	244,124	13,942,771	203,435
Cash flows from (used in) investing activities				
Purchase of Mapcon Mapping Consultants Inc, net of cash acquired (note 3)	(1,176,241)	-	(1,176,241)	-
Advances from (payment to) operating line of credit	(355,093)	-	193,301	-
Increase in restricted cash	(220,000)	-	(220,000)	-
Additions to plant and equipment	(77,955)	(35,666)	(105,379)	(65,364)
Additions to intangibles	(58,081)	(166,093)	(71,664)	(179,031)
	(1,887,370)	(201,759)	(1,379,983)	(244,395)
Translation adjustment	27,050	-	27,050	-
Increase (decrease) in cash	13,580,479	(699,190)	13,329,442	(2,820,550)
Cash – Beginning of period	-	1,716,195	251,037	3,837,555
Cash – End of period	13,580,479	1,017,005	13,580,479	1,017,005

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Notes to the Consolidated Financial Statements (unaudited)
Three and Six Months Ended May 31, 2005 and 2004
(expressed in Canadian dollars)

1 Basis of presentation

These unaudited interim consolidated financial statements have been prepared by management and include the accounts of Offshore Systems International Ltd. and its subsidiaries, collectively referred to as the Company. These unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and all amounts herein have been expressed in Canadian dollars unless otherwise noted. These unaudited interim consolidated financial statements do not include all the information and footnote disclosures required for compliance with U.S. GAAP for annual financial statements applied on a consistent basis. These unaudited interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. These unaudited interim consolidated financial statements conform in all material respects with Canadian generally accepted accounting principles ("Canadian GAAP"), except as disclosed in notes 19 and 20.

The preparation of these unaudited interim consolidated financial statements and the accompanying notes requires management to make estimates and assumptions that affect the amounts reported. In the opinion of management, these unaudited interim consolidated financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to state fairly the results for the periods presented. Actual results could vary from these estimates and the operating results for the interim period presented are not necessarily indicative of the results expected for the full year.

2 Accounting changes

a) Changes in accounting policies relating to the adoption of U.S. GAAP

Effective December 1, 2004, the Company elected to report its consolidated financial statements in conformity with U.S. GAAP. The Company continues to report all amounts in Canadian dollars. All accounting policies are the same as described in note 2 to the Company's audited financial statements for the year ended November 30, 2004, which were prepared accordance with Canadian GAAP filed with the appropriate securities commissions except for the following which have been retroactively adopted to comply with U.S. GAAP:

Stock Based Compensation

The Company grants stock options to employees, officers, directors, and persons providing management or consulting services to the Company pursuant to the stock option plans described in note 11(d). As allowed by Statement of Financial Accounting Standard 123 Accounting for Stock Based Compensation, ("SFAS 123") as amended by Statement of Financial Accounting Standard 148, the Company followed the Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, ("APB 25") and presented pro forma information that is required by SFAS 123. APB 25 requires compensation cost for stock-based employee compensation plans to be recognized over the vesting period based on the difference, if any, between the quoted market price of the Company's stock as of the grant date and the amount an employee must pay to acquire the stock.

For stock options granted to non-employees, the Company follows the requirements of SFAS 123 and related interpretations. Costs are measured at the estimated fair value of the consideration received or the estimated fair value of the options issued, whichever is more reliably measurable. The value of the options issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services.

Beneficial conversion feature and accretion of discount on preference shares issued with attached warrants

For U.S. GAAP purposes, during the fiscal year 2003 and the three months ended May 31, 2005 the Company recorded beneficial conversion features of \$668,785 and \$4,796,649 on the issuance of Class B preference shares Series 1 and 2, respectively, as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. In both cases, the conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of

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Notes to the Consolidated Financial Statements (unaudited)

Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

the beneficial conversion feature. For both the Series 1 and Series 2 Class B preference shares, the discount on these shares that resulted from the allocation of the gross proceeds to the Class B preference shares and to the attached warrants is accreted over the five-year life of the warrants. This resulted in an accretion of \$503,175 and \$536,614 to Deficit for the three and six months ended May 31, 2005 respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004 respectively).

Under Canadian GAAP, there is not a requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants.

Derivative Financial Instruments

Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value; however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP, in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivative are either offset against the fair value of assets, liabilities or firm commitments through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income.

b) Recent pronouncements

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 123R, Share-Based Payment, ("SFAS 123R") a revision to SFAS 123. SFAS 123R requires all share-based payments to be recognized in the financial statements based on their values using either a modified-prospective or modified-retrospective transition method. The standard no longer permits pro-forma disclosure or prospective recognition. Accordingly, from the date of adoption, December 1, 2005, of the revised standard, the Company will be required to recognize compensation expense for all share-based payments based on grant-date fair value, including those granted, modified or settled prior to September 1, 2005, that were previously disclosed on a pro-forma basis. The Company is currently evaluating the impact of SFAS 123R on its consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, "Exchange of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions" ("SFAS No. 153"). The amendments made by SFAS No. 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is to be applied prospectively and is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company is currently evaluating the impact of SFAS No. 153 on its consolidated financial statements.

3 Acquisition

On April 8, 2005, the Company acquired all of the issued and outstanding shares of Mapcon Mapping Consultants Inc. ("Mapcon") of Salt Lake City, Utah for \$1,347,382 (USD\$1,113,907). The acquisition was effective April 1, 2005. Mapcon is a privately held land mapping company in the U.S. geomatics (digital and electronic chart data production) market. The results of Mapcon's operations have been included in the consolidated financial statements commencing April 1, 2005.

The following table summarizes the fair value of the assets acquired and liabilities assumed by the Company at April 1, 2005, the date of acquisition. The acquisition was accounted for using the purchase method whereby assets acquired and liabilities assumed were recorded at their fair values at April 1, 2005. The excess of the purchase price over the fair market value was recorded as goodwill. The allocation of the purchase price is preliminary and the final allocation may be subject to refinement in the next 12 months. The purchase price is subject to certain adjustments related to working capital and the achievement of a minimum level of sales bookings against a specific contract.

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Notes to the Consolidated Financial Statements (unaudited)
Three and Six Months Ended May 31, 2005 and 2004
(expressed in Canadian dollars)

	\$
Assets	
Current assets	819,568
Equipment	208,791
Intangible assets	350,784
Goodwill	382,712
Total assets acquired	<u>1,761,855</u>
Liabilities	
Current liabilities not including deferred tax liabilities	198,165
Deferred tax liabilities – current	42,177
Deferred tax liabilities – long term	75,058
Total liabilities assumed	<u>315,400</u>
Net assets acquired (cash consideration)	1,347,382
Direct acquisition costs incurred by the Company	99,073
Cash of acquired operations	270,214

The following table presents details of the purchased intangible assets:

	Estimated useful life	Amount \$
Customer contract	16 months	157,248
Customer relationships	4 to 10 years	193,536

The pro forma Offshore Systems International Ltd. consolidated operating results assuming the acquisition of Mapcon had occurred as of December 1, 2004, are as follows:

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
	\$	\$	\$	\$
Revenue	2,024,702	3,049,028	4,660,036	7,353,981
Earnings (loss)	(1,651,780)	417,492	(1,767,503)	1,006,686
Earnings (loss) per share – basic	(0.25)	0.01	(0.25)	0.03
Earnings (loss) per share – diluted	(0.25)	0.00	(0.25)	0.01

4 Restricted cash

Restricted cash consists of cash pledged with a bank as collateral for bid bonds.

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Notes to the Consolidated Financial Statements (unaudited)
Three and Six Months Ended May 31, 2005 and 2004
(expressed in Canadian dollars)

5 Accounts receivable

	May 31, 2005	November 30, 2004
	\$	\$
Trade	2,125,855	4,679,207
Unbilled revenue	4,636,448	4,116,828
Technology Partnerships Canada contribution (note 12)	470,628	257,266
Other	109,884	111,234
Allowance for doubtful accounts	(36,362)	(24,057)
	<u>7,306,453</u>	<u>9,140,478</u>

The Company has collateralized its accounts receivable as security against its operating line facility.

6 Inventory

	May 31, 2005	November 30, 2004
	\$	\$
Materials and components	714,429	638,127
Finished goods	165,451	11,300
Work in process	13,874	-
	<u>893,754</u>	<u>649,427</u>

7 Plant and equipment

	<u>May 31, 2005</u>		
	Cost	Accumulated Depreciation	Net
	\$	\$	\$
Equipment	4,044,913	3,126,015	918,898
Furniture and fixtures	138,283	103,088	35,195
Leasehold improvements	234,175	198,316	35,859
	<u>4,417,371</u>	<u>3,427,419</u>	<u>989,952</u>
	<u>November 30, 2004</u>		
	Cost	Accumulated Depreciation	Net
	\$	\$	\$
Equipment	3,910,980	3,038,921	872,059
Furniture and fixtures	131,095	94,705	36,390
Leasehold improvements	222,737	193,084	29,653
	<u>4,264,812</u>	<u>3,326,710</u>	<u>938,102</u>

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(expressed in Canadian dollars)

8 Intangible and other assets

	May 31, 2005		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	1,141,984	621,752	520,232
Customer contract	163,176	20,397	142,779
Customer relationships	200,832	5,029	195,803
Licenses and patents	57,267	39,983	17,284
	<u>1,563,259</u>	<u>687,161</u>	<u>876,098</u>

	November 30, 2004		
	Cost \$	Accumulated Amortization \$	Net \$
Computer software	\$ 936,591	\$ 546,190	\$ 390,401
Licenses and patents	57,267	39,057	18,210
	<u>\$ 993,858</u>	<u>\$ 585,247</u>	<u>\$ 408,611</u>

9 Accounts payable and accrued liabilities

	May 31, 2005 \$	November 30, 2004 \$
Trade	1,285,005	\$ 1,343,129
Accrued employee costs	637,425	572,589
Accrued liabilities	1,125,162	282,227
Accrued royalties (note 12)	91,691	311,851
Class B preference shares Series 1 dividends declared and unpaid	-	86,566
	<u>3,139,283</u>	<u>\$ 2,596,362</u>

10 Credit facilities

In February 2005, the Company renewed certain credit facilities with a Canadian chartered bank, which consist of an operating line, a foreign exchange forward contract facility and standby letters of credit. The operating line bears interest at the chartered bank's prime lending rate plus 0.5% with interest payable monthly. The prime lending rate at May 31, 2005 was 4.25% (2004 – 4.25%). The standby letters of credit are denominated in U.S. dollars and bear interest at the rate of 1.25% per annum. Funds drawn on the operating line and the standby letters of credit are repayable on demand. As of May 31, 2005, letters of credit, relating principally to customer contracts, amounting to U.S. \$nil (2004 – U.S. \$818,398) and Australian

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\$1,605,038 (2004 – Australian \$2,750,000) have been issued. The Company utilizes letters of credit to back certain performance obligations with its customers.

The maximum amount(s) available to the Company under the operating line is \$2,000,000 and under the foreign exchange forward contract facility are U.S. \$2,000,000 and Australian \$2,500,000. The credit facilities are collateralized by an assignment of accounts receivable, a general security agreement from the Company and its subsidiaries Offshore Systems Ltd., OSI Geomatics Ltd. and OSI Geomatics Inc. In addition, the Company is required to meet certain covenants as outlined in the credit facilities agreement. As at May 31, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$818,398) and Australian \$1,605,038 (2004 – \$2,750,000).

11 Capital Stock

(a) Authorized

100,000,000 Class A preference shares with no par value, issuable in series, of which:

10,000,000 shares are designated Series A voting non-cumulative, retractable, convertible at a ratio of 1:1, 1% preference shares

100,000,000 Class B preference shares with a par value of \$50 each, issuable in series, of which:

10,000,000 share are designated Series 1 voting, cumulative, convertible shares at a ratio of 1:45.5, 6% preference shares, and

10,000,000 are designated Series 2 voting, cumulative, convertible shares at a ratio of 1:58.82, 7% preference shares

Unlimited Class C preference shares without par value, issuable in series

Unlimited common shares without par value

(b) Class A preference shares

The Company has 30,262 (November 30, 2004 - 30,262) Class A preference shares outstanding that have a carrying value of \$30,262 for financial statement purposes. These Class A preference shares are being held in escrow but are no longer subject to any escrow restrictions and may be converted at any time into common shares of the Company, by notice in writing from the holders.

(c) Class B preference shares

(i) Series 1

The Company completed a private placement on February 13, 2003 consisting of 61,244 units for total gross proceeds of \$3,004,200. Each unit consists of one Class B Series 1 preference share and 22.75 common share purchase warrants exercisable at \$1.10. The preference shares are voting convertible shares at a ratio of 1:45.5 and have a cumulative dividend of 6% per annum. The Company has the right to redeem the preference shares after five years. The share purchase warrants are convertible to common shares at a ratio of 1:1 and expire five years after issue. The private placement incurred share issue costs of \$297,320.

The gross proceeds of \$3,004,200 were allocated between the preference shares and warrants based on their relative fair value at the date of issuance. The \$2,342,625 fair value of the preference shares has been estimated based on the fair value of the underlying common shares. The \$661,575 fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate of 2.7%, (ii) expected volatility of 66%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%. During the fiscal year 2003, the Company has recorded a beneficial conversion feature of \$668,785 in dividends calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. The conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The preference share discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the warrants. This resulted in an accretion of \$390,672 and \$33,439

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to accumulated deficit for the three and six months ended May 31, 2005 respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004 respectively). During fiscal 2004 3,533 Class B Series 1 preference shares were converted into common shares.

On April 11, 2005, 57,711 Class B Series 1 preference shares were repurchased by the Company at their par value of \$50 per share for aggregate cash consideration of \$2,885,550. The unamortized discount in the amount of \$390,672 as of the repurchase date was amortized and accreted to the Class B series 1 preference shares and the beneficial conversion feature of \$668,785 was deducted from additional paid in capital. The repurchase resulted in a decrease of \$370,967 to deficit.

(ii) Series 2

On April 11, 2005, the Company completed a private placement consisting of 19,500 units for total gross proceeds of \$19,500,195. The issue price was \$1,000.01 per unit. Each unit consist of 20 voting Class B preference shares Series 2 ("Preference Shares") and 588 share purchase warrants ("Warrants"). The Preference Shares entitle the holders to receive a fixed preferential cumulative 7% dividend payable semi-annually. Each Preference Share is convertible at the option of the holder at any time into 58.82 of the Company's common shares, calculated by dividing the issue price of \$50.00 for each Preference Share by the conversion price of \$0.85. Each Warrant entitles the holder to purchase one of the Company's common shares at the exercise price of \$0.85 for a period of five years. Fees for advisory, investment banking and legal and other professional services in connection with this private placement were paid in the amount of \$2,418,363 and 929,064 warrants were issued to an investment bank and related party (note 13) in connection with the private placement. The fair value of the finder's fee warrants was estimated to be \$0.47 per warrant, using the Black-Scholes option pricing model, and has been recognized as a share issue cost.

The gross proceeds of \$19,500,195 were allocated between the Preference Shares and Warrants based on their relative fair value at the date of issuance. The \$20,188,235 fair value of the preference shares has been estimated based on the fair value of the underlying common shares. The \$5,389,020 fair value of the warrants has been estimated using the Black-Scholes option pricing model. Assumptions used in the pricing model included: (i) risk free interest rate of 2.88%, (ii) expected volatility of 59%, (iii) an estimated life of 5 years and (iv) an expected dividend rate of 0%. The Company has recorded a beneficial conversion feature of \$4,796,649 as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the Preference Shares. The conversion feature of the Preference Shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. The Preference Share discount that resulted from the allocation of the gross proceeds is accreted over the five-year life of the Warrants. This resulted in an accretion of \$112,503 to accumulated deficit for the three and six months ended May 31, 2005.

Each Class B Series 2 Preference Share entitles the holder to one vote either in person or by proxy at any general meeting of the shareholders of the Company. The Company has the right to require the shareholders of the Preference Shares to convert each such share into 58.82 Common Shares if (i) at any time after 13 months following the issuance of the Preference Shares, the closing trade price of the Company's common shares exceeds \$2.13 for at least 20 consecutive trading days, or (ii) at any time, the Company completes a firm public underwritten offering of its common shares for more than \$40,000,000 at a price per common share greater than \$1.70. The Preference Shares are redeemable at the option of the Company at any time after the third anniversary of the issuance date for an amount equal to the original issuance price plus a premium of 20% of the original issue price. The Preference Shares are not subject to any right of redemption at the option of the holder.

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(d) Stock option plans

The Company has established three stock option plans under which options to purchase common shares may be granted to directors, officers and employees of the Company and to any other person or Company permitted by the applicable regulatory authorities to purchase unissued common shares. The number of common shares authorized for grant under the Company's stock option plans is 10,930,732, of which 4,375,494 are available for granting. The exercise price of options granted pursuant to the plans may not be less than the market price of the common shares at the time of grant. The plans provide that options may be granted with vesting periods and expiry dates at the discretion of the board of directors. Options granted to directors and executives vest over periods ranging from immediately to three years and options granted to employees vest one year after the date granted.

A summary of the Company's stock options outstanding and exercisable at May 31, 2005 is as follows:

Range of exercise prices \$	Number outstanding at May 31, 2005	Options outstanding		Options exercisable	
		Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at May 31, 2005	Weighted average exercise price \$
0.75 – 1.00	768,000	3.94	0.85	618,000	0.87
1.01 – 1.35	1,620,947	1.00	1.06	1,474,947	1.06
1.36 – 1.41	60,000	0.05	1.41	60,000	1.41
0.75 – 1.41	2,448,947	1.90	1.00	2,252,947	1.01

Stock-based compensation

For the three and six months ended May 31, 2005, the Company incurred non-cash stock-based compensation expense of \$13,137 and \$15,661 respectively, related to stock options granted to third parties (three and six month period ended May 31, 2004 - \$33,006). The expense was included in general and administrative costs and was recorded in additional paid-in capital.

The fair value of stock options was estimated using the Black-Scholes option pricing model using the following weighted average assumptions by grant year:

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.78%	2.21%	2.78%	2.20%
Volatility	41%	58%	41%	83%
Estimated average option lives	1.38 years	3.00 years	1.38 years	1.10 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

Pro forma disclosure

The Company applies the intrinsic value method for employee stock options granted as prescribed in APB 25. Had compensation cost been determined using the fair value approach set forth in SFAS 123, the Company's earnings for the three and six months ended May 31, 2005 and 2004 and earnings (loss) per share would have been in accordance with the pro forma amounts indicated below:

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	For the three months ended		For the six months ended	
	May 31, 2005 \$	May 31, 2004 \$	May 31, 2005 \$	May 31, 2004 \$
Earnings (loss) as reported	(1,697,767)	380,088	(1,917,358)	931,879
Add: Stock-based compensation cost	13,137	33,006	15,661	33,006
Less: Pro forma stock-based compensation cost	(220,582)	(120,724)	(253,051)	(127,024)
Pro forma income (loss)	(1,905,212)	292,370	(2,154,748)	837,861
Pro forma basic earnings (loss) per share	(0.26)	0.01	(0.27)	0.03
Pro forma diluted earnings (loss) per share	(0.26)	(0.01)	(0.27)	0.01
Weighted average number of common shares outstanding – basic	27,488,074	27,145,769	27,488,074	26,964,789
Weighted average number of common shares outstanding – diluted	27,488,074	29,771,620	27,488,074	32,525,826

The fair value of stock options was estimated using the Black-Scholes option pricing model using the following weighted average assumptions by grant year:

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.85%	2.21%	2.85%	2.21%
Volatility	54%	58%	54%	58%
Estimated average option lives	4.06 years	3.00 years	4.06 years	3.00 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

(e) Earnings per share

	Three Months Ended May 31		Six Months Ended May 31	
	2005 \$	2004 \$	2005 \$	2004 \$
Basic earnings (loss) per share				
Net earnings (loss)	(1,697,767)	380,088	(1,917,358)	931,879
Less: Accretion of discount on Class B preference shares Series 1	(390,672)	(33,439)	(424,111)	(66,878)
Accretion of beneficial conversion feature on Class B preference shares Series 2	(4,796,649)	-	(4,796,649)	-
Accretion of discount on Class B preference shares Series 2	(112,503)	-	(112,503)	-
Class B preference share dividends Series 1	(62,785)	(43,283)	(62,785)	(86,566)
Class B preference share dividends Series 2	(190,726)	-	(190,726)	-
Add: Excess of carrying value of Class B preference shares series 1 and beneficial conversion feature over repurchase consideration paid.	370,967	-	370,967	-
Net earnings (loss) available to common shareholders	(6,880,135)	303,366	(7,133,165)	778,435
Weighted average number of common shares outstanding	27,488,074	27,145,769	27,488,074	26,964,789
Basic earnings (loss) per share	(0.25)	0.01	(0.26)	0.03

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	Three Months Ended May 31		Six Months Ended May 31	
	2005	2004	2005	2004
	\$	\$	\$	\$
Diluted earnings (loss) per share				
Net earnings	(1,697,767)	380,088	(1,917,358)	931,879
Less: Accretion of discount on Class B preference shares Series 1	(390,672)	(531,638)	(424,111)	(565,078)
Accretion of beneficial conversion feature on Class B preference shares Series 2	(4,796,649)	-	(4,796,649)	-
Accretion of discount on Class B preference shares Series 2	(112,503)	-	(112,503)	-
Class B preference share dividends Series 1	(62,785)	-	(62,785)	-
Class B preference share dividends Series 2	(190,726)	-	(190,726)	-
Add: Excess of carrying value of Class B preference shares series 1 and beneficial conversion feature over repurchase consideration paid.	370,966	-	370,967	-
Net earnings (loss) available to common shareholders	<u>(6,880,135)</u>	<u>(151,550)</u>	<u>(7,133,165)</u>	<u>366,801</u>
Weighted average number of common shares outstanding	27,488,074	27,145,769	27,488,074	26,964,789
Dilutive effect of Class A preference shares – Series A (*1)	-	-	-	30,262
Dilutive effect of Class B preference shares – Series 1	-	2,625,851	-	2,625,851
Dilutive effect of Class B preference shares – Series 2 (*2)	-	-	-	-
Dilutive effect of warrants (*3)	-	-	-	1,393,301
Dilutive effect of stock options (*1)	-	-	-	1,511,623
Adjusted weighted average number of common shares outstanding	<u>27,488,074</u>	<u>29,771,620</u>	<u>27,488,074</u>	<u>32,525,826</u>
Diluted earnings (loss) per share	<u>(0.25)</u>	<u>(0.01)</u>	<u>(0.26)</u>	<u>0.01</u>

(*1) The Class A preference shares – Series A and stock options were anti-dilutive for the purposes of calculating diluted earnings per share for the three and six months ended May 31, 2005 and for the three months ended May 31, 2004.

(*2) The Class B preference shares – Series 2 were anti-dilutive for the purposes of calculating diluted earnings per share for the three and six months ended May 31, 2005.

(*3) For the three and six months ended May 31, 2005, the outstanding 13,788,365 warrants were not included in the diluted earnings per share calculation as they were anti-dilutive. For the three months ended May 31, 2004, the outstanding 1,393,301 warrants were not included in the diluted earnings per share calculation as they were anti-dilutive.

12 Technology Partnerships Canada

On April 26, 2004, the Company entered into an agreement with Technology Partnerships Canada (“TPC”) whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2007. The maximum eligible contribution by TPC is \$3,768,391. As at May 31, 2005, the Company has claimed \$2,207,559 of assistance under the agreement. Accounts receivable at May 31, 2005 includes \$470,628 of amounts receivable from TPC in connection with these claims (November 30, 2004 – \$257,266).

In addition, under the April 26, 2004 agreement, the Company is required to pay a royalty of 1.4% on annual gross Navigation Systems and Applications revenue for the period January 1, 2006 to December 31, 2008 and a royalty of 2.5% on

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annual gross Navigation Systems and Applications revenue for the period January 1, 2009 to December 31, 2013. Royalty payments will continue until the cumulative royalties paid or payable to December 31, 2013 are at least \$6,079,176 or until December 31, 2017. No amounts for royalty payments in connection with this agreement have been recorded in the financial statements.

On November 15, 1999, the Company entered into an agreement with TPC whereby TPC granted financial assistance to the Company for the purpose of funding research and development activities to be completed on or before March 31, 2003. Under the agreement with TPC, the Company was eligible to receive contributions to a maximum of \$4,000,177 over the period from December 23, 1998 to March 31, 2003. As of March 31, 2003, the Company had received the maximum allowed under the agreement. There are no amounts recorded in accounts receivable with respect to these claims.

In addition, under the November 15, 1999 agreement, the Company is required to pay a royalty of 3% on annual gross Navigation Systems and Applications business unit revenue for the period December 1, 1999 to November 30, 2008. The Company has paid royalties of \$1,242,022 to date (November 30, 2004 – \$929,303) and has accrued royalties of \$91,691 at May 31, 2005 (November 30, 2004 - \$311,851). Royalty payments will continue until the cumulative royalties paid or payable to November 30, 2008 are at least \$7,810,230 or until November 30, 2014.

Although the Company believes that its submissions for TPC funding meet the terms and conditions of the TPC agreements, the final determination may be subject to audit by government authorities in the ordinary course of business. During fiscal year 2004, the Company was subject to an audit by government authorities. The results of the audit have not been communicated to the Company. The Company has no reason to believe that the outcome of the audit will have a material impact on the Company's financial results.

If the Company causes an event of default, as defined in the agreement, TPC can suspend or terminate any obligation to contribute to the costs of the project or require the Company to repay all or part of the contributions made, together with interest, from the date of demand.

13 Related party transactions

On April 11, 2005, Mr. E. Brinton Coxe, a director of the Company, assisted the Company in structuring and arranging the private placement financing (note 11(c)(ii)). In consideration for his services, the Company paid him compensation of \$815,908 and 350,000 common share purchase warrants. The cash compensation of \$815,908 paid to Mr. Coxe included an adjustment in the amount of \$15,908 to reflect exchange rate changes between the U.S. dollar and Canadian Dollar. Mr. Coxe has also participated in the financing by purchasing 100 units personally.

On April 8, 2005, Gerald J. Shields was elected to the Company's Board of Directors and became a related party as he provides legal services to the Company through a law firm in which he has an interest.

14 Contingencies

In July 2002, two of the Company's subsidiaries, Offshore Systems Ltd. and OSI Geomatics Ltd., and four employees became subject to a lawsuit for an undisclosed amount by Triathlon Ltd., a subsidiary of MacDonald, Dettwiler and Associates Ltd., related to use of confidential information and breach of fiduciary duty. No amount has been accrued at May 31, 2005 in respect of these claims because the potential liability for the claims and the amount of damages, if any, cannot be reasonably estimated. Management believe that the claims are without merit.

15 Income taxes

The Company is subject to income taxes in Canada and the United States and the use of estimates is required in determining the Company's provision for income taxes. Although the Company believes its tax estimates are reasonable, the ultimate tax determination involves significant judgement that could become subject to audit by tax authorities in the ordinary course of business. The effective rate used to record income tax expense for the three and six months ended May 31, 2005 differed

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from the Canadian federal and provincial combined statutory tax rate primarily due to the change in valuation allowance to reflect those future tax benefits that were more likely than not to be realized, future income tax payments that will result from the payment of Class B preference share dividends and, also, items not deductible for income tax purposes. The change in effective tax rate from 2004 to 2005 was due primarily to the effect of the change in valuation allowance.

At May 31, 2005, the Company adjusted its valuation allowance against deferred tax assets to reflect the amount of the future tax benefit that was more likely than not to be realized. A valuation allowance continues to be provided against those deferred tax assets for which there is uncertainty of future realization.

	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Deferred income tax expense (recovery)	143,189	(217,363)	(95,176)	(496,266)
Current income tax expense	82,756	147,994	82,756	380,786
Income tax expense (recovery)	<u>225,945</u>	<u>(69,369)</u>	<u>(12,420)</u>	<u>(115,480)</u>
Effective tax rate	(15%)	(22%)	(1%)	(14%)

16 Segmented information

The Company's reportable segments are as outlined below. Accounting policies used by these segments are the same as those described in the significant accounting policies as disclosed in note 2 of the Company's audited consolidated annual financial statements for the year ended November 30, 2004 prepared in accordance with U.S. GAAP. The Company defines reportable segments as components of the Company about which separate financial information is available and which is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

	Three Months Ended May 31, 2005			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	956,378	19,412	905,895	1,881,685
Gross profit	105,823	17,446	247,082	370,351
Technology Partnerships Canada - net	(432,761)	-	-	(432,761)
Interest expense	8,596	-	91	8,687
Income tax expense (recovery)	118,934	-	107,011	225,945
Net earnings (loss)	(999,747)	(211,722)	(486,298)	(1,697,767)
Property, plant and equipment expenditures	64,969	-	12,986	77,955
Intangible expenditures	5,519	-	52,562	58,081
Depreciation and amortization	52,003	1,074	65,107	118,184

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	Six Months Ended May 31, 2005			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	2,897,155	30,912	1,213,475	4,141,542
Gross profit	1,303,913	27,457	271,090	1,602,460
Technology Partnerships Canada - net	(643,587)	-	-	(643,587)
Interest expense	19,827	-	1,576	21,403
Income tax expense (recovery)	(95,176)	-	82,756	(12,420)
Net earnings (loss)	(810,017)	(384,548)	(722,793)	(1,917,358)
Property, plant and equipment expenditures	92,393	-	12,986	105,379
Intangible expenditures	15,867	1,213	54,584	71,664
Depreciation and amortization	104,896	2,149	95,809	202,854

	Three Months Ended May 31, 2004			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	1,691,056	39,986	1,042,793	2,773,835
Gross profit	1,252,341	29,699	492,963	1,775,003
Technology Partnerships Canada - net	(782,654)	(61,180)	-	(843,834)
Interest expense	37	-	66	103
Income tax recovery	(69,369)	-	-	(69,369)
Net earnings (loss)	446,985	(214,047)	147,150	380,088
Property, plant and equipment expenditures	23,737	11,929	-	35,666
Intangible expenditures	10,269	-	155,824	166,093
Depreciation and amortization	55,811	538	27,453	83,802

	Six Months Ended May 31, 2004			
	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
Revenue	4,971,154	68,304	1,764,137	6,803,595
Gross profit	3,648,387	48,667	646,722	4,343,776
Technology Partnerships Canada - net	(733,728)	(61,180)	-	(794,908)
Interest expense	228	-	143	371
Income tax recovery	(115,480)	-	-	(115,480)
Net earnings (loss)	1,417,635	(525,346)	39,590	931,879
Property, plant and equipment expenditures	50,955	14,409	-	65,364
Intangible expenditures	20,062	-	158,969	179,031
Depreciation and amortization	110,614	615	50,620	161,849

Total assets employed	Navigation Systems	Applications	Geomatics	Total
	\$	\$	\$	\$
As at May 31, 2005	22,491,606	16,421	2,956,584	25,464,611
As at November 30, 2004	10,562,064	17,357	1,731,317	12,310,738

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Geographically, revenues reported are based on the location of the Company's customers.

	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Europe	293,678	415,953	1,920,679	2,480,974
Australia/New Zealand	477,049	1,019,610	788,936	1,967,873
United States	631,572	832,518	832,285	1,728,111
Canada	479,386	505,754	599,642	626,637
Total	<u>1,881,685</u>	<u>2,773,835</u>	<u>4,141,542</u>	<u>6,803,595</u>

Geographically, plant and equipment and intangible and other assets are reported based on location. At May 31, 2005 and November 30, 2004, all of the Company's plant and equipment and intangible and other assets were located in Canada and the U.S. as follows:

	Canada		United States	
	May 31, 2005	November 30, 2004	May 31, 2005	November 30, 2004
	\$	\$	\$	\$
Plant and equipment	932,741	938,102	57,212	-
Intangible and other assets	359,599	408,611	913,636	-
Total	<u>1,292,340</u>	<u>1,346,713</u>	<u>970,848</u>	<u>-</u>

17 Financial instruments

Fluctuations in foreign currency exchange rates

The Company enters into transactions denominated in U.S. dollars, Australian dollars and Euros and as such its revenue, expenses, monetary assets and liabilities will be affected by fluctuations in the various currencies relative to its functional currency, the Canadian dollar.

The Company uses foreign exchange forward contracts to hedge transactions denominated in U.S. dollars, Australian dollars and Euros. The purpose of the Company's hedging activities is to reduce the level of exposure to exchange rate movements. At May 31, 2005, the Company had foreign exchange forward contracts maturing in the following periods to sell Australian \$1,605,038 (May 31, 2004 – \$2,750,000). As at May 31, 2005, the Company had drawn on its foreign exchange contract facility in the amount of U.S. \$nil (2004 – U.S. \$818,398) and Australian \$1,605,038 (2004 – \$2,750,000). The exchange rates set in the forward exchange contracts ranged between 0.9486 to 0.9578 for Australian \$1.00. The contracts mature between June and July 2005.

18 Financial guarantees

The Company utilizes letters of credit to back certain performance obligations with its customers. The standby letters of credit are repayable on demand after certain conditions have been met. As of May 31, 2005, one letter of credit, relating principally to a customer contract, had been issued for Australian \$283,886 (November 30, 2004 – Australian \$283,886).

19 Reconciliation of generally accepted accounting principles

The Company prepares its unaudited interim consolidated financial statements in accordance with U.S. generally accepted accounting principles which, as applied in these unaudited interim consolidated financial statements, conform in all material respects to Canadian GAAP, except for the differences below as follows:

(a) Under Canadian GAAP, for stock option awards granted by the Company after December 1, 2003, the Company is required to recognize compensation when stock options are granted to employees and directors under stock option plans with no cash settlement feature based on the fair value method. As permitted by the standard, the Company had applied this change prospectively for new awards granted on or after December 1, 2003. Under U.S. GAAP, the Company accounts for stock based compensation to employees and directors in accordance with the intrinsic value method of the Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees".

(b) Under Canadian GAAP, there is not a requirement to record the beneficial conversion feature and accretion of discount when preference shares are issued with attached warrants. For U.S. GAAP purposes, during the fiscal year 2003 and the three and six months ended May 31, 2005 the Company recorded beneficial conversion features of \$668,785 and \$4,796,649 on the issuance of Class B preference shares Series 1 and 2, respectively as a reduction to the net earnings available to common shareholders calculated on the effective conversion price of the preference shares to common shares based on the proceeds allocated to the preference shares. In both cases, the conversion feature of the preference shares vested immediately and the Company recorded the accretion of the full amount of the beneficial conversion feature. For both the Series 1 and Series 2 Class B preference shares, the discount on these shares that resulted from the allocation of the gross proceeds to the Class B preference shares and to the attached warrants is accreted over the five-year life of the warrants. This resulted in an accretion of \$503,175 and 536,614 to deficit for the three and six months ended May 31, 2005, respectively (\$33,439 and \$66,878 for the three and six months ended May 31, 2004, respectively).

(c) Under Canadian GAAP, there is a requirement for derivatives outside of hedging relationships to be recognized on the balance sheet at fair market value, however for derivatives in hedging relationships, Canadian GAAP does not specify how such derivatives should be recorded. As a result, under Canadian GAAP in some instances derivatives may not be recorded on the balance sheet. Under U.S. GAAP it is required that all derivatives be recorded as assets or liabilities, measured at fair value. Derivatives that are not hedges are adjusted to fair value through income. If the derivative is a hedge, depending upon the nature of the hedge, changes in the fair value of the derivative are either offset against the fair value of assets, liabilities or firm commitments through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a derivative's change in fair value is immediately recognized into income. With respect to the ineffective portion of derivative's changes in fair value, the Company has recorded a foreign exchange loss amount of \$7,748 for the three and six months ended May 31, 2005 under U.S. GAAP which has not been recorded under Canadian GAAP.

(d) Under Canadian GAAP, the Company was not required to record stock based compensation for options granted to third parties prior to December 1, 2001. Under U.S. GAAP, the Company is required to record stock based compensation for options granted to third parties based on the fair value method as required by SFAS 123 retroactive for all prior periods. As a result, these stock based compensation transactions, result in differences when compared to the same balances as previously reported under Canadian GAAP.

(e) For Canadian GAAP financial statement purposes, the Company's 30,262 (November 30, 2004 - 30,262) Class A preference shares have been presented at a nominal value. For U.S. GAAP financial statement purposes, these shares have been presented at a value of \$30,362.

(f) For Canadian GAAP financial statement purposes, the Company has recorded a cumulative translation adjustment of \$23,091 which is a separate component of shareholders' equity. For U.S. GAAP purposes changes in the cumulative translation adjustment are included as a component of accumulated other comprehensive income.

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Notes to the Consolidated Financial Statements (unaudited)
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(expressed in Canadian dollars)

(g) If Canadian GAAP were followed:

i) the effect on the Consolidated Statements of Earnings would be:

	For the three months ended		For the six months ended	
	May 31, 2005 \$	May 31, 2004 \$	May 31, 2005 \$	May 31, 2004 \$
Earnings (loss) for the period, U.S. GAAP	(1,697,767)	380,088	(1,917,358)	931,879
Adjustment for stock based compensation (a),(d)	(201,145)	(81,418)	(224,790)	(81,418)
Adjustment for loss on derivative (c)	7,748	-	7,748	-
Earnings (loss) for the period, Canadian GAAP	(1,891,164)	298,670	(2,134,400)	850,461
Basic earnings (loss) per common share, Canadian GAAP	(0.08)	0.01	(0.09)	0.03
Diluted earnings (loss) per common share, Canadian GAAP	(0.08)	0.01	(0.09)	0.03
Weighted average number of common shares - basic, Canadian GAAP	27,488,074	27,023,112	27,488,074	27,023,112
Weighted average number of common shares - diluted, Canadian GAAP	27,488,074	27,802,463	27,488,074	27,802,463

ii) Balance Sheet items which would differ under Canadian GAAP are as follows:

	May 31, 2005 \$	November 30, 2004 \$
Common shares (d)	19,026,125	19,026,125
Class A preference shares – Series A (e)	-	-
Class B preference shares – Series 1 (b)	-	1,926,157
Class B preference shares – Series 2 (b)	17,081,637	-
Warrants (b)	661,770	661,575
Additional paid in capital (a), (d)	454,943	214,492
Accumulated Deficit (a), (b), (c), (d)	(12,495,870)	(12,193,838)
Cumulative translation adjustment (f)	27,050	-

(h) Pro forma information – Stock based compensation

The following pro forma financial information as required by The Canadian Institute of Chartered Accountants (“CICA”) Handbook section 3870, Stock-Based Compensation and Other Stock – based Payments, presents the earnings had the Company recognized stock-based compensation using a fair value method for all stock awards granted, modified or settled prior to December 1, 2003:

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Three and Six Months Ended May 31, 2005 and 2004

(expressed in Canadian dollars)

	For the three months ended		For the six months ended	
	May 31, 2005	May 31, 2004	May 31, 2005	May 31, 2004
	\$	\$	\$	\$
Earnings (loss) for the period, Canadian GAAP	(1,891,164)	298,670	(2,134,400)	850,461
Add: Stock-based compensation cost	214,282	114,424	240,451	114,424
Less: Pro forma stock-based compensation cost	(220,582)	(120,724)	(253,051)	(127,024)
Pro forma income (loss)	(1,897,464)	292,370	(2,147,000)	837,861
Pro forma basic earnings (loss) per share	(0.08)	0.01	(0.09)	0.03
Pro forma diluted earnings (loss) per share	(0.08)	0.01	(0.09)	0.03
Weighted average number of common shares – basic	27,488,074	27,023,112	27,488,074	27,023,112
Weighted average number of common shares – diluted	27,488,074	27,802,463	27,488,074	27,802,463

The fair value of the stock options was estimated using the Black-Scholes option pricing model using the following weighted average assumptions by grant year:

	3 Months Ended May 31,		6 Months Ended May 31,	
	2005	2004	2005	2004
Risk-free interest rate	2.85%	2.21%	2.85%	2.21%
Volatility	54%	58%	54%	58%
Estimated average option lives	4.06 years	3.00 years	4.06 years	3.00 years
Dividend yield	0.00%	0.00%	0.00%	0.00%

20 Other Information

The following presents the conversion of the Company's comparative financial information from Canadian GAAP to U.S. GAAP and presents a comparison for amounts which differ between Canadian GAAP and U.S. GAAP:

(a) Balance sheet at November 30, 2004:

	As previously reported under Canadian GAAP	As currently reported under U.S. GAAP
	\$	\$
Shareholders' Equity		
Capital stock		
Issued and outstanding		
30,262 Class A preference shares – Series A	-	30,262
57,711 Class B preference shares – Series I	1,926,157	2,163,621
27,488,074 common shares	19,026,125	20,047,731
	20,952,282	22,241,614
Additional Paid in Capital	214,492	928,169
Accumulated Deficit	(12,193,838)	(14,196,847)

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Notes to the Consolidated Financial Statements (unaudited)
Three and Six Months Ended May 31, 2005 and 2004
(expressed in Canadian dollars)

(b) Statement of Earnings and Accumulated Deficit for the three months and six months ended May 31, 2004

	As previously reported under Canadian GAAP		As currently reported under U.S. GAAP	
	For the three months ended May 31, 2004 \$	For the six months ended May 31, 2004 \$	For the three months ended May 31, 2004 \$	For the six months ended May 31, 2004 \$
Accumulated Deficit – Beginning of period	(11,583,655)	(12,043,580)	(13,619,622)	(14,046,108)
Class B preference share dividend paid	86,567	178,433	86,567	178,433
Class B preference share dividend accreted	-	-	33,439	66,878
Accumulated Deficit – End of period	(11,371,552)	(11,371,552)	(12,933,054)	(12,933,054)

21 Subsequent event

On July 11, 2005, the Company announced that it has signed a non-binding letter of intent to acquire a United States defence contracting company. The acquisition is expected to approximately double the Company's revenue and employee base. The target company, with multiple offices in the United States, is a supplier of technology and services to the U.S. Department of Defence and key defence prime contractors.