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FONAR CORP  
Form PRE 14A  
May 22, 2002

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14 (a) OF THE SECURITIES  
EXCHANGE ACT OF 1934

Filed by Registrant  [X]

Filed by a Party other than the Registrant  [ ]

Check the appropriate box:

[ ] Preliminary Proxy Statement

[ ] Confidential, for use of the Commission only (as permitted by  
Rule 14a - 6 (e) (2) )

[X] Definitive Proxy Statement

[ ] Definitive Additional Materials

[ ] Soliciting Material Pursuant to (ss.) 240.14a-12

FONAR CORPORATION

-----  
(Name of Registrant as Specified In Its Charter)

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(Name of Person (s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required

[ ] Fee computed on table below per Exchange Act Rules 14a-6 (i)  
(4) and 0-11.

(1) Title of each class of securities to which transaction  
applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction  
computed pursuant to Exchange Act Rule 0-11 (Set forth the  
amount on which the filing fee is calculated and state how  
it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

[ ] Fee paid previously with preliminary materials.

[ ] Check box if any part of the fee is offset as provided by  
Exchange Act Rule 0-11 (a) (2) and identify the filing for which  
the offsetting fee was paid previously. Identify the previous

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- (1) Amount Previously Paid:
- (2) Form, Schedule or Registration Statement No.:
- (3) Filing Party:
- (4) Date Filed:

Notes:

FONAR CORPORATION

Proxy - Annual Meeting of Stockholders - June 17, 2002

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned, a stockholder of Fonar Corporation (the "Company"), hereby revoking any proxy heretofore given, does hereby appoint Raymond V. Damadian, David B. Terry, and Kurt Reimann, and each of them, proxies with full power of substitution, for and in the name of the undersigned to attend the Annual Meeting of the Stockholders of the Company to be held at Ramada Inn, junction of Interstate 295 and Route 13, New Castle, Delaware on June 17, 2002 at 10:00 a.m., local time, and at any adjournment(s) thereof, and there to vote upon all matters specified in the notice of said meeting, as set forth herein, and upon such other business as may properly and lawfully come before the meeting, all shares of stock of the Company which the undersigned would be entitled to vote if personally present at said meeting.

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED STOCKHOLDER. IF NO DIRECTION IS GIVEN, SUCH SHARES WILL BE VOTED FOR ALL PROPOSALS.

No. 1. ELECTION OF DIRECTORS

For All Nominees listed below (except as marked to the contrary nominees below)	WITHHOLD AUTHORITY to vote for all listed below
+-----+	+-----+
/           /	/           /
/           /	/           /
+-----+	+-----+

(INSTRUCTION: To withhold authority to vote for any individual nominee strike a line through the nominee's name in the list below.)

Raymond V. Damadian, Claudette J. V. Chan, Robert J. Janoff, Charles N. O'Data and Robert Djerejian.

No. 2. To ratify the selection of Grassi & Co., CPAs, P.C. as the Company's independent auditors for the fiscal year ended June 30, 2002.

FOR	AGAINST	ABSTAIN
+-----+	+-----+	+-----+
/           /	/           /	/           /
/           /	/           /	/           /

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+-----+ +-----+ +-----+
No. 3. In their discretion, the Proxies are authorized to vote upon such other business as may properly come before the meeting.

AUTHORITY
GRANTED

AUTHORITY
WITHHELD

+-----+
/ /
/ /
+-----+

+-----+
/ /
/ /
+-----+

Dated:-----, 2002

-----
Signature

-----
Signature if jointly held

PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR STOCK CERTIFICATES. In signing as attorney, executor, administrator, trustee or guardian, indicate such capacity. All joint tenants must sign. If a corporation, please sign in full corporate name by president or other authorized officer. If a partnership, please sign in partnership name by authorized person.

The Board of Directors requests that you fill in, date and sign the Proxy and return it in the enclosed envelope.

FONAR CORPORATION
110 Marcus Drive
Melville, New York 11747
(631) 694-2929

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
June 17, 2002

To The Stockholders:

The Annual Meeting of the stockholders of Fonar Corporation will be held at the Ramada Inn, junction of Interstate 295 and Route 13, New Castle, Delaware, June 17, 2002, at 10:00 a.m. local time for the following purposes:

- 1. To elect five Directors to the Board of Directors.
2. To ratify the selection of Grassi & Co., CPAs, P.C. as the Company's auditors for the fiscal year ended June 30, 2002.
3. To transact such other business as may properly come before the meeting.

Only stockholders of record at the close of business on May 1, 2002 are entitled to notice of, and to vote at, this meeting. A list of such stockholders will be

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available for examination by any stockholder for any purpose germane to the meeting, during normal business hours, at the principal office of the Company, 110 Marcus Drive, Melville, New York, for a period of ten days prior to the meeting.

Whether or not you expect to attend in person, we urge you to sign, date, and return the enclosed Proxy at your earliest convenience. Sending in your Proxy will not prevent you from voting your stock at the meeting if you desire to do so, as your Proxy is revocable at your opinion.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ David B. Terry

David B. Terry, Vice President and Secretary

### PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS TO BE HELD JUNE 17, 2002

This proxy statement, which is first being mailed to shareholders on or about May 15, 2002, is furnished in connection with the solicitation of proxies by the Board of Directors of Fonar Corporation (the "Company"), to be voted at the annual meeting of the stockholders of the Company to be held at 10:00 a.m. on June 17, 2002 and any adjournment(s) thereof for the purposes set forth in the accompanying Notice of Annual Meeting of Stockholders. Stockholders who execute proxies retain the right to revoke them at any time prior to the exercise of the powers conferred thereby, by delivering a signed statement to the Secretary of the Company at or prior to the annual meeting or by executing another proxy dated as of a later date. The cost of solicitation of proxies is to be borne by the Company.

Only stockholders of record at the close of business on May 1, 2002 will be entitled to vote at the meeting. Shares of Common Stock are entitled to one vote per share, shares of Class B Common Stock are entitled to ten votes per share and shares of Class C Common Stock are entitled to twenty-five votes per share. At the close of business on April 11, 2002, there were 67,703,423.889 shares of Common Stock held of record by 4,732 stockholders, 4,211 shares of Class B Common Stock held of record by 12 stockholders and 9,562,824 shares of Class C Common Stock held of record by 4 stockholders. The shares of Class A Nonvoting Preferred Stock (7,836,286.75 shares held of record by 4,027 stockholders at the close of business on April 11, 2002) are not entitled to vote.

Any proxy may be revoked at any time before it is exercised by delivery of a written instrument of revocation or a later dated proxy to the principal executive office of the Company or, while the meeting is in session, to the Secretary of the meeting, without, however, affecting any vote previously taken. The presence of a stockholder at the meeting will not operate to revoke his proxy. The casting of a ballot by a stockholder who is present at the meeting, however, will revoke his proxy, but only as to the matters on which the ballot is cast and not as to any matters on which he does not cast a ballot or as to matters previously voted upon. Proxies received by management will be voted at the meeting or any adjournment thereof. EACH PROXY WILL BE VOTED IN ACCORDANCE WITH THE SPECIFICATIONS MADE THEREIN BY THE PERSON GIVING THE PROXY. TO THE EXTENT NO CHOICE IS SPECIFIED, HOWEVER, THE PROXY WILL BE VOTED FOR MANAGEMENT'S PROPOSALS. All of management's proposals have been unanimously approved by the Board of Directors.

#### 1. ELECTION OF DIRECTORS AND MANAGEMENT INFORMATION

Five directors are to be elected at the annual meeting, to hold office until the

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next annual meeting of stockholders and until their successors are elected and qualified. It is intended that the accompanying proxy will be voted in favor of the following nominees to serve as directors unless the stockholder indicates to the contrary on the proxy. Management expects that each of the nominees will be available for election, but if any of them is not a candidate at the time the election occurs, it is intended that such proxy will be voted for the election of another nominee to be designated by the Board of Directors to fill any such vacancy.

### DIRECTORS, NOMINEE FOR DIRECTOR AND OFFICERS

Raymond V. Damadian, M.D. (age 66) has been the Chairman of the Board and President of FONAR since its inception and Treasurer since February, 2001. Dr. Damadian received an M.D. degree in 1960 from Albert Einstein College of Medicine, New York, and a B.S. degree in mathematics from the University of Wisconsin in 1956. In addition, Dr. Damadian conducted post-graduate work at Harvard University, where he studied extensively in the fields of physics, mathematics and electronics. Dr. Damadian is a 1988 recipient of the National Medal of Technology and in 1989 was inducted into the National Inventors Hall of Fame, for his contributions in conceiving and developing the application of magnetic resonance technology to medical applications including whole body scanning and diagnostic imaging. Dr. Damadian is also the director, President and Treasurer of the Company's subsidiary, Health Management Corporation of America ("HMCA").

Claudette J.V. Chan (age 64) has been a Director of FONAR since October 1987. Mrs. Chan has been employed since 1992 by HMCA and its predecessor, Raymond V. Damadian, M.D. MR Scanning Centers Management Company, as "site inspector," in which capacity she is responsible for supervising and implementing standard procedures and policies for MRI scanning centers. From 1989 to 1994 Mrs. Chan was employed by St. Matthew's and St. Timothy's Neighborhood Center, Inc., as the director of volunteers in the "Meals on Wheels" program, a program which cares for the elderly. She received a bachelor of science degree in nursing from Cornell University in 1960. Mrs. Chan is the sister of Raymond V. Damadian.

Robert J. Janoff (age 74) has been a Director of FONAR since February, 1989. Mr. Janoff has been a self-employed New York State licensed private investigator for more than thirty-five years and was a Senior Adjustor in Empire Insurance Group for more than 15 years until retiring from that position on July 1, 1997. Mr. Janoff also served, from June 1985 to June 1991, as President of Action Data Management Strategies, Ltd., a supplier of computer programs for use by insurance companies. Mr. Janoff is a member of the Board of Directors of Harmony Heights of Oyster Bay, New York, which is a nonprofit residential school for girls with learning disabilities.

Charles N. O'Data (age 66) has been a Director of FONAR since February, 1998. From 1968 to 1997, Mr. O'Data was the Vice President for Development for Geneva College, a liberal arts college located in western Pennsylvania. In that capacity, he acted as the College's chief investment officer. His responsibilities included management of the College's endowment fund and fund raising. In July 1997, Mr. O'Data retired from Geneva College after 36 years of service to assume a position of National Sales Executive for SC Johnson Company's Professional Markets Group (a unit of SC Johnson Wax), and specialized in healthcare and education sales, a position he held until the spring of 1999. Mr. O'Data presently acts an independent financial consultant to various entities, including Pittsburgh National Bank. He founded The Beaver County Foundation, a Community Foundation, in 1992, and serves as its President. Mr. O'Data is a graduate of Geneva College, where he received a B.S. degree in Economics in 1958.

Robert Djerejian (70), nominee for Director. Since 1996 Mr. Djerejian has served as a senior consultant for Haines, Lundberg & Waehler International, an

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architecture, design and engineering firm, which among other specialties designs hospitals and laboratories. Prior to that time he was the senior managing partner of the firm. Mr. Djerejian serves on the Board of Trustees of Pratt Institute, where he is also Vice Chairman of the Executive Committee and on the Board of Directors of the Delaware College of Art and Design, of which he was one of the founding directors. He is a graduate of Pratt Institute, where he received a B.A. in Architecture in 1955.

David B. Terry (53) is the Vice President of Administration and Secretary of the Company. Mr. Terry has been serving as Vice President since December 1998 and as Secretary since May, 1990. Previously, he served as Treasurer from May 1990 to December, 1998, as Secretary from July 1978 through June 1987 and as Treasurer from August 1981 through June 1987. From July 1978 through June 1987, he was also a Director of the Company.

### INFORMATION REGARDING THE BOARD AND ITS COMMITTEES

The five nominees will be elected to hold office for the ensuing year or until their respective successors are elected and qualified.

During the year ended June 30, 2001 the Board of Directors unanimously consented to action in lieu of a meeting on five occasions.

Dr. Damadian receives no cash compensation for serving on the Board. The other directors are each paid \$20,000 per year in their capacities as directors.

The Company's Board of Directors has an audit committee. There is no standing compensation committee or nominating committee.

In accordance with the Nasdaq Marketplace Rules, the Board of Directors adopted a written charter for the audit committee which took effect in June, 2001. All of the directors on the audit committee are independent.

### AUDIT COMMITTEE REPORT

The audit committee has (a) reviewed and discussed the audited financial statements with management, (b) discussed with the independent auditors the matters required to be discussed by SAS 61 and (c) has received the written disclosures and the letter from the independent accountants required by Independence Standards Board, Standard No. 1 and has discussed with the independent accountants the independent accountant's independence.

Based on the foregoing review and discussions, the audit committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2001.

The members of the audit committee are Messrs. Robert J. Janoff and Charles N. O'Data. Messrs. Janoff and O'Data are independent directors, as defined in the Nasdaq Market Place Rules. Upon his election as a director, Mr. Robert Djerejian will serve on the audit committee, replacing Dr. Luis E. Todd, who previously resigned from the Board.

### VOTE REQUIRED AND BOARD RECOMMENDATION

The directors will be elected by the vote of a plurality of the votes represented at the meeting. THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR ALL OF THE NOMINEES FOR DIRECTOR.

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### INFORMATION REGARDING BENEFICIAL OWNERSHIP OF PRINCIPAL STOCKHOLDERS, DIRECTORS, AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of the Company's common shares by the nominees for directors, the Company's Chief Executive Officer, and the directors and executive officers as a group as of April 1, 2002.

Name and Address of Beneficial Owner (1)	Shares Beneficially Owned	Percent of Class
Raymond V. Damadian, M.D. c/o FONAR Corporation Melville, New York Director, President CEO, 5% + Stockholder		
Common Stock	2,488,274	4.14%
Class C Stock	9,561,174	99.98%
Class A Preferred	477,328	6.09%
Claudette Chan Director		
Common Stock	2,648	*
Class A Preferred	800	*
Robert J. Janoff Director		
Common Stock	50,000	*
Class A Preferred	1,999	*
Charles N. O'Data Director		
Common Stock	700	*
All Officers, Directors and Nominees as a Group (5 persons) (2) (3)		
Common Stock	2,548,220	4.24%
Class C Stock	9,561,174	99.98%
Class A Preferred	480,165	6.13%

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\* Less than one percent

1. Address provided for each beneficial owner owning more than five percent of the voting securities of the Company.

2. Includes 101 shares of the Company's Common Stock and 19 shares of the Company's Class A Non-voting Preferred Stock held by an officer jointly with his wife and 192 shares of the Company's Common Stock and 38 shares of the Company's Class A Non-voting Preferred Stock held in trust by an officer for his children.

3. Includes options to purchase 6.286 shares of Common Stock held by an officer.

### CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

See Item 13, "Certain Relationships and Related Transactions" of the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2001 which is specifically incorporated by reference herein. A copy of the Form 10-K is included in the Annual Report to Stockholders which is being sent to the Company's stockholders with this Proxy Statement.)

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The Company believes that each of the related transactions described therein were on terms at least as favorable to the Company as were available from non-affiliated parties.

### COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS.

With the exception of the Chief Executive Officer, Dr. Raymond V. Damadian, the compensation of the Company's executive officers is based on a combination of salary and bonuses based on performance. The Chief Executive Officer's compensation consists only of a salary which has remained constant for more than the past three fiscal years. The Board of Directors does not have a compensation committee. Dr. Raymond V. Damadian, President, Chief Executive Officer and Chairman of the Board, is the only executive officer who is a member of the Board of Directors. Dr. Damadian participates in the determination of executive compensation for the Company's officers.

As noted above, the Company's compensation policy is primarily based upon the practice of pay-for-performance. Section 162(m) of the Internal Revenue Code imposes a limitation on the deductibility of nonperformance-based compensation in excess of \$1 million paid to the Chief Executive Officer. No officer of the Company received compensation in excess of \$1 million in fiscal 2001 or in any previous fiscal year. The Board currently believes that the Company should be able to continue to manage its executive compensation program for others so as to preserve the related federal income tax deductions.

The following table discloses compensation received for the three years ended June 30, 2001 by the Company's Chief Executive Officer.

Name and Principal Position	Year	Annual Compensation		Long-Term Compensation Awards	All Other Compensation
		Salary	Other		
Raymond V. Damadian Chairman of the; Board; President; Chief Executive Officer; Director	2001	\$86,799.96	0	0	0
	2000	\$86,799.97	0	0	0
	1999	\$86,779.96	0	0	0

### Compensation Pursuant to Stock Options and SAR Grants

No stock options or stock appreciation rights were granted to the Company's Chief Executive Officer during fiscal 2001.

### Option/SAR Exercises and Year End Values

No options or stock appreciation rights were exercised by the Company's Chief Executive Officer during fiscal 2001. The Company's Chief Executive Officer did not hold any unexercised stock options or stock appreciation rights at the end of fiscal 2001.

### Performance Graph

The following graph compares the annual change in the Company's cumulative total shareholder return on its Common Stock during a period commencing on June 30, 1996 and ending on December 31, 2001 (as measured by dividing (i) the sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend reinvestment and (B) the difference between the Company's share price at the end and the beginning of the measurement period; by (ii) the share price at the beginning of the measurement period) with the cumulative total return of each



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of: (a) the CRSP Total Return Index for Nasdaq U.S. companies ("Nasdaq"); (b) the CRSP Total Return Index for Nasdaq Medical Device Manufacturers ("Nas-MDM"); and (c) the CRSP Total Return Index for Nasdaq Health companies ("Nas-Hea.") during such period, assuming a \$100 investment on June 30, 1996. The stock price performance on the graph below is not necessarily indicative of future price performance.

(PERFORMANCE GRAPH APPEARS HERE)

### Relative Dollar Values

	6/28/96	6/30/97	6/30/98	6/30/99	6/30/00	6/29/01	12/31/01
Fonar Common Stock	\$100.00	\$114.84	\$89.96	\$46.72	\$84.18	\$78.14	\$47.93
NASDAQ-US	\$100.00	\$121.62	\$160.09	\$230.22	\$340.43	\$184.52	\$166.43
NAS-MDM	\$100.00	\$96.46	\$112.29	\$149.94	\$172.71	\$161.90	\$165.39
NAS-Hea.	\$100.00	\$92.41	\$90.03	\$84.73	\$65.39	\$93.31	\$91.45

## 2. RATIFICATION OF SELECTION OF AUDITORS

The Board of Directors has selected Grassi & Co., CPAs, P.C., as the Company's independent auditors for the fiscal year ending June 30, 2002. The stockholders will be asked to ratify this action by the Board.

The Company's previous auditors, Tabb, Conigliaro & McGann, P.C., merged into Grassi & Co., CPAs, P.C. Tabb, Conigliaro & McGann were the Company's auditors for the fiscal years ending June 30, 1990 through June 30, 2000. Grassi & Co., CPA's, P.C. were the Company's auditors for the fiscal year ended June 30, 2001.

One or more representatives of Grassi & Co., CPAs, P.C. are expected to be present at the Meeting with the opportunity to make a statement if they desire to do so, and to be available to respond to appropriate questions.

The affirmative vote of shares holding a majority of the votes represented at the meeting is required to ratify the selection of auditors by the Board of Directors. THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE PROPOSAL.

### AUDIT FEES

The aggregate fees billed by Grassi & Co., CPAs, P.C. for the audit of the Company's annual financial statements for the fiscal year ended June 30, 2001 and the reviews of the financial statements included in the Company's Forms 10-Q for the fiscal year ended June 30, 2001 were \$302,706.

### FINANCIAL INFORMATION SYSTEMS DESIGN AND IMPLEMENTATION

No fees were billed by Grassi & Co., CPAs, P.C. for the fiscal year ended June 30, 2001 for designing, operating, supervising or implementing any of the Company's financial information systems or any hardware or software systems for the Company's financial information.

### ALL OTHER FEES

The aggregate fees billed by Grassi & Co., CPAs, P.C. for all other services rendered by them during the fiscal year ended June 30, 2001 were \$314,503, which included services in connection with the registration of securities and tax preparation and planning.

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The Company's audit committee believes that the provision by Grassi & Co., CPAs, P.C. of services in addition to audit services in fiscal 2001 was compatible with maintaining their independence.

All persons performing work on behalf of Grassi & Co., CPAs, P.C. in connection with their engagement to audit the Company's financial statements for the fiscal year ended June 30, 2001 were full-time permanent employees of Grassi & Co., CPAs, P.C.

### PROPOSALS OF STOCKHOLDERS

Proposals of stockholders intended to be presented at the 2003 annual meeting of stockholders must be received by the Company no later than January 10, 2002 to be included in the Company's proxy statement and form of proxy related to that meeting.

### SOLICITATION OF PROXIES

The proxy accompanying this Proxy Statement is solicited by the Board of Directors of the Company. Proxies may be solicited by officers, directors, and regular supervisory and executive employees of the Company, none of whom will receive any additional compensation for their services. Such solicitations may be made personally, or by mail, e-mail, facsimile, telephone, telegraph, or messenger. The Company will pay persons holding shares of common stock in their names or in the names of nominees, but not owning such shares beneficially, such as brokerage houses, banks, and other fiduciaries, for the expense of forwarding solicitation materials to their principals. All of the costs of solicitation of proxies will be paid by the Company.

### VOTING TABULATION

The election of the Company's directors requires a plurality of the votes represented in person or by proxy at the meeting, and the ratification of the selection of auditors requires the affirmative vote of a majority of the votes represented in person or by proxy at the meeting. Votes cast by proxy or in person at the meeting will be tabulated by the Company.

A stockholder who abstains from voting on any or all proposals will be included in the number of shareholders present at the meeting for the purpose of determining the presence of a quorum. Abstentions will not be counted either in favor of or against the election of the nominees or other proposals. Under the rules of the National Association of Securities Dealers, brokers holding stock for the accounts of their clients who have not been given specific voting instructions as to a matter by their clients may vote their clients' proxies in their own discretion. Where a proposal requires a majority of the votes present for its passage, an abstention or non-vote will have the same effect as a negative vote.

### OTHER MATTERS

The Board of Directors does not intend to bring any other business before the meeting, and so far as is known to the Board, no matters are to be brought before the meeting except as specified in the notice of the meeting. However, as to any other business which may properly come before the meeting, it is intended that proxies, in the form enclosed, will be voted in respect thereof in accordance with the judgment of the persons voting such proxies.

DATED: Melville, New York, May 15, 2002

A COPY OF THE COMPANY'S FORM 10-K REPORT FOR FISCAL YEAR 2001, CONTAINING INFORMATION ON OPERATIONS, FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, IS

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AVAILABLE UPON REQUEST. PLEASE WRITE TO:

INVESTOR RELATIONS DEPARTMENT  
FONAR CORPORATION  
110 MARCUS DRIVE  
MELVILLE, NEW YORK 11747

2001 ANNUAL REPORT

FONAR CORPORATION

Dear Stockholders,

The year 2002 is the year of the Stand-Up MRI(TM)! As many of you know, we have invested heavily, both in time and resources, in developing this product. With the R&D and the product engineering efforts finally completed, we now offer the most revolutionary product the MRI market has seen since we created this industry nearly 25 years ago. The company that invented MR scanning has just reinvented it!

The Stand-Up MRI(TM) is one of a kind. Its unique design enables it to detect pathology that no other MRI scanner can, and to provide an entirely new kind of openness, making it the only true Open MRI. Our sales and marketing teams are in place; the marketplace has been extremely receptive; and we're selling! At this writing, we have sold 18 Stand-Up MRIs.

A brief status report on each of the installed Stand-Up MRIs will communicate why we at FONAR Corporation are so excited about this product:

### Status of the First Stand-Up MRI(TM) Installations

Washington Open MRI, Inc., the first to purchase and install the Stand-Up MRI(TM) (Greenbelt, Maryland) has already ordered two more. In February, 2002, at the time the third unit was ordered, the president of the company, Phyllis Newfield, said, "Based upon the very positive response we've received from patients and referring physicians, right from the very beginning, I knew we had made the right choice and that we would be ordering several more Stand-Up MRIs from FONAR. There's no other scanner like it. It's definitely in a class of its own."

Rose Radiology Centers, Inc., the first in Florida to purchase and install the Stand-Up MRI(TM) ordered its second unit in April 2002. Owner and board-certified diagnostic radiologist Dr. Manuel S. Rose stated, "The response from the local community has been very positive, particularly among orthopedic surgeons. In the past they had no choice but to rely on what could be seen by the MRI of patients scanned only in recumbent positions. That's no longer the case, in the Tampa area anyway. For example, if the problem is a herniated disk, it's quite possible that the herniation, when visualized with the patient in a supine position, could appear far less severe than it actually is, or it could disappear altogether. We've seen this happen on several occasions. Through no fault of their own, surgeons are at a serious disadvantage, consequently resulting in failed surgeries. With the Stand-Up MRI, the surgeon can, for the first time, visualize pathology in both the supine and upright positions, allowing him to accurately evaluate the full extent of the problem."

The Stand-Up MRI(TM) in Islandia, New York, which is managed by FONAR's subsidiary, Health Management Corporation of America (HMCA), opened in January of this year and is performing 400 scans per month. Patients have traveled to Islandia from as far away as Michigan, North Carolina, Tennessee, the

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Netherlands, and London.

The Stand-Up MRI of Orlando in Florida, which opened in the same month is following in Islandia's footsteps, with scan volume steadily rising. A spokesman for the facility described the response from the medical and legal community as overwhelming.

Fourteen more Stand-Up MRIs are in various stages of production or installation.

### The Product

What makes the Stand-Up MRI(TM) revolutionary is its physical configuration. With the magnetic poles vertically oriented, rather than in the usual horizontal orientation, patients can be scanned, for the first time, in upright positions - standing, sitting, or even bending over. This allows medical practitioners to visualize anatomy under normal weight-bearing conditions, and in their positions of pain or symptoms. In the relatively short period of time that we have been working with the Stand-Up MRI(TM) in clinical environments, we have seen case after case where pathology, particularly spine pathology, that had gone undetected on conventional lie-down MRIs was clearly visible on the Stand-Up MRI(TM).

Physicians and surgeons rely heavily on the accuracy of diagnostic tests in order to provide the best possible care and treatment of their patients. They are also careful to avoid unnecessary risks. With the introduction of the Stand-Up MRI(TM), the decision to refer a patient with back pain to a recumbent MRI scanner when there is the option of sending him to a nearby Stand-Up MRI(TM) simply makes no sense. Considering the fact that roughly half of all MRI scans performed today are of the spine, one immediately recognizes the enormous appeal and sales potential of this product.

I would like to underscore the importance of the Stand-Up MRI's unique ability to see inside the human body with patients in normal, everyday positions or postures. From your own experience, I'm sure you understand that some pains or symptoms only manifest themselves, or are more acute, when you assume a particular position. The Stand-Up MRI(TM), and only the Stand-Up MRI(TM), allows the physician to assess such problems with the patient in those very positions. We call it Position Imaging(TM). If a patient is dizzy only when he is upright, he should be scanned upright; if a knee hurts only when it's in a certain position, it should be scanned in that position; if the patient's back hurts only when he is upright, he should be scanned upright. As a physician who knows and has worked with many other physicians, I have no doubt that once this machine is in the hands of the able, creative and innovative medical community, its utility will skyrocket.

### Patient Comfort

The Stand-Up MRI's physical configuration also makes the scanner extraordinarily comfortable, roomy and patient friendly. Its front- and top-open design creates an entirely new kind of MRI experience. It is entirely free of anything that might induce a claustrophobic reaction, a common problem even among Open MRIs. With Stand-Up MRI(TM), there is nothing directly in front of the patient's face or overhead; there is a clear and direct path out of the scanner; patients don't have to lie down to be pushed into or under something; they feel "in control"; they don't feel "trapped." Indeed, the scanner is advertised to the public as the only true Open MRI, where the only thing in front of the patient's face is a TV.

In fact, we have successfully scanned a host of patients in the Stand-Up MRI(TM) that could not tolerate any other MRI, including other Open MRIs. The extraordinary spaciousness of the scanner also enables it to accommodate extremely large patients, such as a 400-pound man and a 5-foot, 300-pound woman

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recently scanned at a Stand-Up MRI(TM) facility.

The vigorous response from local advertising of the Stand-Up MRI(TM) in Islandia, New York, is concrete proof that patient comfort is a major issue, one of growing importance. Most patients there are scanned in a comfortable sitting position watching a TV mounted on the scanner room wall. We have learned that patients invariably prefer sitting for their exams to lying down... and the Stand-Up MRI(TM) is the only scanner that does it.

### Not a Specialty Scanner

It is also important to point out that the Stand-Up MRI(TM) does not just scan patients standing up, as might be inferred from its name. It scans patients lying down, just like any other MRI, but in a host of other positions as well. Patients can be scanned standing, sitting, or bending. MRI images can be made of cervical spine in flexion or extension, and of the lumbar spine in flexion, extension, tilted laterally or rotated at the hip. Shoulders, hips and knees can be scanned with the joints in just about any position imaginable. A patient can have an MRI scan of the prostate, non-invasively, in a comfortable sitting position as he watches TV. The possibilities seem endless.

### 0.6 Tesla Technology

The Stand-Up MRI is built on proven 0.6 Tesla technology, a technology that FONAR pioneered and has since mastered. The speed and image quality of the Stand-Up MRI(TM) are second to none. Its full range of advanced software features and state-of-the-art pulse sequences provide the user with all the tools necessary to achieve diagnostic precision. In short, the Stand-Up MRI(TM) is the finest high-field Open MRI available today.

### Media Blitz

We have launched a national media blitz that includes local TV and radio advertising in the metropolitan New York area, and, at the national level, journal ads, direct mail and telemarketing. The response has been very encouraging. We have two goals in mind - to generate sales leads in the metropolitan New York area, and to generate business for the Stand-Up MRI in Islandia, Long Island. The realization of the latter goal will also demonstrate to potential buyers the enormous appeal that the Stand-Up MRI(TM) has for informed physicians and for an informed public. I'm pleased to report that we are indeed achieving our goals. We've accumulated a sizeable number of sales leads; visits to the FONAR Web site ([www.fonar.com](http://www.fonar.com)) have doubled since the start of the advertising; and the patient volume at the Islandia facility is currently running at 400 scans per month. What better sales tool is there than a packed MRI appointment book?

### GE

In April 2002, General Electric purchased Stand-Up MRIs for two of its customers. This, of course, is an important milestone for FONAR. GE, as a well-respected provider of quality medical equipment, has established longstanding relationships with prestigious institutions and hospitals all over the world. GE's inclusion of the Stand-Up MRI in their product line gives FONAR, for the first time, access to these important market segments. Such exposure has the potential to accelerate our penetration of the worldwide MRI market. The arrangement between GE and FONAR has enormous potential for both companies.

### Ready to Sell

There are many phases that a company must go through in the process of successfully bringing a new product to market. We are now in the final phase with our Stand-Up MRI(TM). The design work has been completed; we have

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successfully produced, tested and installed 4 scanners; we have another 14 scanners in production to be installed; our production and field service departments are ready to meet the anticipated sales demand; we have built a national sales and marketing team; we have launched a national sales and marketing campaign; the patient schedules of the first Stand-Up MRI(TM) owners are packed; patients and referring physicians are delighted with the product; and we finally have operating Stand-Up MRI(TM) sites that we can invite prospective customers to visit. Everything is in place, which is why we say that 2002 is year of the Stand-Up MRI(TM).

Thank You

I believe that FONAR is entering the most exciting and promising time in its history. Over the past few years we have invested in making the transition from the R&D company to a full-scale MRI manufacturing company. We plowed, we planted, we watered and now it's finally harvest time. I offer my special thanks to our loyal FONAR shareholders who have waited so patiently for this day.

Sincerely,

Raymond V. Damadian  
President and Chairman

SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

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FORM 10-K/A  
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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 [Fee Required]  
For the fiscal year ended June 30, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES AND EXCHANGE ACT OF 1934 [No Fee Required]  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File No. 0-10248

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FONAR CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE 11-2464137  
(State of incorporation) (IRS Employer Identification Number)

110 Marcus Drive, Melville, New York 11747  
(Address of principal executive offices) (Zip Code)

(631) 694-2929  
(Registrant's telephone number, including area code)

\_\_\_\_\_  
Securities registered pursuant to Section 12(b) of the Act:

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None

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, par value \$.0001 per share  
(Title of Class)

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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  No

As of September 20, 2001, 60,044,124 shares of Common Stock, 4,211 shares of Class B Common Stock, 9,562,824 shares of Class C Common Stock and 7,836,287 shares of Class A Non-voting Preferred Stock of the registrant were outstanding. The aggregate market value of the approximately 57,521,655 shares of Common Stock held by non-affiliates as of such date (based on the closing price per share on September 20, 2001 as reported on the NASDAQ System) was approximately \$82.3 million. The other outstanding classes do not have a readily determinable market value.

DOCUMENTS INCORPORATED BY REFERENCE  
None

### REASONS FOR ADMENDMENT

Fonar Corporation's 10-K has been admended to unconsolidate the physical rehabilitation and medical practices which are managed by Health Management Corporation of America, Fonar's wholly-owned subsidiary.

The Company no longer consolidates any medical practices which it manages. In the original 10-K for 2001 and also in 2000 and 1999, the Company consolidated certain medical practices managed as a result of the 1998 acquisitions of A & A Services, Inc. and Dynamic Health Care Management, Inc. The Company also consolidated the practices conducted by Superior Medical Services, P.C. The Company has determined that consolidation of such medical practices is not appropriate because the underlying management agreements do not meet all of the six criteria of Emerging Issues Task Force ("EITF") Consensus No. 97-2.

Accordingly, the consolidated financial statements have been restated. The significant effect of such restated financial statements for 2001, 2000 and 1999 has been to decrease revenue and related costs by \$4.2 million, \$3.8 million and \$3.7 million, respectively. Consequently, these changes had no effect on the results of operations for the years ended June 30, 2001, 2000 and 1999. Additional disclosure has also been added concerning HMCA's management agreements in the Description of Business, Management's Discussion and Analysis of Financial Condition and Certain Relationships and Related Transactions sections of the 10-K.

All financial information provided in the 10-K/A has been revised to reflect the restatement.

### ITEM 1. BUSINESS

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### GENERAL

FONAR Corporation (the "Company" or "FONAR") is a Delaware corporation which was incorporated on July 17, 1978. The Company's address is 110 Marcus Drive, Melville, New York 11747 and its telephone number is (631) 694-2929. FONAR also maintains a WEB site at [www.fonar.com](http://www.fonar.com).

FONAR is engaged in the business of designing, manufacturing, selling and servicing magnetic resonance imaging ("MRI" or "MR") scanners which utilize MRI technology for the detection and diagnosis of human disease. FONAR introduced the first MRI scanner in 1980 and is the originator of the iron-core non-superconductive and permanent magnet technology.

FONAR's iron frame technology made FONAR the originator of "open" MRI scanners. FONAR introduced the first "open" MRI in 1980. It has concentrated since on further application of its "open" MRI, introducing the Stand-Up MRI scanner, the QUAD MRI, the Open Sky MRI and its works in progress MRI operating room.

Health Management Corporation of America (formerly U.S. Health Management Corporation and hereinafter sometimes referred to as "HMCA") was formed by the Company in March 1997 as a wholly-owned subsidiary in order to enable the Company to expand into the business of providing comprehensive management services to medical providers. HMCA provides management services, administrative services, office space, equipment, repair and maintenance service and clerical and other non-medical personnel to physicians and other medical providers, including diagnostic imaging centers.

See Note 21 to the Financial Statements for separate financial information respecting the Company's medical equipment and physician and diagnostic management services segments.

### FORWARD LOOKING STATEMENTS.

Certain statements made in this Annual Report on Form 10-K are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of Management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. The Company's plans and objectives are based, in part, on assumptions involving the expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Company. Although the Company believes that its assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statement included herein, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved.

### RECENT DEVELOPMENTS AND OVERVIEW.

The Company's products and works-in-progress (dubbed the "Fonar Seven") are intended to significantly improve the Company's competitive position. The Company's products are the "Stand-Up MRI" also called "Indomitable (TM)", the Fonar 360(TM), the "QUAD(TM)" MRI scanner and the Echo(TM) MRI scanner.



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Indomitable(TM) permits, for the first time, MRI diagnoses to be made in the weight-bearing state. It is also anticipated that in the future Indomitable(TM) will enable MRI-guided surgical and interventional procedures to be performed when the patient is upright. The Company received FDA approval for Indomitable in October, 2000.

The Fonar 360, approved for marketing by the FDA on March 16, 2000, includes the "Open Sky(TM)" MRI. The magnet frame is incorporated into the floor, ceiling and sidewalls of the scan room and is open. Consequently, physicians and family members can walk inside the magnet to approach the patient. The Open Sky version of the Fonar 360 is decoratively designed so that it is incorporated into the panoramic landscape that decorates the walls of the scan room. The ability of the Fonar 360 to give physicians direct 360 access to patients and the availability of MRI compatible surgical instruments will also enable the Fonar 360, in its future "OR-360(TM)" version, to be used for image guided surgery.

The "QUAD(TM) 12000" MR scanner utilizes a electromagnet and is accessible from four sides. The QUAD 12000 is the first "open" MR scanner at high field. The greater field strength of the QUAD'S magnet, when enhanced by the electronics already utilized by the Company's scanners, produces images of a quality and clarity competitive with high field superconductive magnets. The QUAD 12000 scanner magnet is the highest field "open MRI" in the industry.

In addition, the Company offers a low cost, low field strength open MRI scanner, the "Echo(TM)"

The Company's current "works in progress" include the "Pinnacle(TM)" which combines many of the features of the QUAD scanners with a superconducting magnet. (See "Works in Progress".)

The Company's "works in progress" also include an in-office, weight-bearing extremities scanner designed for examining the knee, foot, elbow, hand and wrist under both weight-bearing and non-weight bearing conditions.

Fonar has increased its internal sales force to approximately 24 persons, concentrating on domestic sales. Fonar continues to use distributors for its foreign sales efforts. Fonar has also expanded its website to a full-scale interactive product information desk for reaching new customers and assisting existing customers.

In March 1997, FONAR formed Health Management Corporation of America (formerly U.S. Health Management Corporation and hereinafter sometimes referred to as "HMCA") as a wholly-owned subsidiary for the purpose of engaging in the business of providing comprehensive management and administrative services, office space, equipment, repair and maintenance service for equipment and clerical and other personnel (other than physicians) to physicians' practices and other medical providers, including diagnostic centers.

HMCA currently is managing 19 diagnostic imaging centers and 11 primary care and specialty medical practices located principally in New York State and Florida.

### PRODUCTS

The Company's principal products are its Stand-Up MRI, also called Indomitable, the Fonar 360, the QUAD 12000 series and the Echo.

The Company's Indomitable(TM) scanner will allow patients to be scanned while standing, sitting or reclining. As a result, for the first time, MRI will

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be able to be used to show abnormalities and injuries under full weight-bearing conditions, particularly the spine and joints.

A floor-recessed elevator brings the patient to the height appropriate for the targeted image region. A custom-built adjustable bed will allow patients to sit or lie on their backs, sides or stomachs.

Full-range-of-motion studies of the joints in virtually any direction will be possible, an especially promising feature for sports injuries. Full range of motion cines, or movies, of the lumbar spine will be achieved under full body weight.

Indomitable(TM) will also be useful for MR-directed surgical procedures as the surgeon would have unhindered access to the patient with no restrictions in the vertical direction.

This easy-entry, mid-field-strength scanner should be ideal for trauma centers where a quick MRI-screening within the first critical hour of treatment will greatly improve patients' chances for survival and optimize the extent of recovery.

The Company received approval from the FDA for Indomitable in October, 2000.

The Fonar 360 has an enlarged room sized magnet in which the magnet frame is incorporated into the floor, ceiling and walls of the scan room. This is made possible by Fonar's patented Iron-Frame(TM) technology which allows the Company's engineers to control, contour and direct the magnet's lines of flux in the patient gap where wanted and almost none outside of the steel of the magnet where not wanted. Physicians and family members are able to actually enter the scanner and approach the patient. In its Open Sky version, the Fonar 360 serves as an open patient friendly scanner which allows 360 access to the patient on the scanner bed. The walls can be decorated with panoramic murals and the entire scan room can be decorated to be incorporated into the pictured landscape. The Company received approval from the FDA for the Fonar 360 in March 2001.

In its future interventional OR-360 version, which is still in the planning stages, the enlarged room sized magnet and 360 access to the patient afforded by the Fonar 360 permit full-fledged surgical teams to walk into the magnet and perform surgery on the patient inside the magnet. Most importantly the exceptional quality of the MRI image and its exceptional capacity to exhibit tissue detail on the image, by virtue of the nuclear resonance signal's extraordinary capacity to create image contrast, can then be obtained real time during surgery to guide the surgeon in the surgery. Thus surgical instruments, needles, catheters, endoscopes and the like can be introduced directly into the human body and guided to the malignant lesion by means of the MRI image. The number of inoperable lesions should be greatly reduced by the availability of this new capability. Most importantly treatment can be carried directly to the target tissue.

A Neurosurgeon, for example, has direct access to the patient's head while the patient is lying in the scanner and can perform image guided neurosurgery in this magnet. The unimpeded access in the space above the patient is also useful for surgical access, positioning of life support devices, neuro-surgical microscopes and anaesthetic gases. It should be noted that these procedures have not yet been performed in the scanner, although they are promising possibilities.

With current treatment methods, therapy must always be restricted in the doses that can be applied to the malignant tissue because of the adverse effects on the healthy tissues. Thus chemotherapies must be limited at the first sign of toxic side effects. The same is the case with radiation therapy. The Company

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expects that with the OR-360 treatment agents may be administered directly to the malignant tissue through small catheters or needles allowing much larger doses of chemotherapy, x-rays, laser ablation, microwave, or if to be applied directly and exclusively to the malignant tissue with more effective results. Since the procedure of introducing a treatment needle or catheter under image guidance will be minimally invasive the procedure can be readily repeated should metastases occur elsewhere, with minimum impact on the patient beyond a straightforward needle injection.

The presence of the MRI image during treatment will enable the operator to make assessments during treatment if his treatment is being effective.

The interventional OR-360 version of the Fonar 360 is still in the planning stages. There is not a prototype. A separate FDA submission for the interventional 360 has not been made as yet and might not be necessary in that it was not required of other MRI manufacturers in similar situations. We note that other manufacturers have incorporated the use of their imaging machine for use in interventional procedures without separate FDA submissions.

To optimize the patient-friendly character of the Open Sky MRI, the walls, floor, ceiling and magnet poles are decorated with landscape murals. The patient gap is twenty inches and the magnetic field strength, like that of FONAR's QUAD 12000, is 0.6 Tesla. The Open Sky MRI shares the fundamental technology of the QUAD 12000 and offers the same speed, precision and image quality.

The QUAD(TM) 12000 MR scanner utilizes a 6000 gauss iron core electromagnet and is accessible from four sides. The QUAD 12000 is the first "open" MR scanner at high field.

In addition to the patient comfort, increased throughput and new applications (such as MRI directed surgery and MRI breast imaging) made possible by the QUAD scanners' open design, the QUAD scanners are designed to maximize image quality through an optimal combination of signal-to-noise (S/N) and contrast-to-noise (C/N) ratios. The technical improvements realized in the QUAD's design over its predecessors also include increased image-processing speed and diagnostic flexibility.

MRI directed surgery (laproscopic surgical procedures) is possible by the QUAD's ability to supply images to a monitor positioned next to the patient, enabling a surgeon to view in process surgical procedure from an unlimited number of vantage points. The marked openness of FONAR's QUAD scanners enables surgeons to perform a wide range of surgical procedures inside the magnet.

The "QUAD" scanners are unique MR scanners in that four sides are open, thus allowing access to the scanning area from four vantage points. The starshaped open design of the QUAD will also make possible a host of new applications, particularly MRI breast imaging and MRI directed surgery (Interventional MRI).

With the QUAD's multi-bed patient handling system, many more short scan procedures such as those used in breast imaging can be done in a day, allowing the price of MRI breast imaging to drop without reducing the scanner's revenue-generating capacity. At the same time, there is not the painful compression of the breast characteristic of X-ray mammography.

The principal difference between the QUAD scanners and other open MRI scanners is in field strength. Other open MRIs operate at significantly lower magnetic field strengths and, therefore, are unable to produce the amount of MRI image-producing signal necessary to make high-quality MRI images (measured by signal-to-noise ratios, S/N).

The QUAD 12000 scanner utilizes a 6000 gauss (.6 Tesla field strength) iron

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core electromagnet. The greater field strength of the 6000 gauss magnet, when enhanced by the electronics already utilized by the Company's scanners, produces images of a higher quality and clarity than other open MRI scanners. The QUAD 12000 scanner magnet is the highest field "open MRI" in the industry and operates at a field strength that is almost two times its closest competitor (.6 Tesla field strength versus .35 Tesla field strength).

The QUAD scanners are designed to maximize image quality through an optimal combination of signal-to-noise (S/N) and contrast-to-noise (C/N) ratios. The technical improvements realized in the QUAD's design over its predecessors also include increased image-processing speed and diagnostic flexibility.

Maximal S/N is achieved when the direction of the magnetic field and the direction of the receiving coil axis are perpendicular to one another, as is the case with the QUAD scanners. The orientation of the magnetic field is vertical and when combined with any one of FONAR's array of solenoidal (wrap-around) surface coils, the QUAD 12000, for example, produces as much S/N as a supercon MRI at twice the field strength. So that prospective buyers can make an accurate comparison, the number 12,000 is used to describe the S/N equivalency of the QUAD 12000 to 12,000-gauss superconductive machines.

Several technological advances have been engineered into the QUAD scanners for extra improvements in S/N, including: new high-S/N Organ Specific(TM) receiver coils; new ceramic magnet poles that provide advanced eddy-current control; new advanced front-end electronics featuring high-speed, wide-dynamic-range analog-to-digital conversion and a miniaturized ultra-low-noise pre-amplifier; high-speed automatic tuning, bandwidth-optimized pulse sequences, multi-bandwidth sequences, and off-center FOV imaging capability.

In addition to the signal-to-noise ratio, however, the factor that must be considered when it comes to image quality is contrast, the quality that enables reading physicians to clearly distinguish adjacent, and sometimes minute, anatomical structures. This quality is measured by contrast-to-noise ratios (C/N). Unlike S/N, which increases with increasing field strength, relaxometry studies have shown that C/N peaks in the mid-field range and actually falls off precipitously at higher field strengths. The QUAD 12000 scanners operate squarely in the optimum C/N range. In addition, the Company's works-in-progress, the OR-360, Open Sky MRI and Stand-Up MRI are also designed to operate with said C/N range.

The QUAD provides various features allowing for versatile diagnostic capability. For example, SMART(TM) scanning allows for same-scan customization of up to 63 slices, each slice with its own thickness, resolution, angle and position. This is an important feature for scanning parts of the body that include small-structure sub-regions requiring finer slice parameters. There's also Evolving Images(TM), Multi-Angle Oblique (MAO)(TM) imaging, and oblique imaging.

The QUAD console includes a mouse-driven, multi-window interface for easy operation and a 19-inch, 1280 x 1024-pixel, 20-up, high-resolution image monitor with features such as electronic magnifying glass and real-time, continuous zoom and pan.

The Company also offers a low cost open scanner, the Echo, which operates at a .3 Tesla field strength. The Echo is an open upgraded version of the Company's former principal product, the Beta MRI scanner, but open on four sides to provide four directions for patient access instead of two.

Prior to the introduction of the QUAD scanners, the Ultimate(TM) 7000 scanner, introduced in 1990, was the Company's principal product. The Ultimate scanner replaced the Company's traditional principal products, the Beta(TM) 3000

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scanner (which utilized a permanent magnet) and the Beta(TM) 3000M scanner (which utilized an iron core electromagnet). All of the Company's current and earlier model scanners create cross-sectional images of the human body.

During fiscal 2001, sales of the Company's QUAD scanners accounted for approximately 7.3% of the Company's total revenues and 29% of its medical equipment segment revenues, as compared to 7.6% of total revenues and 46.4% of medical equipment revenues during fiscal 2000. During fiscal 2001, sales of the Company's Stand-Up scanners accounted for approximately 3.8% of total revenues and 15.5% of medical equipment revenues, and sales of Echo scanners accounted for 2.5% of total revenues and 10% of medical equipment revenues. There were no sales of Stand-Up scanners or Echo scanners in fiscal 2000 or of Ultimate scanners in fiscal 2001 or 2000. There were no sales of Beta scanners in fiscal 2001, but 0.2% of total revenues and 1.4% of medical equipment revenues in fiscal 2000 were derived from the sale of a refurbished Beta scanner.

The materials and components used in the manufacture of the Company's products (circuit boards, computer hardware components, electrical components, steel and plastic) are generally available at competitive prices. The Company has not had difficulty acquiring such materials.

### WORKS-IN-PROGRESS

All of the Company's products and works-in-progress seek to bring to the public MRI products that are expected to provide important advances against serious disease.

MRI takes advantage of the nuclear resonance signal elicited from the body's tissues and the exceptional sensitivity of this signal for detecting disease. Much of the serious disease of the body occurs in soft tissue. The principal diagnostic modality currently in use for detecting disease, as in the case of x-ray mammography, are diagnostic x-rays. X-rays discriminate soft tissues like healthy breast tissue and cancerous tissue poorly because the x-ray particle traverses the tissues almost equally thereby rendering the target film equally exposed by the two tissues and creating healthy and cancerous shadows on the film that differ very little in brightness. The image contrast between cancerous and healthy tissue is poor, making the detection of breast cancers by the x-ray mammogram less than optimal. If microscopic stones (microcalcifications) are not present to provide the missing contrast the breast cancer goes undetected. They frequently are not present. The maximum contrast available by x-ray with which to discriminate disease is 4%. Brain cancers differ from surrounding healthy brain by only 1.6%.

On the other hand the soft tissue contrasts with which to distinguish cancers on images by MRI are up to 180%. This is because the nuclear resonance signals from the body's tissues differ so dramatically. Liver cancer and healthy liver signals differ by 180%. Thus there is some urgency to bring to market an MRI based breast scanner that can overcome the x-ray limitation and assure that mammograms do not miss serious lesions. The added benefit of MRI mammography relative to x-ray mammography is the elimination of the need for the patient to disrobe and the painful compression of the breast typical of the x-ray mammogram. The patient is scanned in her street clothes in MRI mammography. Moreover MRI mammogram scans the entire chest wall including the axilla for the presence of nodes which the x-ray mammogram cannot reach.

Among its other uses, the Company envisions that its Open Sky MRI(TM) scanner will meet the public need for an MRI breast scanner.

The Company is developing a superconductive version of its open iron frame magnets, the "Pinnacle" (TM), and has completed construction of a prototype with a 0.6 Tesla superconductive magnet. The Company's design of its superconductive

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magnet anticipated the possibility of making its other products available as superconducting magnets. Therefore, it is the Company's objective to make Indomitable(TM) and the Fonar 360 available to FONAR's customers as either iron-frame resistive models or iron-frame superconductive magnets depending on customer preference and pricing.

The Pinnacle will have a field strength between 0.6 to 1.0 Tesla and a 18-inch gap vertical field. This MRI scanner will combine the benefits of its open non claustrophobic patented iron-frame, vertical field magnet design with the high field strength of a superconducting magnet. The Company received FDA approval for the Pinnacle in June, 2001.

In addition, the Company's works in progress include an in-office weight bearing extremities scanner which will be able to be used to examine the knee, foot, elbow, hand and wrist. This scanner will allow scans to be performed in under both weight-bearing and non-weight-bearing conditions.

### PRODUCT MARKETING

The principal markets for the Company's scanners are hospitals and private scanning centers.

Fonar has increased its internal sales force to approximately 24 persons. Our internal sales force handles the domestic market while we continue to use independent distributors for foreign markets. In addition to its internal domestic sales force, Fonar and G.E. Medical, a division of General Electric, have entered into an arrangement pursuant to which G.E. Medical will act as independent distributor for Fonar's Stand-Up MRI scanner.

In addition, the Company has expanded its website to include an interactive product information desk for reaching customers. The Company plans to commence a program for providing demonstrations of its products to potential customers on an international basis.

The Company has exhibited its new products at the annual trade show held by the Radiological Society of North America ("RSNA") in Chicago since November 1995 and plans to attend the RSNA trade show in November 2001 and future years. The RSNA trade show is held annually and is attended by most manufacturers of MRI scanners.

The Company is directing its marketing efforts to meet the demand for both "open" and high field strength MRI scanners. Fonar plans to devote its principal efforts to marketing the Stand-Up MRI, which has the unique capability of scanning patients under weight-bearing conditions. In addition the Company will continue to market its Fonar 360, QUAD and Echo MRI scanners. Utilizing a 6000 gauss (0.6 Tesla field strength) iron core electromagnet, the Stand-Up, Fonar 360 and QUAD 12000 scanner magnets are the highest field "open MRI" in the industry.

The Company also will seek to introduce new MRI applications for its scanners such as MRI-directed surgery and head-to-toe MRI preventive screening.

Fonar's areas of operations are principally in the United States. During the fiscal year ended June 30, 2001, 0% of the Company's revenues were generated by foreign sales, as compared to 2.8% and 3.4% for fiscal 2000 and 1999 respectively.

The Company is seeking to promote foreign sales and has sold scanners in various foreign countries. Foreign sales, however, have not yet proved to be a significant source of revenue.

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### SERVICE AND UPGRADES FOR MRI SCANNERS

The Company's customer base of installed scanners has been and will continue to be an additional source of income, independent of direct sales.

Income is generated from the installed base in two principal areas namely, service and upgrades. Service and maintenance revenues from the Company's installed base were approximately \$2.3 million in fiscal 1999, \$1.7 million in fiscal 2000 and \$2.0 million in fiscal 2001. The decrease in fiscal 2000 was principally the result of the retirement of old scanners. This trend has been reversed in 2001.

The Company anticipates that its new line of scanners will result in upgrades income in future fiscal years. The potential for upgrades income originates in the versatility and productivity of the MRI technology. New medical uses for the technology are constantly being discovered. New features can often be added to the scanner by the implementation of little more than versatile new software packages. For example, software can be added to current MRI angiograms to synchronize the angiograms to the cardiac cycle. By doing so the dynamics of blood vessel filling and emptying can be visualized with movies. Such enhancements are attractive to the end users because they extend the useful life of the equipment and enable the user to avoid obsolescence and the expense of having to purchase new equipment. At the present time, however, upgrade revenue is not significant. Upgrade revenues were approximately \$14,500 in fiscal 1999, \$36,000 in fiscal 2000 and \$0 in fiscal 2001.

Service and upgrade revenues are expected to increase as sales of scanners and the size of the customer base increases.

### RESEARCH AND DEVELOPMENT

During the fiscal year ended June 30, 2001, the Company incurred expenditures of \$6,621,225 (\$754,804 of which was capitalized) on research and development, as compared to \$5,893,648 (\$361,323 of which was capitalized) and \$6,647,555 (none of which was capitalized) incurred during the fiscal years ended June 30, 2000 and June 30, 1999, respectively.

Research and development activities have focused principally, on the development and enhancement of the new Indomitable (TM) and Fonar 360 MRI scanners and its new extremities scanner. The Indomitable (TM) MRI, Fonar 360(OR-360 and Open Sky MRI), involve significant software and hardware development as the new products represent entirely new hardware designs and architecture requiring a new operating software. The Company's research activity includes developing a multitude of new features for the upright scanning made possible by the high speed processing power of its scanners. In addition, the Company's research and development efforts include the development of new software, such as its "Sympulse" (TM) software and hardware upgrade. The Company received FDA approval for the Sympulse upgrade in January, 2001.

### BACKLOG

The Company's backlog of unfilled orders at July 1, 2001 was approximately \$10.8 million, as compared to \$2.05 million at July 1, 2000. Of these amounts, approximately \$1.6 million and \$0.45 million had been paid to the Company as customer advances as at July 1, 2001 and July 1, 2000, respectively. Of the backlog amounts at July 1, 2001, \$4.4 million represented orders from affiliates. It is expected that the existing backlog of orders will be filled within the current fiscal year. The Company's contracts generally provide that if a customer cancels an order, the customer's initial down payment for the MRI scanner is nonrefundable.

### PATENTS AND LICENSES

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The Company currently has numerous patents in effect which relate to the technology and components of the MRI scanners. The Company believes that these patents, and the know-how it developed, are material to its business.

Dr. Damadian granted an exclusive world-wide license to the Company to make, use and sell apparatus covered by certain domestic and foreign patents in his name relating to MRI technology. No patents covered by this license are in effect any longer.

One of the patents, issued in the name of Dr. Damadian and covered by said license, was United States patent No. 3,789,832, Apparatus and Method for Detecting Cancer in Tissue (the "1974 Patent"). The development of the Beta 3000 was based upon the 1974 Patent, and Management believes that the 1974 Patent was the first of its kind to utilize MR to scan the human body and to detect cancer. The 1974 Patent was extended beyond its original 17-year term and expired in February, 1992. None of the recoveries with respect to the enforcement of this patent were received by Dr. Damadian.

Historically, the patent for multiple angle oblique imaging generated significant revenues in connection with the enforcement and settlement of our patent litigations. As a result of these litigations and settlements, our competitors are now entitled to use this technology as well. This patent will expire in 2006.

The Company has significantly enhanced its patent position within the industry and now possesses a substantial patent portfolio which provides the Company, under the aegis of United States patent law, "the exclusive right to make, use and sell" many of the scanner features which FONAR pioneered and which are now incorporated in most MRI scanners sold by the industry. The Company has 59 patents issued and 62 patents pending. A substantial number of FONAR's existing patents specifically relate to protecting FONAR's position in the high field iron frame open MRI market. The patents further enhance Dr. Damadian's pioneer patent (the 1974 Patent), that initiated the MRI industry and provided the original invention of MRI scanning. The 59 issued patents expire at various times between June 23, 2004 and November 25, 2018.

The Company has entered into a cross-licensing agreement (utilizing other than FONAR's MRI technology) with another entity to use prior art developed for nuclear magnetic resonance technology and has entered into a license to utilize the MRI technology covered by the existing patent portfolio of a patent holding company. The Company also has patent cross-licensing agreements with other MRI manufacturers.

### PRODUCT COMPETITION

#### MRI SCANNERS

A majority of the MRI scanners in use in hospitals and outpatient facilities and at mobile sites in the United States are based on high field air core magnet technology while the balance are based on open iron frame magnet technology. In 1998 the size of the MRI market in the United States was approximately \$957 million. The market share of high field air core MRI's was approximately 57%. In 1999 the size of the MRI market in the United States was approximately \$1.074 billion. FONAR's open iron frame MRI scanners are competing principally with high field air core scanners. The QUAD 12000 scanner, however, utilizing a 6,000 gauss (0.6 Tesla field strength) iron core electromagnet, is the first "open" MR scanner at high field strength. In addition FONAR's works-in-progress include a superconductive version of its open iron frame magnets.

FONAR believes that its MRI scanners have significant advantages as



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compared to the high field air core scanners of its competitors. These advantages include:

1. There is no expansive fringe magnetic field. High field air core scanners require a more expensive shielded room than is required for the iron frame scanners. The shielded room required for the iron frame scanners is intended to prevent interference from external radio frequencies.

2. They are more open, quiet and in the case of the QUAD scanners allow for faster throughput of patients.

3. Their annual operating costs are lower.

4. They can scan the trauma victim, the cardiac arrest patient, the respirator-supported patient, and premature and newborn babies. This is not possible with high field air core scanners because their magnetic field interferes with conventional life-support equipment.

The principal competitive disadvantage of the Company's products is that they are not "high field strength" (1.0 Tesla +) magnets. As a general principle, the higher field strength can produce a faster scan. In some parts of the body a faster scan can be traded for a clearer picture. Although the Company believes that the lower cost of its systems plus the benefits of "openness" provided by its scanners compensate for the lower field strength, certain customers will still prefer the higher field strength.

FONAR faces competition within the MRI industry from such firms as General Electric Company; Marconi Medical (formerly Picker International), Philips N.V., Toshiba Corporation, Hitachi Corporation and Siemens A.G. Most competitors have marketing and financial resources more substantial than those available to the Company and have in the past, and may in the future, heavily discount the sales price of their scanners. Such competitors sell both high field air core and iron frame products. FONAR's current market share of the market for MRI scanners is less than 1.0%. FONAR introduced the first "Open MRI" in 1982. "Open MRI" was made possible by FONAR's introduction of an MRI magnet built on an iron frame. Thus the magnetic flux generating apparatus of the magnet (magnet coils or permanent magnet bricks) was built into a frame of steel. The steel frame provided a return path for the magnetic lines of force and thereby kept the magnetic lines of force contained within the magnet. This enabled FONAR, from 1982 on, to show that the FONAR magnet was the only magnet that allowed the patients to stretch out their arms, the only "open" MRI.

The iron frame, because it could control the magnetic lines of force and place them where wanted and remove them from where not wanted (such as in the operating room where surgeons are standing), provided a much more versatile magnet design than was possible with air core magnets. Air core magnets contain no iron but consist entirely of turns of current carrying wire. FONAR's patented work-in-progress superconductive iron frame magnet, however, combines the high field capability of the air core superconductive magnets with the control and versatility of the open iron frame magnets, thereby joining the best features of both designs into a single magnet. Thus the air core superconductive magnets made by Fonar's large competitors that have dominated the MRI market since 1983 remain the confining "tunnel" design that the public has generally resented.

For an 11 year period from 1983-1994, Fonar's large competitors (with one exception) generally rejected Fonar's "open" design but by 1994 all (with one exception) added the iron frame "open" magnet to their MRI product line. In 1997 the sale of iron frame "open" magnets exceeded the sale of traditional air core superconductive magnets. One principal reason for this market shift, in addition to patient claustrophobia, is the awareness that the "open" magnet designs permit access to the patient to perform surgical procedures under MRI image guidance, a field which is now growing rapidly and is called "interventional

MRI."

Fonar's future OR-360 version of the Fonar 360 explicitly addresses this growing market reception of MRI guided surgical procedures but is not yet available as a product. Fonar's Indomitable and QUAD series magnets do also. Although not enabling a full operating theater as the OR-360 does, the iron frame "Open" QUAD and Indomitable designs permit ready access to the patient from four sides and therefore enables a wide range of interventional surgical procedures such as biopsies and needle or catheter delivered therapies to be performed under MRI image guidance. The "tunnel" air core superconductive scanners do not permit access to the patient while the patient is inside the scanner.

While Fonar's current market share of the domestic MRI market is under 1.0%, FONAR expects to be a leader in domestic open market for several reasons. In MRI, scanning speed and image quality is controlled by the strength of the magnetic field. Fonar's QUAD 12000 scanner operates at almost twice the field strength of the next highest field strength open magnet, manufactured by Toshiba (0.6 Tesla vs. 0.35 Tesla). The Company's Fonar 360 and Indomitable scanners also operate at this field strength. High field MRI manufacturers convinced the marketplace for FONAR, and the marketplace accepts, that higher field strength translates directly into superior image quality and faster scanning speeds. This is the principal reason GE's 1.5 Tesla air core superconductive scanner achieved market dominance in the MRI market before the marketplace shifted and registered an increased demand for the iron frame "Open MRI." No companies possess the Fonar 360 and FONAR possesses the pioneer patents on "Open MRI" technology.

#### OTHER IMAGING MODALITIES

FONAR's MRI scanners also compete with other diagnostic imaging systems, all of which are based upon the ability of energy waves to penetrate human tissue and to be detected by either photographic film or electronic devices for presentation of an image on a television monitor. Three different kinds of energy waves - X-ray, gamma and sound - are used in medical imaging techniques which compete with MRI medical scanning, the first two of which involve exposing the patient to potentially harmful radiation. These other imaging modalities compete with MRI products on the basis of specific applications.

X-rays are the most common energy source used in imaging the body and are employed in three imaging modalities:

1. Conventional X-ray systems, the oldest method of imaging, are typically used to image bones and teeth. The image resolution of adjacent structures that have high contrast, such as bone adjacent to soft tissue, is excellent, while the discrimination between soft tissue organs is poor because of the nearly equivalent penetration of x-rays.

2. Computerized Tomography ("CT") systems couple computers to x-ray instruments to produce cross-sectional images of particular large organs or areas of the body. The CT scanner addresses the need for images, not available by conventional radiography, that display anatomic relationships spatially. However, CT images are generally limited to the transverse plane and cannot readily be obtained in the two other planes (sagittal and coronal). Improved picture resolution is available at the expense of increased exposure to x-rays from multiple projections. Furthermore, the pictures obtained by this method are computer reconstructions of a series of projections and, once diseased tissue has been detected, CT scanning cannot be focused for more detailed pictorial analysis or obtain a chemical analysis.

3. Digital radiography systems add computer image processing capability to conventional x-ray systems. Digital radiography can be used in a number of diagnostic procedures which provide continuous imaging of a particular area with

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enhanced image quality and reduced patient exposure to radiation.

Nuclear medicine systems, which are based upon the detection of gamma radiation generated by radioactive pharmaceuticals introduced into the body, are used to provide information concerning soft tissue and internal body organs and particularly to examine organ function over time.

Ultrasound systems emit, detect and process high frequency sound waves reflected from organ boundaries and tissue interfaces to generate images of soft tissue and internal body organs. Although the images are substantially less detailed than those obtainable with x-ray methods, ultrasound is generally considered harmless and therefore has found particular use in imaging the pregnant uterus.

X-ray machines, ultrasound machines, digital radiography systems and nuclear medicine compete with the MRI scanners by offering significantly lower price and space requirements. However, FONAR believes that the quality of the images produced by its MRI scanners is generally superior to the quality of the images produced by those other methodologies.

### GOVERNMENT REGULATION

#### FDA Regulation

The Food and Drug Administration in accordance with Title 21 of the Code of Federal Regulations regulates the manufacturing and marketing of FONAR's MRI scanners. The regulations can be classified as either pre-market or post-market. The pre-market requirements include obtaining marketing clearance, proper device labeling, establishment registration and device listing. Once the products are on the market, FONAR must comply with post-market surveillance controls. These requirements include the Quality Systems (QS) regulation, also known as Good Manufacturing Practices or GMPs, and Medical Device Reporting (MDR) regulations. The QS regulation is a quality assurance requirement that covers the design, packaging, labeling and manufacturing of a medical device. The MDR regulation is an adverse event-reporting program.

#### Classes of Products

Under the Medical Device Amendments of 1976 to the Federal Food, Drug and Cosmetic Act, all medical devices are classified by the FDA into one of three classes. A Class I device is subject only to certain controls, such as labeling requirements and manufacturing practices; a Class II device must comply with certain performance standards established by the FDA; and a Class III device must obtain pre-market approval from the FDA prior to commercial marketing.

FONAR's products are Class II devices. Class I devices are subject to the least regulatory control. They present minimal potential for harm to the user and are often simpler in design than Class II or Class III devices. Class I devices are subject to "General Controls" as are Class II and Class III devices. General Controls include: 1. Establishment registration of companies which are required to register under 21 CFR Part 807.20, such as manufacturers, distributors, re-packagers and re-labelers. 2. Medical device listing with FDA of devices to be marketed. 3. Manufacturing devices in accordance with the Good Manufacturing Practices (GMP) regulation in 21 CFR Part 820. 4. Labeling devices in accordance with labeling regulations in 21 CFR Part 801 or 809. 5. Submission of a Premarket Notification [510(k)] before marketing a device.

Class II devices are those for which general controls alone are insufficient to assure safety and effectiveness, and existing methods are available to provide such assurances. In addition to complying with general controls, Class II devices are also subject to special controls. Special

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controls may include special labeling requirements, guidance documents, mandatory performance standards and post-market surveillance.

The Company received approval to market its Beta 3000 and Beta 3000M scanners as Class III devices on September 26, 1984 and November 12, 1985. On July 28, 1988, the Magnetic Resonance Diagnostic Device which includes MR Imaging and MR Spectroscopy was reclassified by the FDA to Class II status. Consequently, Fonar's products are now classified as Class II products. On June 25, 1992, Fonar received FDA clearance to market the Ultimate Magnetic Resonance Imaging Scanner as a Class II device. Fonar received FDA clearance to market the QUAD 7000 in April 1995 and the QUAD 12000 in November 1995. On March 16, 2000, Fonar received FDA clearance to market the Fonar 360 for diagnostic imaging (the Open Sky version). On August 9, 2000, the Company applied for FDA clearance for the Stand-Up MRI. The Company anticipates that it will need FDA clearance for Pinnacle MRI scanners and may need clearance for the OR-360 version of the Fonar 360.

### Premarketing Submission

Each person who wants to market Class I, II and some III devices intended for human use in the U.S. must submit a 510(k) to FDA at least 90 days before marketing unless the device is exempt from 510(k) requirements. A 510(k) is a pre-marketing submission made to FDA to demonstrate that the device to be marketed is as safe and effective, that is, substantially equivalent (SE), to a legally marketed device that is not subject to pre-market approval (PMA). Applicants must compare their 510(k) device to one or more similar devices currently on the U.S. market and make and support their substantial equivalency claims.

The FDA is committed to a 90-day clearance after submission of a 510(k), provided the 510(k) is complete and there is no need to submit additional information or data.

The 510(k) is essentially a brief statement and description of the product. As Fonar's scanner products are Class II products, there are no pre-market data requirements and the process is neither lengthy nor expensive.

An investigational device exemption (IDE) allows the investigational device to be used in a clinical study pending FDA clearance in order to collect safety and effectiveness data required to support the Premarket Approval (PMA) application or a Premarket Notification [510(k)] submission to the FDA. Clinical studies are most often conducted to support a PMA.

For the most part, however, Fonar has not found it necessary to utilize IDE's. The standard 90 day clearance for our new MRI scanner products classified as Class II products makes the IDE unnecessary, particularly in view of the time and effort involved in compiling the information necessary to support an IDE.

### Quality System Regulation

The Quality Management System is applicable to the design, manufacture, administration of installation and servicing of magnetic resonance imaging scanner systems. The FDA has authority to conduct detailed inspections of manufacturing plants, to establish Good Manufacturing Practices which must be followed in the manufacture of medical devices, to require periodic reporting of product defects and to prohibit the exportation of medical devices that do not comply with the law.

Two of the required elements under the QS regulation are design controls and labeling. Each manufacturer is required by regulation to establish and maintain design control procedures and proper labeling.

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Because the intrinsic quality level of devices and processes is established during the design phase, the quality system program includes this phase to assure overall quality, meet customer requirements, meet company quality claims, and comply with the intent of the Food Drug & Cosmetics Act.

By a formal process under a total quality system during the design phase, clear and concise printed and/or software labeling are written and reviewed; and the ink substrate and attachment methods for printed labeling are developed. Such labeling is designed to meet customer and regulatory requirements. Thereafter, the procurement, use of the correct label, and correct attachment of labels will be assured under the quality system element for these activities during manufacturing.

### Medical Device Reporting Regulation

Manufacturers must report all MDR reportable events to the FDA. Each manufacturer must review and evaluate all complaints to determine whether the complaint represents an event which is required to be reported to FDA. Section 820.3(b) of the Quality Systems regulation defines a complaint as, "any written, electronic or oral communication that alleges deficiencies related to the identity, quality, durability, reliability, safety, effectiveness, or performance of a device after it is released for distribution."

A report is required when a manufacturer becomes aware of information that reasonably suggests that one of their marketed devices has or may have caused or contributed to a death, serious injury, or has malfunctioned and that the device or a similar device marketed by the manufacturer would be likely to cause or contribute to a death or serious injury if the malfunction were to recur.

Malfunctions are not reportable if they are not likely to result in a death, serious injury or other significant adverse event experience.

A malfunction which is or can be corrected during routine service or device maintenance still must be reported if the recurrence of the malfunction is likely to cause or contribute to a death or serious injury if it were to recur.

Fonar has established and maintains written procedures for implementation of the MDR regulation. These procedures include internal systems that:

- provide for timely and effective identification, communication and evaluation of adverse events;

- provide a standardized review process and procedures for determining whether or not an event is reportable; and

- provide procedures to insure the timely transmission of complete reports.

These procedures also include documentation and record keeping requirements for:

- information that was evaluated to determine if an event was reportable;

- all medical device reports and information submitted to the FDA;

- any information that was evaluated during preparation of annual certification report(s); and

- systems that ensure access to information that facilitates timely follow up and inspection by FDA.

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### FDA Enforcement

FDA may take the following actions to enforce the MDR regulation:

#### FDA-Initiated or Voluntary Recalls

Recalls are regulatory actions that remove a hazardous, potentially hazardous, or a misbranded product from the marketplace. Recalls are also used to convey additional information to the user concerning the safe use of the product. Either FDA or the manufacturer can initiate recalls.

There are three classifications, i.e., I, II, or III, assigned by the Food and Drug Administration to a particular product recall to indicate the relative degree of health hazard presented by the product being recalled.

#### Class I

Is a situation in which there is a reasonable probability that the use of, or exposure to, a violative product will cause serious adverse health consequences or death.

#### Class II

Is a situation in which use of, or exposure to, a violative product may cause temporary or medically reversible adverse health consequences or where the probability of serious adverse health consequences is remote.

#### Class III

Is a situation in which use of, or exposure to, a violative product is not likely to cause adverse health consequences.

FONAR has initiated four Class II recalls. The recalls involved making minor corrections to the product in the field. Frequently, corrections which are made at the site of the device are called field corrections as opposed to recalls.

#### Civil Money Penalties

The FDA, after an appropriate hearing, may impose civil money penalties for violations of the FD&C Act that relate to medical devices. In determining the amount of a civil penalty, FDA will take into account the nature, circumstances, extent, and gravity of the violations, the violator's ability to pay, the effect on the violator's ability to continue to do business, and any history of prior violations. The civil money penalty may not exceed \$15,000 for each violation and may not exceed \$1,000,000 for all violations adjudicated in a single proceeding, per person.

#### Warning Letters

FDA issues written communications to a firm, indicating that the firm may incur more severe sanctions if the violations described in the letter are not corrected. Warning letters are issued to cause prompt correction of violations that pose a hazard to health or that involve economic deception. The FDA generally issues the letters before pursuing more severe sanctions.

#### Seizure

A seizure is a civil court action against a specific quantity of goods which enables the FDA to remove these goods from commercial channels. After seizure, no one may tamper with the goods except by permission of the court. The

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court usually gives the owner or claimant of the seized merchandise approximately 30 days to decide a course of action. If they take no action, the court will recommend disposal of the goods. If the owner decides to contest the government's charges, the court will schedule the case for trial. A third option allows the owner of the goods to request permission of the court to bring the goods into compliance with the law. The owner of the goods is required to provide a bond (security deposit) to assure that they will perform the orders of the court, and the owner must pay for FDA supervision of any activities by the company to bring the goods into compliance.

### Citation

A citation is a formal warning to a firm of intent to prosecute the firm if violations of the FD&C Act are not corrected. It provides the firm an opportunity to convince FDA not to prosecute.

### Injunction

An injunction is a civil action filed by FDA against an individual or company. Usually, FDA files an injunction to stop a company from continuing to manufacture, package or distribute products that are in violation of the law.

### Prosecution

Prosecution is a criminal action filed by FDA against a company or individual charging violation of the law for past practices.

### Foreign and Export Regulation

The Company obtains approvals as necessary in connection with the sales of its products in foreign countries. In some cases, FDA approval has been sufficient for foreign sales as well. The Company's standard practice has been to require either the distributor or the customer to obtain any such foreign approvals or licenses which may be required.

Legally marketed devices that comply with the requirements of the Food Drug & Cosmetic Act require a Certificate to Foreign Government issued by the FDA for export. Other devices that do not meet the requirements of the FD&C Act but comply with the laws of a foreign government require a Certificate of Exportability issued by the FDA. All products which Fonar sells have FDA clearance and would fall into the first category.

Foreign governments have differing requirements concerning the import of medical devices into their respective jurisdictions. The European Union (EU), made up of 15 individual countries, has some essential requirements described in the EU's Medical Device Directive (MDD). In order to export to one of these countries, FONAR must meet the essential requirements of the MDD and any additional requirements of the importing country. The essential requirements are similar to some of the requirements mandated by the FDA. In addition the MDD requires that FONAR enlist a Notified Body to examine and assess our documentation (Technical Construction File) and verify that the product has been manufactured in conformity with the documentation. The notified body must carry out or arrange for the inspections and tests necessary to verify that the product complies with the essential requirements of the MDD, including safety performance and Electromagnetic Compatibility (EMC). Also required is a Quality System (ISO-9001) assessment by the Notified Body. Fonar was approved for ISO 9001 certification for its Quality Management System in April, 1999.

Fonar received clearance to sell the Quad scanners in the EU in May, 1999 and is working on obtaining clearance for the Fonar 360 and Stand-Up scanners.

Other countries such as China and Russia require that their own testing

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laboratories perform an evaluation of our devices. This requires that we must bring the foreign agency's personnel to the USA to perform the evaluation at Fonar's expense before exporting.

Some countries, including many in Latin America and Africa, have very few regulatory requirements.

Because Fonar's export sales are not material at this point, foreign regulation does not have a material effect on Fonar. In any case, Fonar does not believe that foreign regulation will deter its efforts to penetrate foreign markets.

### Reimbursement to Medical Providers for MRI Scans

Effective November 22, 1985, the Department of Health and Human Services authorized reimbursement of MRI scans under the Federal Medicare program. In addition, most private insurance companies have authorized reimbursement for MRI scans.

### Anti-Kickback and Self-Referral Legislation

Proposed and enacted legislation at the State and Federal levels has restricted referrals by physicians to medical and diagnostic centers in which they or their family members have an interest. In addition, regulations have been adopted by the Secretary of Health and Human Services which provide limited "safe harbors" under the Medicare Anti-Kickback Statute. These safe harbors describe payments and transactions which are permitted between an entity receiving reimbursement under the Medicare program and those having an interest in or dealings with the entity. Although the Company cannot predict the overall effect of the adoption of these regulations on the medical equipment industry, the use and continuation of limited partnerships (where investors may be referring physicians) to own and operate MRI scanners could be greatly diminished.

### HEALTH MANAGEMENT CORPORATION OF AMERICA (PHYSICIAN AND DIAGNOSTIC MANAGEMENT SERVICES BUSINESS)

Health Management Corporation of America (formerly known as U.S. Health Management Corporation and referred to as "HMCA") was organized by the Company in March 1997 as a wholly-owned subsidiary for the purpose of engaging in the business of providing comprehensive management services to physicians' practices and other medical providers, including diagnostic imaging centers and ancillary services. The services provided by the Company include development, administration, leasing of office space, facilities and medical equipment, provision of supplies, staffing and supervision of non-medical personnel, legal services, accounting, billing and collection and the development and implementation of practice growth and marketing strategies.

Since its formation, HMCA has completed five acquisitions. HMCA became actively engaged in the physician and diagnostic management services business through its initial two acquisitions which were consummated effective June 30, 1997. Following these two initial acquisitions, HMCA completed two additional acquisitions in fiscal 1998 and one additional acquisition in fiscal 1999. Dr. Raymond V. Damadian, the President, Chairman of the Board and principal stockholder of Fonar, was the owner of Raymond V. Damadian, M.D. MR Scanning Centers Management Company, which was acquired by HMCA in the second acquisition. The entities acquired in the other acquisitions were not affiliates of either Fonar or Dr. Damadian.

The first acquisition was of a group of several interrelated corporations, limited liability companies and a partnership engaged in the business of



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managing three diagnostic imaging centers and one multi-specialty practice in New York State. The transaction was effected through a merger between a wholly-owned subsidiary of HMCA (formed for the purpose of effecting the transaction) and Affordable Diagnostics, Inc., one of the acquired companies which immediately prior to the merger had acquired the assets and assumed the liabilities of the other acquired companies (together, the "Affordable Companies"). The consideration paid for the Affordable Companies consisted of 2,340,000 shares of the common stock of Fonar.

The business of the Affordable Companies, which is being continued by HMCA, consisted of providing management, space, equipment, personnel and other resources to the four managed facilities. The services provided at the facilities include MRI scans, CAT scans, x-rays, physical rehabilitation, and in connection with physical rehabilitation, ultra-sound and SSEP/EMG electromyographic diagnostics. The four managed facilities are located in Brewster, New York (MRI), Yonkers, New York (MRI and x-ray), Bronx, New York (MRI and CT) and Riverdale, New York (multi-specialty practice, ultra-sound and SSEP/EMG electromyographic diagnostics). The assets acquired through the acquisition include three MRI scanners, one CT scanner, one x-ray machine, rehabilitation equipment and ultra-sound and electromyographic machines. The equipment is leased to and used at the managed facilities. In addition, HMCA consummated the acquisition of an additional MRI scanner pursuant to a contract entered into prior to the acquisition.

The second completed acquisition was of Raymond V. Damadian, M.D. MR Scanning Centers Management Company ("RVDC"). Pursuant to the terms of the transaction, HMCA purchased all of the issued and outstanding shares of stock of RVDC from Raymond V. Damadian in exchange for 10,000 shares of the Common Stock of FONAR. Raymond V. Damadian, the principal stockholder, President and Chairman of the Board of FONAR, was the sole stockholder, director and President of RVDC immediately prior to the acquisitions. The business of RVDC, which is being continued by HMCA, was the management of MRI diagnostic imaging centers in New York, Florida, Georgia and other locations. The assets of RVDC included nine MRI scanners, office equipment and office furnishings. RVDC also held partnership interests in three partnerships owning MRI scanning centers.

As a result of the acquisition of RVDC, HMCA acquired the business of managing 21 MRI scanning centers. Eighteen of the scanning centers were managed pursuant to management agreements, and 3 of the centers are partnerships with RVDC as the general partner. Effective July 1, 1997, HMCA entered into new management agreements with the centers. Pursuant to the management agreements, HMCA provided comprehensive management services, including administrative services, office facilities, office equipment, supplies and personnel (except for physicians) to the centers. Service for the centers' MRI scanning equipment is provided under the management agreements in these cases. MRI scanning systems are provided to 9 of the centers pursuant to scanner leases entered into effective July 1, 1997. All of the facilities previously managed by RVDC are MRI scanning centers.

The third completed acquisition, consummated on January 20, 1998, was an acquisition of the business and assets of Central Health Care Services Management Company, LLC (Central Health). Central Health is a management service organization (MSO) managing a multi-specialty practice in Yonkers, New York. The assets acquired include therapy and rehabilitation equipment, x-ray equipment, office equipment and office furnishings. The purchase price of Central Health was \$1,454,160, of which \$601,665 was paid in cash, \$551,665 by notes, \$25,000 by assumptions of liabilities and the balance in shares of Fonar common stock valued at \$275,830.

The fourth completed acquisition, consummated effective March 20, 1998, was the acquisition of A & A Services, Inc. ("A & A Services"), an MSO managing four primary care practices in Queens County, New York. A & A Services provides the

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practices with management services, office space, equipment, repair and maintenance service for the equipment and clerical and other non medical personnel. The office locations for the practices are located in Woodhaven, Richmond Hill, Corona and Ridgewood in Queens County, New York and account for over 39,000 primary care patient visits per year. The assets owned by A&A Services included medical and office equipment and office furnishings. The purchase price for A&A was \$10 million, \$4 million of which was paid in cash at closing and \$6 million of which is payable pursuant to promissory notes over a total of six years from closing. The notes are secured by the assets of the acquired businesses as of the date of the acquisition. Additional consideration is payable if net income for the acquired business exceeds \$2.3 in any of the five years following the closing as follows: in each year, 75% of net income between \$2.3 million and \$2.8 million; 50% of net income between \$2.8 million and \$3.5 million and 25% of net income in excess of \$3.5 million. During the fiscal year ended June 30, 2001, the net operating income from the A&A acquisition was approximately \$234,000 and for the years ended June 30, 2000 and June 30, 1999 approximately \$1.2 million and \$1.6 million, respectively.

In connection with the acquisition, one of the companies managed by HMCA entered into fifteen year term employment agreements with the two former owners of A & A Services. The agreements provides for a base annual salary of \$150,000 per annum for the first five years and of \$315,000 per annum for sixth year. Thereafter the salaries increase 5% per year up to \$500,000 per annum. Additionally, each agreement provides for a bonus commencing in the sixth year of the agreement, contingent upon meeting thresholds of net income.

The fifth completed acquisition, consummated effective August 20, 1998, was the acquisition of Dynamic Health Care Management, Inc. ("Dynamic"). Dynamic is an MSO which manages three physician practices in Nassau and Suffolk Counties on Long Island, New York. The office locations for these practices are in Bellmore and Hempstead in Nassau County and Deer Park in Suffolk County and account for approximately 109,000 patient visits per year. The assets of Dynamic included therapy and rehabilitation equipment, office equipment and office furnishings. The purchase price for Dynamic was \$11,576,231, consisting of \$2.0 million in cash and the balance payable pursuant to promissory notes over an aggregate period of five years from the closing. The notes are secured by the assets of the acquired business as of the date of the acquisition.

In connection with the acquisition of Dynamic, HMCA entered into ten year term employment agreements with the two former owners of Dynamic. Each agreement provides for base compensation of \$150,000 in the first year with annual cost of living increases for the first five years and an increase of \$100,000 commencing in the sixth year. In addition, the agreements provide for bonus compensation contingent upon the pretax earnings of Dynamic.

### HMCA GROWTH STRATEGY

In addition to purchasing management companies, HMCA may also pursue acquisitions in which HMCA would purchase the assets of physicians' practices. Simultaneously with the acquisition of the assets, HMCA would enter into agreements with the physicians (or a professional corporation employing the physicians) pursuant to which HMCA would lease the use of the assets and provide management services to the physicians or their professional corporations. The professional corporation could be either affiliated with HMCA or owned by the selling physicians. This second alternative has not been utilized by HMCA to date.

HMCA believes that there are numerous existing medical practices that could benefit from improved management techniques which would allow the physicians to spend more time treating patients (thereby increasing their revenue) and less time being concerned with the day to day tasks of managing the business. Although the disadvantages to physicians would be the increased administrative

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costs in the form of management fees payable to HMCA, and the lack of direct accountability of the nonprofessional staff to the physicians, the Company believes the ability of the physicians to spend more time practicing medicine will more than compensate for these disadvantages.

In addition, expansion plans for HMCA's clients include opening more offices and expanding existing offices so as to enable practices to treat more patients more efficiently.

HMCA is seeking to create a network of physicians to participate in managed care and to promote an expansion of the medical services offered by its medical practice clients.

HMCA believes that the creation of this network will be particularly helpful to its clients where capitated fee agreements are negotiated with insurers since its clients will be able to offer more services from more locations and thereby obtain a higher capitation rate than they might otherwise have been able to obtain. Capitated fee arrangements are arrangements with HMO's whereby the physician or physician practice is paid a fixed monthly fee based on the age and gender of covered person. The fees vary from HMO to HMO and are essentially set by the HMO's.

HMCA's growth strategy is intended to enable its medical practice clients to retain and enhance revenues and to offer patients cost-effective medical care within an integrated practice offering a broad range of evaluation, testing, diagnostic, treatment and therapeutic services. In the longer term, as the network of offices to which it provides its management services grows, HMCA believes that it will be in an excellent position to attract managed care contracts for its clients from employers and insurance carriers.

During the fiscal years ended June 30, 2001 and June 30, 2000, however, HMCA did not conclude any additional acquisitions primarily because it has not had the capital resources to acquire suitable businesses on favorable terms. HMCA was unable in negotiations to offer substantial cash payments at closing but had to seek longer payout terms. HMCA has been unable to identify any businesses available for acquisition which it believed represented good value on such terms.

### PHYSICIAN AND DIAGNOSTIC MANAGEMENT SERVICES

HMCA's services to the facilities and practices it manages encompass substantially all of the their business operations. The medical and professional operations of the facilities and medical practices are controlled, however, by the physicians, not HMCA, and all medical services are performed by the physicians. HMCA is the management company and performs services of a non-professional nature. These services include:

- (1) Offices and Equipment. HMCA provides office space and equipment to its clients. This includes technologically sophisticated medical equipment. HMCA also provides improvements to leaseholds, assistance in site selection and advice on improving, updating, expanding and adapting to new technology.
- (2) Personnel. HMCA staffs all the non-medical positions of its clients with its own employees, eliminating the client's need to interview, train and manage non-medical employees, as well as process the necessary tax, insurance and other documentation relating to employees.
- (3) Administrative. HMCA assists in the scheduling of patient appointments, purchasing of medical supplies and equipment and handling of reporting, accounting, processing and filing systems. It prepares and files the physician portions of complex forms to ensure full and timely regulatory

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compliance and appropriate cost reimbursement under no-fault insurance and workers' compensation guidelines.

- (4) Billing and Collections. HMCA is responsible for the billing and collection of revenues from third-party payors including those governed by no-fault and workers' compensation statutes.
- (5) Cost Saving Programs. Based on available volume discounts, HMCA seeks to obtain favorable pricing for medical supplies, equipment, pharmaceuticals and other inventory for its clients.
- (6) Diagnostic Imaging and Ancillary Services. HMCA can offer access to diagnostic imaging equipment through diagnostic imaging facilities managed by it. The Company is expanding the ancillary services offered in its network to include CT-scans, x-rays, ultrasound, and other ancillary services useful to its clients.
- (7) Marketing Strategies. HMCA is responsible for developing marketing plans for its clients.
- (8) Expansion Plans. HMCA assists the clients in developing expansion plans. These plans are mutually developed. Additional physicians and physicians assistants have been added where needed.

HMCA advises clients on all aspects of their business, including expansion where it is a reasonable objective, on a continuous basis. HMCA's objective is to free physicians from as many non-medical duties as practicable. Practices can treat patients more efficiently if the physicians can spend less time on business and administrative matters and more time practicing medicine.

HMCA provides its services pursuant to negotiated contracts with its clients. While HMCA believes it can provide the greatest value to its clients by furnishing the full range of services appropriate to that client, HMCA would also be willing to enter into contracts providing for a more limited spectrum of management services.

In the case of contracts with the MRI facilities, fees are charged by HMCA based on the number of procedures performed. These agreements are for one year terms which renew automatically unless notice of termination is provided at least 60 days prior to the commencement of each renewal term. The fees are reviewed and subject to adjustment on an annual basis. Adjustments require mutual agreement. Currently the per procedure charges to the MRI facilities range from \$250 to \$760 per MRI scan.

In the case of the physical rehabilitation and medical practices, fixed fees are charged on a monthly basis. These fees are adjusted annually, historically on the basis of changes in HMCA's costs plus a percentage. The agreements with the physical rehabilitation and medical practices have a term of twenty years. The monthly fees charged to the medical and physical rehabilitation practices range from approximately \$53,850 to \$272,500. Only one medical practice, located in Florida where the corporate practice of medicine is permitted, is owned by HMCA. Only one chiropractic practice managed by HMCA, providing HMCA with management fees of approximately \$210,000 in fiscal 2001, is owned by a seller in an acquisitions.

The practices and the facilities enter into contracts with managed care companies. Although HMCA negotiates and administers these contracts on behalf of the practices and facilities, the contracts are with either the practices and facilities or the individual practicing physicians. With the exception of some capitated health plans in which the medical practices participate, neither HMCA's clients nor HMCA participate in any risk sharing arrangements capitated plans are those HMO programs where the provider is paid a flat monthly fee per

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patient. For the fiscal years ended June 30, 2001 and June 30, 2000, fees to HMCA's clients from capitated plans amounted to approximately \$814,000 and \$1.0 million, respectively, an amount equal to 2.6% and 3.3% respectively, of HMCA's revenues for the fiscal year. All of these were attributable to medical professional corporations managed by A & A Services, Inc., representing 26%, and 25% of their revenues in fiscal 2001 and fiscal 2000, respectively.

### HMCA MARKETING

HMCA's marketing strategy is to increase the size, number and locations of medical practices and facilities which it manages. HMCA will also seek to broaden the types of medical practices which it services and to develop a client base of primary care and specialty practices as well as diagnostic imaging facilities and other ancillary services. HMCA will seek to promote growth of its clients' patient and revenue bases by developing a network of medical providers and assisting its clients in the development of multi-specialty medical practices.

Marketing activities include locating medical practices which meet the size, quality and operating parameters set by HMCA. HMCA will focus on opportunities for expanding the services clients offer and expanding into new geographic areas. HMCA will also seek to increase the patient volume of clients.

To date, HMCA has not been able to add a significant number of specialty practices to its client base. In part this difficulty stems from HMCA's lack of capital resources to fund acquisitions; this lack of capital resources similarly has prevented HMCA from broadening its client base generally.

### DIAGNOSTIC IMAGING CENTERS AND OTHER ANCILLIARY SERVICES

Diagnostic imaging centers managed by HMCA provide diagnostic imaging services to patients referred by physicians who are either in private practice or affiliated with managed care providers or other payor groups. The centers are operated in a manner which eliminates the admission and other administrative inconveniences of in-hospital diagnostic imaging services. Imaging services are performed in an outpatient setting by trained medical technologists under the direction of interpreting physicians. Following diagnostic procedures, the images are reviewed by the interpreting physicians who prepare a report of these tests and their findings. These reports are transcribed by HMCA personnel and then delivered to the referring physician.

In addition, HMCA is expanding the ancillary services offered in its network to include CT scans, virtual colonoscopies, x-rays, ultrasound and other modalities as may be appropriate for the physician practice mix.

HMCA develops marketing programs in an effort to establish and maintain profitable referring physician relationships and to maximize reimbursement yields. These marketing approaches identify and target selected market segments consisting of area physicians with certain desirable medical specialties and reimbursement yields. Corporate and center managers determine these market segments based upon an analysis of competition, imaging demand, medical specialty and payor mix of each referral from the local market. HMCA also directs marketing efforts at managed care providers.

Managed care providers are becoming an increasingly important factor in the diagnostic imaging industry. To further its position, HMCA will seek to expand the imaging modalities offered at its managed centers or to create networks with other imaging centers.

### COMPETITION (HMCA)

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The physician and diagnostic management services field is highly competitive. A number of large hospitals have acquired medical practices and this trend may continue. HMCA expects that more competition will develop. Many competitors have greater financial and other resources than HMCA.

With respect to the diagnostic imaging centers managed by HMCA, the outpatient diagnostic imaging industry is highly competitive. Competition focuses primarily on attracting physician referrals at the local market level and increasing referrals through relationships with managed care organizations. HMCA believes that principal competitors for the diagnostic imaging centers are hospitals and independent or management company-owned imaging centers. Competitive factors include quality and timeliness of test results, ability to develop and maintain relationships with managed care organizations and referring physicians, type and quality of equipment, facility location, convenience of scheduling and availability of patient appointment times.

### GOVERNMENT REGULATION APPLICABLE TO HMCA

#### FEDERAL REGULATION

##### Stark Law

Under the federal Self-Referral Law (the "Stark Law") (which is applicable to Medicare and Medicaid patients) and the self-referral laws of various States, certain health practitioners (including physicians, chiropractors and podiatrists) are prohibited from referring their patients for the provision of designated health services (including diagnostic imaging and physical therapy services) to any entity with which they or their immediate family members have a financial relationship, unless the referral fits within one of the specific exceptions in the statutes or regulations. Statutory exceptions under the Stark Law include, among others, direct physician services, in-office ancillary services rendered within a group practice, space and equipment rental and services rendered to enrollees of certain prepaid health plans. Some of these exceptions are also available under the State self-referral laws.

##### Anti-kickback Regulation

Under the federal Anti-kickback statute, which is applicable to Medicare and Medicaid, it is illegal, among other things, for a provider MRI services to pay or offer money or other consideration to induce the referral of MRI scans. Neither HMCA nor its clients engage in this practice.

Approximately 8.8% of the revenues of HMCA's clients are attributable to Medicare and 0.25% are attributable to Medicaid.

##### State Regulation

In addition to the federal self-referral law and federal Anti-kickback statute, many States, including those in which HMCA and its clients operate, have their own versions of self-referral and anti-kickback laws. These laws are not limited in their applicability, as are the federal laws, to specific programs. HMCA believes that it and its clients are in compliance with these laws.

Various States prohibit business corporations from practicing medicine. Various States also prohibit the sharing of professional fees or fee splitting. Consequently, HMCA leases space and equipment to clients and provides clients with a range of non-medical administrative and managerial services for agreed upon fees. HMCA does not engage in the practice of medicine or establish standards of medical practice or policies for its clients in any such State. The existence of these restrictions have not had a material effect on HMCA's business.

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HMCA's clients generate revenue from patients covered by no-fault insurance and workers' compensation programs. For the fiscal year ended June 30, 2001, Approximately 56% of our clients' receipts were from patients covered by no-fault insurance and approximately 10% of our client's receipts were from patients covered by worker's compensation programs. In the event that changes in these laws alter the fee structures or methods of providing service, or impose additional or different requirements, HMCA could be required to modify its business practices and services in ways that could be more costly to HMCA or in ways that decrease the revenues which HMCA receives from its clients.

HMCA believes that it and its clients are in compliance with applicable Federal, State and local laws. HMCA does not believe that such laws will have any material effect on its business.

### EMPLOYEES

As of July 1, 2001, the Company employed 585 persons on a full-time and part-time basis. Of such employees, 29 were engaged in marketing and sales, 43 in research and development, 82 in production, 45 in customer support services, 348 in administration (including 244 on site at facilities and offices managed by HMCA and 85 performing billing, collection and transcription services for those facilities) and 38 professional MRI technicians on site at diagnostic imaging centers managed by HMCA.

### ITEM 2. PROPERTIES

Fonar leases approximately 135,240 square feet of office and plant space at its principal offices in Melville, New York and at two other locations in Melville and Farmingdale, New York at a current aggregate annual rental rate of approximately \$834,000, excluding utilities, taxes and other related expenses. The term of one of the leases extends through 2002 with options to renew up through 2008 and the term of the other lease extends to the beginning of 2009. The Company also leases space in Harrisburg, Pennsylvania at a rental of \$1350 per month. Management believes that these premises are adequate for its current needs. HMCA leases approximately 16,850 square feet for its headquarters in Melville, New York at a current annual rental rate of \$369,865. The term of the lease extends through September, 2009. In addition, HMCA maintains leased office premises for its clients at approximately 38 site locations having an aggregate annual rental rate of approximately \$1.9 million under leases having various terms.

### ITEM 3. LEGAL PROCEEDINGS

There is no material litigation pending, or to its knowledge, threatened against the Company.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

## Part II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

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The Company's Common Stock is traded in the Nasdaq SmallCap market under the National Association of Securities Dealers Automated Quotation System ("NASDAQ") symbol FONR. The following table sets forth the high and low trades reported in NASDAQ System for the periods shown.

Fiscal Quarter	High	Low
-----	----	----
January - March 1998	3.09	2.38
April - June 1998	2.75	1.94
July - September 1998	2.50	1.25
October - December 1998	2.00	0.97
January - March 1999	1.78	1.19
April - June 1999	1.50	1.03
July - September 1999	1.18	0.91
October - December 1999	3.25	0.69
January - March 2000	5.00	1.63
April - June 2000	3.44	1.44
July - September 2000	3.47	1.50
October - December 2000	2.31	1.03
January - March 2001	2.00	0.97
April - June 2001	1.97	1.28
July - September 17, 2001	2.49	1.50

On September 20, 2001, the Company had approximately 5,340 stockholders of record of its Common Stock, 12 stockholders of record of its Class B Common Stock, 4 stockholders of record of its Class C Common Stock and 4,063 stockholders of record of its Class A Non-voting Preferred Stock.

At the present time, the only class of the Company's securities for which there is a market is the Common Stock.

The Company paid cash dividends in fiscal 1998 and the first three quarters of fiscal 1999 on monies it received from the enforcement of its patents. Prior to these dividends, the Company had not paid any cash dividends. The Company anticipates paying additional dividends on monies it receives from the enforcement of its patents. Except for these dividends, however, it is expected that the Company will continue to retain earnings to finance the development and expansion of its business.

### Item 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data has been extracted from the Company's consolidated financial statements for the five years ended June 30, 2001. For the years ended June 30, 2001, 2000 and 1999, the selected financial data has been extracted from the restated consolidated financial statements for those fiscal years. The restated financial statements reflect the change to no longer consolidate any medical practices managed by HMCA. See Note 2 to the consolidated financial statements of the Company included in Item 8 for a further explanation of the restatement. This selected consolidated financial data should be read in conjunction with the consolidated financial statements of the Company and the related notes included in Item 8 of this form. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of the Company's business plan.

### Item 6. SELECTED FINANCIAL DATA (Continued)

As of, or For the Period Ended June 30,



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	2001	2000	1999	1998	1997
STATEMENT OF OPERATIONS					
Revenues	\$42,273,301	\$36,154,797	\$33,289,044	\$27,554,357	\$17,633,
Cost of revenues	\$27,797,198	\$26,592,069	\$26,061,682	\$ 23,841,844	\$18,428,
Research and Development Expenses	\$5,866,421	\$5,532,325	\$ 6,647,555	\$ 6,506,995	\$ 3,928,
Net Income (loss)	\$ (15,183,862)	\$ (10,955,987)	\$ (14,215,763)	\$ (5,653,086)	\$ 56,068,
Basic and Diluted Net income (loss) per common share	\$ (.22)	\$ (.17)	\$ (.22)	\$ (.09)	\$1
Weighted average number Of shares outstanding	68,633,758	66,304,716	64,071,151	61,175,986	56,097,
BALANCE SHEET DATA					
Working capital (deficit)	\$17,744,379	\$24,439,609	\$37,863,029	\$54,426,483	\$62,659,
Total assets	\$84,900,413	\$84,413,037	\$97,461,168	\$108,447,780	\$106,690,
Long-term debt and obligations under capital leases	\$21,244,149	\$20,969,186	\$24,821,834	\$16,003,479	\$ 4,626,
Stockholder's equity	\$41,830,294	\$51,284,758	\$59,303,773	\$72,572,486	\$73,245,

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION INTRODUCTION.

The Company was formed in 1978 to engage in the business of designing, manufacturing and selling MRI scanners. In 1997, the Company formed a wholly-owned subsidiary, Health Management Corporation of America ("HMCA"), formerly known as U.S. Health Management Corporation, in order to expand into the physician and diagnostic management services business.

FONAR's principal MRI products are its Stand-Up, also called "Indomitable"

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(TM), Fonar 360, QUAD and Echo MRI scanners. The Stand-Up MRI allows patients to be scanned for the first time under weight-bearing conditions. The Company is aggressively seeking new sales. The Stand-Up MRI is the only MRI capable of producing images in the weight bearing state. The Fonar 360, QUAD and Stand-Up MRI scanners are highly competitive and totally new non-claustrophobic scanners not previously available in the MRI market. At 0.6 Tesla field strength, the QUAD 12000 magnet is the highest field "Open MRI" in the industry, offering non-claustrophobic MRI together with high-field image quality for the first time. The Fonar 360 and Stand-Up MRI(TM) share the fundamental technology of the QUAD scanners and also have a field strength of 0.6 Tesla. The Company's work-in-progress Pinnacle MRI scanner will combine Fonar's iron frame magnet with a superconducting driver, and is expected to have a field strength between 0.6 and 1.0 Tesla. Fonar also offers the Echo, a low cost open MRI scanner. Fonar's works in progress also include an in-office extremities scanner. (See "Description of Business - Products, Works-in-Progress and Product Marketing.")

HMCA commenced operations in July, 1997 and generates revenues from providing comprehensive management services (including development, administration, accounting and billing and collection services) together with office space, medical equipment, supplies and non-medical personnel to its clients. Revenues are in the form of management and leasing fees, which are earned under contracts with MRI facilities, medical practices and physical rehabilitation practices.

Between 98% and 99% of HMCA's revenues for the fiscal years ended June 30, 2000 and June 30, 2001 were derived from contracts with such facilities and practices owned by Dr. Raymond V. Damadian, the President of Fonar and HMCA and principal stockholder of Fonar. The agreements with the MRI facilities are for one year terms which renew automatically on an annual basis unless terminated. The fees are based on the number of procedures performed and currently range from \$250 to \$760 per MRI scan. The fees are reviewed and if appropriate, adjusted on an annual basis by mutual agreement.

The agreements with the medical practices and physical rehabilitation practices are for a term of 20 years. The fees are fixed monthly fees adjusted annually. Historically, adjustments have been on the basis of changes in HMCA's costs plus a percentage. Currently, the monthly fees under these contracts range from approximately \$53,850 to \$272,500.

### RESTATEMENT OF FINANCIAL STATEMENTS

The Company no longer consolidates any medical practices which it manages. In 1999, 2000 and 2001, the Company had consolidated certain medical practices managed as a result of the 1998 acquisitions of A & A Services, Inc. and Dynamic Health Care Management, Inc. The Company also previously consolidated the practices conducted by Superior Medical Services, P.C. in 1999, 2000 and 2001. The Company has determined that consolidation of such medical practices is not appropriate because the underlying management agreements do not meet all of the six criteria of Emerging Issues Task Force ("EITF") Consensus No. 97-2. Accordingly, the consolidated financial statements have been restated. The significant effect of such restated financial statements for 1999, 2000 and 2001 has been to decrease revenue and related costs by \$3.7 million, \$3.8 million and \$4.2 million, respectively. In addition, the balance sheet caption "Excess of Cost Over Net Assets of Businesses Acquired - Net" has been reclassified to "Management Agreements - Net".

### RESULTS OF OPERATIONS. FISCAL 2001 COMPARED TO FISCAL 2000

In fiscal 2001, the Company experienced a net loss of \$15.2 million on revenues of \$42.3 million, as compared to net loss of \$11.0 million on revenues of \$36.2 million for fiscal 2000. This represents a increase in the net loss of 38% and an increase in revenues of 16.9%. The Company's consolidated operating

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loss increased by 4.5% to \$16.2 million for fiscal 2001 from a loss of \$15.5 million for fiscal 2000.

Revenues attributable to the Company's physician and diagnostic management services segment (HMCA) increased by 5.3% to \$31.8 million in fiscal 2001 from \$30.2 million in fiscal 2000. Operating income of \$1.0 million was recognized from the Company's physician and diagnostic management services in fiscal 2001, as compared to an operating income of \$2.5 million in fiscal 2000, representing a decrease of 60%.

Revenues attributable to the Company's medical equipment segment increased by 75% to \$10.5 million in fiscal 2001 from \$6.0 million in fiscal 2000, reflecting an increase in scanner sales of 79.4%, from \$3.4 million in fiscal 2000 to \$6.1 million in fiscal 2001 and an increase in service revenue of 11.1%, from \$1.7 million in fiscal 2000 to \$2.0 million in fiscal 2001. The Company attributes the increase in scanner sales to the growing market penetration of its products, particularly its Stand-Up MRI, also called "Indomitable", which is unique in that it permits MRI scans to be performed on patients in the weight-bearing state.

Notwithstanding the Company's expectation of increased demand for its MRI scanners, sales to unrelated parties increased by 113% in fiscal 2001 from \$1.6 million in fiscal 2000 to \$3.4 million in fiscal 2001. Sales to unrelated parties declined by 50% in fiscal 2000 from \$3.2 million in fiscal 1999 to \$1.6 million in fiscal 2000. The Company believes that its difficulties in achieving greater market penetration are primarily attributable to the better name recognition and larger sales forces of its larger competitors such as General Electric, Siemens and Hitachi and the ability of some of its competitors to offer attractive financing terms through affiliates, such as G.E. Capital.

Results of operations for the medical equipment segment improved by 9% from a loss of \$18.9 million in fiscal 2000 to a loss of \$17.2 million in fiscal 2001. Increased license and royalty revenue (from \$920,000 in fiscal 2000 to \$2.4 million in fiscal 2001) was a principal factor.

Other income of \$1.0 million (principally the sales of a partnership interest) and investment income of \$1.8 million were recognized by the Company in fiscal 2001 as compared to other income of approximately \$5.6 million (principally the net proceeds from the Company's patent enforcement lawsuits) and investment income of \$1.9 million in fiscal 2000. This represents a decrease of 82% in other income and a decrease of 5.2% in investment income. As a result, the net loss increased from \$11.0 million in fiscal 2000 to \$15.2 million in fiscal 2001.

Costs of revenues and expenses increased by 13.2% to \$58.5 million in fiscal 2001 from \$51.7 million in fiscal 2000. The increase in selling, general and administrative expenses was attributable primarily to the expansion of HMCA and expansion of Fonar's internal sales force.

Cost of revenue for the Company's physician management services segment decreased from \$19.8 million or 65.5% of related revenues for the year ended June 30, 2000 to \$19.3 million or 60.7% of related revenues for the year ended June 30, 2001. Operating income of this segment declined from \$2.5 million in fiscal 2000 to \$1.0 million in fiscal 2001 due to increases in selling, general and administrative expenses of \$1.9 million, increases in compensatory element of stock issuance of \$1.4 million, increases in provision for bad debt expense of \$.2 million offset by an improvement in gross profit of \$2.0 million.

Research and development expenses increased by 6.8% to \$5.9 million in fiscal 2001 as compared to \$5.5 million in fiscal 2000. This increase represented continued research and development of Fonar's scanners and its new hardware and software product, "Sympulse (TM)".

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Overall, costs of revenues and expenses for the Company's medical equipment segment, however, increased by 13.9% to \$28.7 million in fiscal 2001 from \$25.3 million in fiscal 2000.

This reflects an increase of 41% in costs of product sales from \$4.4 million in fiscal 2000 to \$6.2 million in fiscal 2001. This also reflects an increase of 8.3% in selling, general and administrative expenses to \$11.7 million in fiscal 2001 from \$10.8 million in fiscal 2000.

The increase in compensatory element of stock issuances from approximately \$1.9 million in fiscal 2000 to \$4.0 million in fiscal 2001 reflected greater use of Fonar's stock bonus plan to pay certain highly compensated employees and others in stock rather than cash.

The higher provision for bad debt of \$442,505 in fiscal 2001 as compared to \$177,162 in fiscal 2000, reflected reserves for fees from HMCA managed facilities that were closed during the year.

The amortization expense in fiscal 2001 and 2000 of approximately \$1.2 million in each year reflects the amortization of management agreements attributable to HMCA's acquisitions.

The Company recognized revenues of \$1.6 million from the sale of its new Stand-Up scanners and of \$1.1 million from the sale of Echo scanners in fiscal 2001. There were no sales of Stand-Up scanners or Echo scanners in fiscal 2000. Revenues generated by sales of QUAD MRI scanners decreased slightly by 6.3% from \$3.2 million (8.8% of total revenues) in fiscal 2000 to \$3.0 million (7.1% of total revenues) in fiscal 2001. Revenues attributable to sales of the Company's Ultimate scanners during the same periods were \$0.00.

Sales of Beta scanners were \$0 in fiscal 2001 (0% of total revenues) and \$84,255 (approximately 0.2% of total revenues) in fiscal 2000. The sales in fiscal 2000 represented the sale of refurbished equipment, as the company no longer manufactures Beta scanners.

Product sales revenues for fiscal 2001 included revenues from the sale of seven scanners. Product sales revenues for fiscal 2000 included revenues from the sales of three scanners and for fiscal 1999, five MRI scanners, two of which were used scanners which Fonar had reacquired.

Sales to affiliated parties, consisting of professional corporations owned by Dr. Damadian represented approximately 6.4% (\$2,686,646) of the Company's revenues in fiscal 2001, as compared to 4.9% (\$1,752,298) of the Company's revenues in fiscal 2000.

Negative gross profit margins on product sales (negative 0.3% in fiscal 2001 and negative 31.7% in fiscal 2000) were principally attributable to the medical equipment segment operating at a low level of capacity and reflect the inefficiencies attendant to Fonar's fixed factory overhead expenses, such as salaries and benefits. The improvement in fiscal 2001 reflects increased sales volume.

The Company is enthusiastic about the future of its FONAR 360 product line and Indomitable(TM) scanners which will bring a new plateau of "openness" to diagnostic MRI and a new frontier in surgery for performing surgical treatments using MRI images to guide surgery. The Company believes its new products are beginning to successfully penetrate the market, as reflected in the increase in product sales from approximately \$3.4 million in fiscal 2000 to \$6.1 million in fiscal 2001. In addition to increased product sales, the decline in service and repair fees has been reversed, as reflected by the increase in service and repair fees from \$1.7 million in fiscal 2000 to \$2.0 million in fiscal 2001.

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Continuing its tradition as the originator of MRI, the Company remained committed to maintaining its position as the leading innovator of the industry through aggressive investing in research and development. In fiscal 2001 the Company continued its investment in the development of its new MRI scanners, together with software and upgrades, with an investment of \$6,621,225 in research and development (\$754,804 of which was capitalized) as compared to \$5,893,648 (\$361,623 of which was capitalized) in fiscal 2000. The research and development expenditure was approximately 108% of revenues attributable to the Company's medical equipment segment (and 15.7% of total revenues) in 2001 and 174% of medical equipment segment revenues in 2000 (and 16.3% of total revenues). This represented an increase of approximately 12% in research and development expenses from fiscal 2000 to fiscal 2001.

During the fiscal year ended June 30, 2001, the Company realized other income of approximately \$1.0 million, principally from the sale of a partnership interest, as compared to other income of approximately \$5.6 million (principally from the settlement of patent infringement disputes) in fiscal 2000. This represented a decline of 82%.

### RESULTS OF OPERATIONS. FISCAL 2000 COMPARED TO FISCAL 1999

In fiscal 2000, the Company experienced a net loss of \$11.0 million on revenues of \$36.2 million as compared to a net loss of \$14.2 million on revenues of \$33.3 million for fiscal 1999. This represented an decrease in the net loss of 22.5% and an increase in revenues of 8.6%.

Revenues attributable to the Company's physician and diagnostic management services segment (HMCA) increased to \$30.2 million in fiscal 2000 from \$27.6 million in fiscal 1999, representing an increase of 9.5%.

Operating income of \$2.5 million was recognized from the Company's physician and diagnostic management services in fiscal 2000, as compared to income of \$3.1 million in fiscal 1999, representing a decrease of 19.4%.

Revenues attributable to the Company's medical equipment segment increased by 5.3% to \$6.0 million in fiscal 2000 from \$5.7 million in fiscal 1999, reflecting higher license fees and royalties in fiscal 2000.

Results of operations for the medical equipment segment declined, from a loss of \$18.7 million in fiscal 1999 to a loss of \$18.9 million in fiscal 2000, representing a 1.1% decline.

Other income of \$1.0 million (principally the net proceeds from the Company's patent enforcement lawsuits) and investment income of \$2.1 million were recognized by the Company in fiscal 1999 as compared to other income of \$5.6 million (principally the net proceeds from the Company's patent enforcement lawsuits) and investment income of \$1.9 million in fiscal 2000, representing an increase of 460% in other income and a decrease of 9.5% in investment income.

Costs of revenues and expenses increased by 5.8% from \$48.9 million in fiscal 1999 to \$51.7 million in fiscal 2000, reflecting the expansion of the Company's physician and diagnostic management services operations.

Costs of revenue and expenses for the Company's physician and diagnostic management services increased by 7.3% to \$19.8 million in fiscal 2000 from \$18.4 million in fiscal 1999.

Research and development expenses decreased by 16.7% to \$5.5 million in fiscal 2000 as compared to \$6.6 million in fiscal 1999.

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Overall, costs of revenues and expenses for the Company's medical equipment segment, however, declined by 3.2% to \$24.3 million in fiscal 2000 from \$25.1 million in fiscal 1999.

This reflects reductions of 10.2% in costs of product sales from \$4.4 million in fiscal 2000 to \$4.9 million in fiscal 1999.

This also reflects an increase of 13% in general and administrative expenses to \$8.7 million in fiscal 2000 from \$7.7 million in fiscal 1999.

Costs of revenue declined by 16.8% to \$7.9 million in fiscal 2000 as compared to \$9.5 million in fiscal 1999.

Revenues generated by sales of QUAD MRI scanners were \$2.6 million (approximately 8% of total revenues) in fiscal 1999 and \$3.2 million (9% of total revenues) in fiscal 2000, representing an increase 23%. Revenues attributable to sales of the Company's Ultimate scanners during the same period were \$0.00.

Sales of Beta scanners were \$430,000 in fiscal 1999 (approximately 1% of total revenues) and approximately \$84,255 (approximately 0.2% of total revenues) in fiscal 2000.

Product sales revenues for fiscal 2000 included revenues from the sale of three scanners, and for fiscal 1999, five MRI scanners, two of which were used.

Sales to affiliated parties represented approximately 4.9% (\$1.8 million) of the Company's revenues in fiscal 2000, as compared to approximately 0.5% (\$150,000) in fiscal 1999.

Gross profit margins on product sales to unrelated parties were negative (49%) in fiscal 1999 and negative (86.7%) in fiscal 2000. This reflected the losses on sales of the Company's QUAD scanners.

To reduce the cost of manufacturing its QUAD scanners, the Company expanded its manufacturing capacity in fiscal 2000, 1999 and 1998 by acquiring approximately \$2.1 million, \$3.8 million and \$1.4 million, respectively, worth of new capital equipment. In addition, the Company expanded its operating capacity by hiring additional personnel.

Notwithstanding the Company's increased manufacturing activities, revenues attributable to the Company's medical equipment segment declined by 4.6% to approximately \$6.2 million in fiscal 2000 from approximately \$6.5 million in fiscal 1999. This trend reflected a decline in service revenue of 26.1% from \$2.3 million in fiscal 1999 to \$2.7 million in fiscal 2000.

In fiscal 2000 the Company continued its investment in the development of its new MRI scanners, together with software and upgrades, with an investment of \$5,893,648 (\$361,323 of which was capitalized) in research and development as compared to \$6,647,555 in fiscal 1999. The research and development expenditure was approximately 98% of revenues attributable to the Company's medical equipment segment and 16.3% of total revenues in 2000 and 102% of medical equipment segment revenues and 20% of total revenues in fiscal 1999.

During the fiscal year ended June 30, 2000, the Company realized income of approximately \$5.6 million from the settlement of various legal disputes, which were essentially its patent infringement actions, as compared to approximately \$1.0 million in fiscal 1999.

### LIQUIDITY AND CAPITAL RESOURCES

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Cash, cash equivalents and marketable securities declined by 9% from \$22.9 million at June 30, 2000 to \$20.1 million at June 30, 2001. Principal uses of cash during fiscal 2001 included capital expenditures of \$2.6 million, repayment of indebtedness and capital lease obligations in the amount of \$5.7 million, costs of capitalized software development of \$800,000 and costs in connection with debt financing of \$200,000.

Marketable securities approximated \$6.1 million as of June 30, 2001 as compared to \$11.5 million as of June 30, 2000. From June 30, 2000 to June 30, 2001 the Company maintained investments in equity securities of \$0, reduced its investments in U.S. Government obligations from approximately \$10.2 million to \$4.1 million and increased its investments in corporate and government agency bonds from approximately \$1.6 million to \$1.9 million. This has had the intended effect of reducing the volatility of the Company's investment portfolio.

Cash provided by operating activities for fiscal 2001 approximated \$1,106,000. Cash used in operating activities was attributable substantially to the funding of the net loss for fiscal 2001.

Cash provided by investing activities for fiscal 2001 approximated \$2.6 million. The principal source of cash from investing activities during fiscal 2001 consisted of the proceeds from the sale of marketable securities of \$5.7 million less expenditures for property and equipment of approximately \$2.6 million.

Cash used in financing activities for fiscal 2001 approximated \$1,085,000. The principal uses of cash in financing activities during fiscal 2001 consisted of repayment of principal on long-term debt of approximately \$5.7 million and the principal sources were proceeds from the issuance of convertible debentures of \$4.5 million and proceeds from the sale of a partnership interest of \$750,000.

Total liabilities increased since June 30, 2000 by approximately \$9.8 million, or 30% to approximately \$42.9 million at June 30, 2001. The increase in liabilities from June 30, 2000 was attributable principally to the issuance of convertible debentures and deferred license fee revenue.

As at June 30, 2001, the Company's obligations included approximately \$2.7 million in various state taxes. The Company has entered into payment plans with taxing authorities with respect to \$1.5 million past due taxes.

As of June 30, 2001, the Company had a bank credit facility of \$5,500,000. The unused portion of the facility was approximately \$329,000. The interest on loans made under the facility is either the bank's prime rate, as in effect from time to time or 0.5% plus the bank's cost of funds rate, as selected by Fonar when the loan is made.

Advances and notes to affiliates and related parties increased by 33.33% from \$1.2 million at June 30, 2000 to \$1.6 million at June 30, 2001. As these are long-term assets, they tend to reduce the Company's liquidity.

The Company's working capital surplus as of June 30, 2001 approximates \$17.7 million, as compared to a working capital surplus of \$24.9 million as of June 30, 2000.

The change in the Company's working capital position resulted primarily from its investments in new equipment (\$2.6 million), note payments primarily on the purchase prices for HMCA's acquisitions (\$5.7 million), its overall operating losses, and an increase in its current liabilities of approximately \$4.9 million (\$23.1 million as at June 30, 2001 as compared to \$18.2 million as at June 30, 2000).

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As at June 30, 2001, the Company had current assets of \$40.9 million and current liabilities of \$23.1 million, resulting in working capital of \$17.8 million. The Company believes that these resources alone provide an adequate reserve to fund its operations for approximately two years. For the longer term, the Company will need to rely on income generated by sales of its MRI products and the profitability of HMCA.

In order to conserve its capital resources, the Company has issued common stock under its stock bonus and stock option plans to compensate employers and non-employees for services rendered. In fiscal 2001, the compensatory element of stock issuances was \$4.0 as compared to \$1.9 for fiscal 2000. Utilization of equity in lieu of cash compensation has improved the Company's liquidity since it increases cash available for other expenditures.

The foregoing trends in Fonar's capital resources are expected to improve as Fonar's MRI scanner products gain wider market acceptance and produce greater sales revenues.

Capital expenditures for fiscal 2001 and 2000 approximated \$2.6 million and \$2.8 million, respectively, and substantially consisted of office and production equipment.

Fonar has not committed to making capital expenditures in the 2002 fiscal year other than its intention to continue research and development expenditures at current levels.

The Company's business plan currently includes an aggressive program for manufacturing and selling its new line of Open MRI scanners. In addition, the Company is enhancing its revenue by participating into the physician and diagnostic management services business through its subsidiary, HMCA.

The Company's plan calls for a continuing emphasis on providing its customers with enhanced equipment service and maintenance capabilities and delivering state-of-the-art, innovative and high quality equipment upgrades at competitive prices. Fees for on-going service and maintenance from the Company's installed base of scanners were \$1.7 million for the year ended June 30, 2000 and \$2.0 million for the year ended June 30, 2001 (transactions between the Company and its subsidiaries are eliminated in the consolidation).

The Company believes that the above mentioned financial resources will provide the cash flows needed to achieve the sales, service and production levels necessary to support its operations. In addition, the Company is exploring other financing alternatives which may become available as the success of the previously described programs accelerates.

### ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has investments in fixed rate instruments. None of the fixed rate instruments in which the Company invests extend beyond June 30, 2007. Below is a tabular presentation of the maturity profile of the fixed rate instruments held by the Company at June 30, 2001.

#### INTEREST RATE SENSITIVITY PRINCIPAL AMOUNT BY EXPECTED MATURITY WEIGHTED AVERAGE INTEREST RATE

Date	Investments in Fixed Rate Instruments	Weighted Average Interest Rate
------	--	-----------------------------------



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6/30/02	512,110	5.4%
6/30/03	3,377,898	5.8%
6/30/04	1,157,820	5.4%
6/30/05	353,734	6.5%
6/30/06	399,569	6.0%
6/30/07	200,000	6.1%
Total:	6,001,131	
Fair Value at 6/30/01	6,085,266	

All of the Company's revenue, expense and capital purchasing activities are transacted in United States dollars.

See Note 12 to the Company's Financial Statements for information on long term debt.

Item 8.

### FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

#### FONAR CORPORATION AND SUBSIDIARIES

#### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES

#### INDEPENDENT AUDITORS' REPORT

#### CONSOLIDATED BALANCE SHEETS

At June 30, 2001 AND 2000

#### CONSOLIDATED STATEMENTS OF OPERATIONS

For the Three Years Ended June 30, 2001, 2000 and 1999

#### CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Three Years Ended June 30, 2001, 2000 and 1999

#### CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Years Ended June 30, 2001, 2000 and 1999

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### SELECTED FINANCIAL DATA

For the Five Years Ended June 30, 2001

(\*)

#### SCHEDULE OF VALUATION ALLOWANCES

For the three years ended June 30, 2001, 2000 and 1999

(\*\*)

(\*) Included in Part II, Item 6 of the Form.

(\*\*) Included in Part II, Item 14 of this Form.

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INDEPENDENT AUDITORS' REPORT  
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To the Board of Directors  
FONAR Corporation and Subsidiaries

We have audited the accompanying consolidated balance sheets of FONAR Corporation and Subsidiaries as at June 30, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows and schedules for each of the three years ended June 30, 2001. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

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

In our opinion, the consolidated financial statements and schedules referred to above present fairly, in all material respects, the consolidated financial position of FONAR Corporation and Subsidiaries at June 30, 2001 and 2000, and the consolidated results of their operations and cash flows for each of the years in the three-year period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company changed its consolidation policy and no longer consolidates certain managed medical practices. The accompanying consolidated financial statements have been retroactively restated to account for such change.

During each of the years in the three-year period ended June 30, 2001, a significant portion of the Company's revenues was from related parties (see Notes 2, 3, 5, 8 and 20).

/s/ Grassi & Co., CPAs, P.C.  
GRASSI & CO., CPAs, P.C.

New York, New York  
September 28, 2001, except for Note 13,  
as to which the date is October 25, 2001

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS  
-----

June 30,

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	2001	2000
Current Assets:		
Cash and cash equivalents	\$ 14,040,334	\$ 11,429,519
Marketable securities	6,085,266	11,484,176
Accounts receivable - net	849,740	1,686,811
Accounts receivable - related medical practices - net	13,180,654	12,896,851
Costs and estimated earnings in excess of billings on uncompleted contracts	1,768,856	968,159
Inventories	3,725,375	3,536,169
Investment in sales-type leases with related parties	191,304	57,832
Investment in sales-type lease	119,549	-
Prepaid expenses and other current assets	903,751	604,059
	-----	-----
Total Current Assets	40,864,829	42,663,576
Restricted Cash	5,500,000	5,000,000
Property and Equipment - Net	10,637,397	11,227,454
Advances and Notes to Related Parties, Net of discounts and allowance for doubtful accounts of \$316,035 and \$904,000 at June 30, 2001 and 2000, respectively	1,559,159	1,158,998
Investment in Sales-Type Leases with Related parties	2,513,703	872,603
Investment in Sales-Type Lease	861,249	-
Notes Receivable, Net of allowance for doubtful accounts of \$-0- and \$477,456 at June 30, 2001 and 2000, respectively	375,000	500,810
Management Agreements, Net of accumulated amortization of \$3,935,551 and \$2,716,859 at June 30, 2001 and 2000, respectively	20,438,298	21,656,990
Other Intangible Assets, Net	1,853,506	1,035,924
Other Assets	297,272	296,682
	-----	-----
Total Assets	\$ 84,900,413	\$ 84,413,037
	=====	=====

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

-----

June 30,

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	2001	2000
Current Liabilities:		
Current portion of long-term debt and capital leases	\$ 6,634,863	\$ 6,224,727
Accounts payable	3,020,832	1,738,847
Other current liabilities	6,175,757	8,780,929
Customer advances	1,672,522	582,551
Income taxes payable	764,884	896,913
Billings in excess of costs and estimated earnings on uncompleted contracts	351,592	-
Convertible debenture	4,500,000	-
<b>Total Current Liabilities</b>	<b>23,120,450</b>	<b>18,223,967</b>
Long-term Debt and Capital Leases, Less Current Maturities	10,109,286	14,744,459
Deferred Revenue - License Fee	9,360,000	-
Other Liabilities	327,411	138,338
<b>Total Liabilities</b>	<b>42,917,147</b>	<b>33,106,764</b>
Minority Interest	152,972	21,515

Commitments, Contingencies and Other Matters (Notes 1, 2, 3, 5, 11, 12, 13, 16 and 21)

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

(Continued)

	June 30,	
	2001	2000
Stockholders' Equity:		
Common stock - \$.0001 par value; authorized - 85,000,000 and 60,000,000 shares; issued - 59,524,455 and 56,315,471 shares at June 30, 2001 and 2000, respectively; outstanding - 59,233,391 and 56,026,207 shares at June 30, 2001 and 2000, respectively	\$ 5,952	\$ 5,631
Class B common stock (10 votes per share) -		

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\$.0001 par value; authorized - 4,000,000 shares; issued and outstanding - 4,211 shares at June 30, 2001 and 2000, respectively	-	-
Class C common stock (25 votes per share) - \$.0001 par value; authorized - 10,000,000 shares; issued and outstanding - 9,562,824 shares at June 30, 2001 and 2000	956	956
Class A non-voting preferred stock - \$.0001 par value; authorized - 8,000,000 shares; issued and outstanding - 7,836,287 shares at June 30, 2001 and 2000	784	784
Preferred stock - \$.001 par value; authorized - 10,000,000 shares; issued and outstanding - none	-	-
Paid-in capital in excess of par value	104,984,020	98,581,757
Accumulated other comprehensive income	84,133	(264,808)
Accumulated deficit	(60,000,686)	(44,816,824)
Notes receivable from stockholders	(1,040,457)	(1,338,005)
Unearned compensation	(1,529,018)	(213,374)
Treasury stock - 291,064 and 289,264 shares of common stock at June 30, 2001 and 2000, respectively	(675,390)	(671,359)
Total Stockholders' Equity	41,830,294	51,284,758
Total Liabilities and Stockholders' Equity	\$ 84,900,413	\$ 84,413,037

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended June 30,		
	2001	2000	1999
Revenues			
Product sales - net	\$ 3,370,826	\$ 1,606,229	\$ 3,230,467
Product sales - related parties - net	2,686,646	1,752,298	150,000
Service and repair fees - net	2,016,337	1,692,537	2,301,488
Patient revenue - net	1,285,028	996,337	203,261
Management and other fees - related medical practices - net	30,490,464	29,187,396	27,361,828
License fees and royalties	2,424,000	920,000	42,000
Total Revenues - Net	42,273,301	36,154,797	33,289,044
Costs and Expenses			
Costs related to product sales	3,206,385	2,281,709	4,786,773
Costs related to product sales - related parties	2,956,668	2,141,207	145,030
Costs related to service and repair fees	2,361,026	2,396,609	2,697,695
Costs related to patient revenue	1,138,569	953,619	317,740
Costs related to management and other fees - related parties	18,134,550	18,818,925	18,114,444
Research and development	5,866,421	5,532,325	6,647,555

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Selling, general and administrative	19,118,276	16,211,414	14,383,842
Compensatory element of stock issuances for selling, general and administrative expenses	4,044,826	1,929,706	275,242
Provision for bad debts	442,505	177,162	260,836
Amortization of management agreements	1,218,692	1,218,693	1,225,942
	-----	-----	-----
Total Costs and Expenses	58,487,918	51,661,369	48,855,099
	-----	-----	-----
Loss from Operations	(16,214,617)	(15,506,572)	(15,566,055)
Interest Expense	(1,255,440)	(1,710,188)	(2,051,290)
Investment Income	1,841,869	1,919,744	2,110,780
Other Income	964,488	4,655,375	1,001,119
Minority Interests in Income of partnerships	(480,166)	(270,669)	(300,235)
	-----	-----	-----
Loss Before Provision (Benefit) for Taxes	(15,143,866)	(10,912,310)	(14,805,681)
Provision (Benefit) for Income Taxes	39,996	43,677	(589,918)
	-----	-----	-----
Net Loss	\$ (15,183,862)	\$ (10,955,987)	\$ (14,215,763)
	=====	=====	=====
Basic and Diluted Net Loss Per Share	\$ (.22)	\$ (.17)	\$ (.22)
	=====	=====	=====
Weighted Average Number of Shares Outstanding	68,633,758	66,304,716	64,071,151
	=====	=====	=====

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 2001

	Per Share Amount	Class A Common Stock Shares	Class A Common Stock Amount	Class C Common Stock	Class A Non- Voting Preferred Stock	Paid-in Capital in Excess of Par Value
	-----	-----	-----	-----	-----	-----
Balance - June 30, 2000	\$ -	56,315,471	\$ 5,631	\$ 956	\$ 784	\$98,581,75
Net loss	-	-	-	-	-	-
Other comprehensive income, net of tax:						
Unrealized losses on securities arising during the year, net of tax	-	-	-	-	-	-
Less:						
Reclassification adjustment						
for (gains) losses included in net loss	-	-	-	-	-	-
Exercise of stock options	1.17	24,000	2	-	-	28,17
Purchase of common stock	1.44	-	-	-	-	-
Stock issued to employees						

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under stock bonus plans	1.61	1,636,602	164	-	-	2,636,41
Issuance of stock for professional services	1.50	435,976	44	-	-	653,89
Shares returned in cancellation of notes receivable	-	-	-	-	-	-
Issuance of stock under consulting contracts	1.77	923,482	92	-	-	1,632,98
Issuance of stock for research and development expenses	1.87	183,924	18	-	-	344,83
Issuance of stock for note receivable shareholders	2.06	5,000	1	-	-	10,31
Value assigned to warrants issued in debt financing	1.14	-	-	-	-	1,095,65
Net reduction in notes receivable from stockholders	-	-	-	-	-	-
Amortization of unearned compensation	-	-	-	-	-	-
		-----	-----	-----	-----	-----
BALANCE - JUNE 30, 2001		59,524,455	\$ 5,952	\$ 956	\$ 784	\$104,984,02
		=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 2001

	Notes Receivable from Stockholders -----	Unearned Compensation -----	Accumulated Other Comprehensive Income -----	Accumulated Deficit -----
Balance - June 30, 2000	\$ (1,338,005)	\$ (213,374)	\$ (264,808)	\$ (44,816,824)
Net loss	-	-	-	(15,183,862)
Other comprehensive income, net of tax:				
Unrealized gains on securities arising during the year, net of tax	-	-	342,050	-
Less: Reclassification adjustment for (gains) losses included in net loss	-	-	6,891	-
Exercise of stock options	-	-	-	-
Purchase of common stock	-	-	-	-
Stock issued to employees under stock bonus plans	-	-	-	-
Issuance of stock for professional services	-	-	-	-
Shares returned in cancellation of notes	-	-	-	-

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receivable	-	-	-	-
Issuance of stock under consulting contracts	-	(1,247,813)	-	-
Issuance of stock for research and development expenses	-	-	-	-
Issuance of stock for notes receivable shareholders	(10,312)	-	-	-
Value assigned to warrants in debt financing	-	(1,095,651)	-	-
Net reduction in notes receivable from stockholders	307,860	-	-	-
Amortization of unearned Compensation	-	1,027,820	-	-
	-----	-----	-----	-----
BALANCE - JUNE 30, 2001	=====	=====	=====	=====
	\$ (1,040,457)	\$ (1,529,018)	\$ 84,133	\$ (60,000,686)

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 2000

	Per Share Amount	Class A Common Stock Shares	Class A Common Stock Amount	Class C Common Stock	Class A Non-Voting Preferred Stock	Paid-in Capital in Excess of Par Value
	-----	-----	-----	-----	-----	-----
Balance - June 30, 1999	\$ -	53,793,042	\$ 5,378	\$ 956	\$ 784	\$95,385,86
Net loss	-	-	-	-	-	-
Other comprehensive income, net of tax:						
Unrealized losses on securities arising during the year, net of tax	-	-	-	-	-	-
Less: Reclassification adjustment for (gains) losses included in net loss	-	-	-	-	-	-
Exercise of stock options	1.13	389,000	39	-	-	455,78
Purchase of common stock	.95	-	-	-	-	-
Stock issued to employees under stock bonus plans	2.00	193,523	20	-	-	396,66
Issuance of stock for professional services	1.51	490,000	49	-	-	742,32
Shares returned in cancellation of notes receivable	-	-	-	-	-	-
Issuance of stock under consulting contracts	1.07	1,429,574	143	-	-	1,539,37
Issuance of stock for						



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acquisition of Central Health Care	3.19	19,332	2	-	-	61,75
Net reduction in notes receivable from stockholders	-	-	-	-	-	-
Amortization of unearned compensation	-	-	-	-	-	-
Conversion of Class B common stock to Class A common stock	-	1,000	-	-	-	-
BALANCE - JUNE 30, 2000		56,315,471	\$ 5,631	\$ 956	\$ 784	\$98,581,75

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 2000

	Notes Receivable from Stockholders	Unearned Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit
	-----	-----	-----	-----
Balance - June 30, 1999	\$ (1,226,148)	\$ (206,878)	\$ (203,106)	\$ (33,860,837)
Net loss	-	-	-	(10,955,987)
Other comprehensive income, net of tax:				
Unrealized losses on securities arising during the year, net of tax	-	-	(47,830)	-
Less: Reclassification adjustment for (gains) losses included in net loss	-	-	(13,872)	-
Exercise of stock options	(391,250)	-	-	-
Purchase of common stock	-	-	-	-
Stock issued to employees under stock bonus plans	-	-	-	-
Issuance of stock for professional services	-	-	-	-
Shares returned in cancellation of notes receivable	-	-	-	-
Issuance of stock under consulting contracts	-	(726,962)	-	-
Issuance of stock for acquisition of Central Health Care	-	-	-	-
Net reduction in notes receivable from stockholders	279,393	-	-	-

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Amortization of unearned compensation	-	720,466	-	-
Conversion of Class B common stock to Class A common stock	-	-	-	-
BALANCE - JUNE 30, 2000	<u>\$ (1,338,005)</u>	<u>\$ (213,374)</u>	<u>\$ (264,808)</u>	<u>\$ (44,816,824)</u>

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 1999

	Per Share Amount	Class A Common Stock Shares	Class A Common Stock Amount	Class C Common Stock	Class A Non-Voting Preferred Stock	Paid-in Capital in Excess of Par Value
Balance - June 30, 1998	\$ -	52,954,465	\$ 5,294	\$ 956	\$ 784	\$94,502,71
Net loss	-	-	-	-	-	-
Other comprehensive income, net of tax:						
Unrealized losses on securities arising during the year, net of tax	-	-	-	-	-	-
Less: Reclassification adjustment for losses included in net loss	-	-	-	-	-	-
Purchase of common stock	2.03	-	-	-	-	-
Stock issued to employees under stock bonus plans	1.54	161,180	16	-	-	206,26
Issuance of stock for professional services	-	463,161	47	-	-	664,60
Shares returned in cancellation of notes receivable	-	(190,000)	(19)	-	-	(539,35
Issuance of stock under consulting contracts	1.37	202,018	20	-	-	275,81
Issuance of stock for acquisition of Central Health Care	1.37	202,018	20	-	-	275,81
Net change in notes receivable from stockholders	-	-	-	-	-	-
Amortization of unearned compensation	-	-	-	-	-	-
Conversion of Class B common stock to Class A common stock	-	200	-	-	-	-

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BALANCE - JUNE 30, 1999	53,793,042	\$ 5,378	\$ 956	\$ 784	\$95,385,86
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
FOR THE YEAR ENDED JUNE 30, 1999

	Notes Receivable from Stockholders	Unearned Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit
	-----	-----	-----	-----
Balance - June 30, 1998	\$ (1,854,450)	\$ -	\$ (42,296)	\$ (19,645,074)
Net loss	-	-	-	(14,215,763)
Other comprehensive income, net of tax:				
Unrealized losses on securities arising during the year, net of tax	-	-	(194,647)	-
Less: Reclassification adjustment for losses included in net loss	-	-	33,837	-
Purchase of common stock	-	-	-	-
Stock issued to employees under stock bonus plans	-	-	-	-
Issuance of stock for professional services	-	-	-	-
Shares returned in cancellation of notes receivable	539,376	-	-	-
Issuance of stock under consulting contracts	-	(275,837)	-	-
Issuance of stock for acquisition of Central Health Care	-	-	-	-
Net change in notes receivable from stockholders	88,926	-	-	-
Amortization of unearned compensation	-	68,959	-	-
Conversion of Class B common stock to Class A common stock	-	-	-	-
BALANCE - JUNE 30, 1999	\$ (1,226,148)	\$ (206,878)	\$ (203,106)	\$ (33,860,837)
	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

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## FONAR CORPORATION AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended June 30,		
	2001	2000	1999
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net loss	\$ (15,183,862)	\$ (10,955,987)	\$ (14,215,763)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Minority interest in income of partnerships	480,166	270,669	300,235
Depreciation and amortization	4,712,767	4,670,473	4,657,819
Amortization of unearned license fee	(2,340,000)	-	-
License fee	11,700,000	-	-
Gain on sale of partnership interest	(750,000)	-	-
Issuance of stock for research and development expenses	344,839	-	-
Gain on sale of equipment	(150,000)	-	(53,573)
Imputed interest on deferred payment obligations	52,087	397,521	482,716
Provision for bad debts	442,505	177,162	260,836
Compensatory element of stock issuances	4,049,210	1,929,706	275,242
Stock issued for professional services	653,895	742,372	664,656
Liabilities assumed by purchaser on sale of subsidiary	-	(824,394)	-
Deferred income taxes	-	-	(793,794)
(Increase) decrease in operating assets, net:			
Accounts receivable	110,763	(859,090)	(2,385,223)
Notes receivable	125,810	(476,014)	40,955
Costs and estimated earnings in excess of billings on uncompleted contracts	(800,697)	495,291	(629,835)
Inventories	(189,206)	701,609	(724,156)
Sales-type lease receivable - related party	(1,895,000)	(935,000)	-
Sales-type lease receivable	(1,083,192)	4,565	-
Principal payments received on sales-type lease - related parties	120,428	-	-
Principal payments received on sales-type lease	102,394	-	-
Prepaid expenses and other current assets	(299,692)	97,374	(415,468)
Other assets	(590)	(3,064)	239,817
Receivables and advances to related parties	(400,161)	275,691	65,425
Increase (decrease) in operating liabilities, net:			
Accounts payable	1,281,985	(434,425)	372,374
Other current liabilities	(1,556,133)	(673,669)	(130,242)
Customer advances	1,089,971	487,033	(574,213)
Billings in excess of costs and estimated earnings on			

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uncompleted contracts	351,592	-	(31,032)
Other liabilities	189,073	6,709	17,966
Income taxes payable	(52,029)	(60,227)	2,498
	-----	-----	-----
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	1,106,923	(4,965,695)	(12,572,760)
	-----	-----	-----

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended June 30,		
	2001	2000	1999
	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in marketable securities	\$ 5,747,851	\$ 8,651,820	\$ (106,676)
Expenditures for acquisitions	-	-	(2,651,665)
Purchases of property and equipment	(2,556,982)	(2,807,264)	(4,774,603)
Costs of capitalized software development	(752,285)	(361,323)	-
Proceeds from sale of equipment	150,000	-	-
Cost of patents and copyrights	-	-	(19,686)
	-----	-----	-----
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	2,588,584	5,483,233	(7,552,630)
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from convertible debenture	4,500,000	-	-
Proceeds from long-term debt	500,000	-	-
Increase in restricted cash	(500,000)	-	-
Costs in connection with debt financing	(270,729)	-	-
Repayment of borrowings and capital lease obligations	(5,739,395)	(3,750,205)	(2,097,596)
Proceeds from exercise of stock options and warrants	28,172	64,569	-
Proceeds from sale of partnership interest	750,000	-	-
Dividends paid	-	-	(3,909,366)
Purchase of common stock	(4,031)	(79,120)	(196,794)
Distributions to holders of minority interests	(348,709)	(347,067)	(398,754)
	-----	-----	-----
NET CASH USED IN FINANCING ACTIVITIES	(1,084,692)	(4,111,823)	(6,602,510)
	-----	-----	-----
INCREASE (DECRERASE) IN CASH	2,610,815	(3,594,285)	(26,727,900)
CASH - BEGINNING OF YEAR	11,429,519	15,023,804	41,751,704
	-----	-----	-----
CASH - END OF YEAR	\$ 14,040,334	\$ 11,429,519	\$ 15,023,804
	=====	=====	=====

See accompanying notes to consolidated financial statements.

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## FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

### NOTE 1 - DESCRIPTION OF BUSINESS

FONAR Corporation (the "Company") or "FONAR") is a Delaware corporation, which was incorporated on July 17, 1978. FONAR is engaged in the research, development, production and marketing of medical scanning equipment, which uses principles of Magnetic Resonance Imaging ("MRI") for the detection and diagnosis of human diseases. In addition to deriving revenues from the direct sale of MRI equipment, revenue is also generated from its installed-base of customers through its service and upgrade programs.

Health Management Corporation of America ("HMCA") was organized by the Company in March 1997, as a wholly-owned subsidiary, in order to enable the Company to expand into the business of providing comprehensive management services to physicians' practices and other medical providers, including diagnostic imaging centers and ancillary services. The services provided by the Company include development, administration, leasing of office space, facilities and medical equipment, provision of supplies, staffing and supervision of non-medical personnel, legal services, accounting, billing and collection and the development and implementation of practice growth and marketing strategies.

HMCA entered the physician and diagnostic management services business through the consummation of two acquisitions effective June 30, 1997, two acquisitions, which were consummated during fiscal 1998, and one acquisition consummated in August of 1998. The acquired companies in all cases were actively engaged in the business of managing medical providers. The medical providers are diagnostic imaging centers, principally MRI scanning centers, multi-specialty practices and primary care practices.

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Principles of Consolidation

-----

The consolidated financial statements include the accounts of FONAR Corporation, its majority and wholly-owned subsidiaries and partnerships. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company no longer consolidates any medical practices which it manages. In 1999, 2000 and 2001, the Company had consolidated certain medical practices managed as a result of the 1998 acquisitions of A & A Services, Inc. and Dynamic Health Care Management, Inc. The Company also previously consolidated the practices conducted by Superior Medical Services, P.C. in 1999, 2000 and 2001. The Company has determined that consolidation of such medical practices is not appropriate because the underlying management agreements do not meet all of the six criteria of Emerging Issues Task Force ("EITF") Consensus No. 97-2. Accordingly, the consolidated financial statements have been restated. The significant effect of such restated financial statements for 1999, 2000 and 2001 has been to decrease revenue and related costs by \$3.7 million, \$3.8 million and \$4.2 million, respectively. In addition, the balance sheet caption "Excess of Cost Over Net Assets of Businesses Acquired - Net" has been reclassified to "Management Agreements - Net".

Net revenue from the Company's wholly-owned Florida multi-specialty practice is

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reflected in the accompanying Consolidated Statement of Operations under the caption "Patient Revenues - Net". Net revenue from the management of related medical practices is reflected in the accompanying Consolidated Statements of Operations under the caption "Management and Other Fees - Related Medical Practices - Net".

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

##### Use of Estimates

-----

The preparation of the consolidated 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 in the consolidated financial statements and accompanying notes. The most significant estimates relate to contractual and other allowances, income taxes, contingencies and the useful lives of equipment. In addition, healthcare industry reforms and reimbursement practices will continue to impact the Company's operations and the determination of contractual and other allowance estimates. Actual results could differ from those estimates.

##### Investment in Marketable Securities

-----

The Company accounts for its investments using Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). This standard requires that certain debt and equity securities be adjusted to market value at the end of each accounting period. Unrealized market value gains and losses are charged to earnings if the securities are traded for short-term profit. Otherwise, such unrealized gains and losses are charged or credited to comprehensive income.

Management determines the proper classifications of investments in obligations with fixed maturities and marketable equity securities at the time of purchase and re-evaluates such designations as of each balance sheet date. At June 30, 2001, all securities covered by SFAS No. 115 were designated as available for sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in comprehensive income. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the Consolidated Statement of Operations.

##### Inventories

-----

Inventories consist of purchased parts, components and supplies, as well as work-in-process, and are stated at the lower of cost (materials, labor and overhead determined on the first-in, first-out method) or market.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property and Equipment

-----

Property and equipment procured in the normal course of business is stated at cost. Property and equipment purchased in connection with an acquisition is stated at its estimated fair value, generally based on an appraisal. Property and equipment is being depreciated for financial accounting purposes using the straight-line method over the shorter of their estimated useful lives, generally five to seven years, or the term of a capital lease, if applicable. Leasehold improvements are being amortized over the shorter of the useful life or the remaining lease term. Upon retirement or other disposition of these assets, the cost and related accumulated depreciation of these assets are removed from the accounts and the resulting gains or losses are reflected in the results of operations. Expenditures for maintenance and repairs are charged to operations. Renewals and betterments are capitalized.

### Management Agreements

-----

Management agreements are being amortized using the straight-line method over the 20 year term of the agreements.

### Other Intangible Assets

-----

#### 1) Capitalized Software Development Costs

Certain software development costs incurred subsequent to the establishment of the software's technological feasibility and completion of the research and development on the product hardware, in which it is to be used, are required to be capitalized. Capitalization ceases when the product is available for general release to customers, at which time amortization of capitalized costs begins. Amortization is calculated on the straight-line basis over 5 years.

#### 2) Patents and Copyrights

Amortization is calculated on the straight-line basis over 17 years.

### Long-Lived Assets

-----

The Company periodically assesses the recoverability of long-lived assets, including property and equipment, intangibles and management agreements, when there are indications of potential impairment, based on estimates of undiscounted future cash flows. The amount of impairment is calculated by comparing anticipated discounted future cash flows with the carrying value of the related asset. In performing this analysis, management considers such factors as current results, trends, and future prospects, in addition to other economic factors.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)



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### Revenue Recognition

-----

Revenue on sales contracts for scanners is recognized under the percentage-of-completion method. The Company manufactures its scanners under specific contracts that provide for progress payments. Production and installation take approximately six months. The percentage of completion is determined by the ratio of costs incurred to date on completed sub-assemblies to the total estimated cost for each scanner. Contract costs include material, direct labor and overhead. Provisions for estimated losses on uncompleted contracts, if any, are made in the period in which such losses are determined. The asset, "Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts", represents revenues recognized in excess of amounts billed. The liability, "Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts", represents billings in excess of revenues recognized.

Revenue on scanner service contracts are recognized on the straight-line method over the related contract period, usually one year.

Revenue from sales of other items are recognized upon shipment.

Revenue from sales-type leases are recognized when collectibility of the minimum lease payments is reasonably predictable and no important uncertainties surround the amount of unreimbursable costs yet to be incurred by the Company as lessor under the lease. The minimum lease payments, plus the unguaranteed residual value accruing to the benefit of the Company as lessor, are recorded as the gross investment in the lease. The difference between the gross investment in the lease and the sum of the present value of the minimum lease payments and unguaranteed residual value, accruing to the Company's benefit as lessor, are recorded as unearned income.

Revenue under management and lease contracts is recognized based upon contractual agreements for management services rendered by the Company and leases of medical equipment under various agreements with related medical providers (the "PC's"). The PC's are primarily owned by Raymond V. Damadian, M.D., President and Chairman of the Board of FONAR. The Company's agreements with the diagnostic imaging PC's stipulate fees for services rendered and equipment leased, are primarily calculated on activity based efforts at pre-determined rates per unit of activity. Fees are re-negotiable at the anniversary of the agreements and each year thereafter. The Company charges a management fee to the multi-specialty and primary care practices based on a fixed monthly fee adjusted annually.

Patient revenue from the Company's wholly-owned Florida multi-specialty practice is recorded in the period that the services are rendered at established rates reduced by provisions for doubtful accounts and contractual adjustments. Such adjustments represent the difference between charges at established rates and estimated recoverable amounts and are recognized in the period the services are rendered. Any differences between estimated contractual adjustments and actual final settlements are recognized as contractual adjustments in the year final settlements are determined.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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Research and Development Costs  
-----

Research and development costs are charged to expense as incurred. The costs of materials and equipment that are acquired or constructed for research and development activities, and have alternative future uses (either in research and development, marketing or production), are classified as property and equipment and depreciated over their estimated useful lives. Certain software development costs are capitalized. See property and equipment and intangible assets (capitalized software development costs) sections of this note.

During the year ended June 30, 2001, the Company acquired a minority interest in a development stage company through the issuance of 270,000 shares valued at 344,857. The entire amount of the purchase price was charged to research and development expenses.

Advertising Costs  
-----

Advertising costs are expensed as incurred.

Shipping Costs  
-----

The Company's shipping and handling costs are included under costs of product sales for all periods presented.

Income Taxes  
-----

Deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Product Warranty  
-----

The Company provides currently for the estimated cost to repair or replace products under warranty provisions in effect at the time of installation (generally for one year).

Customer Advances  
-----

Cash advances and progress payments received on sales orders are reflected as customer advances until such time as revenue recognition begins.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings (Loss) Per Share  
-----

Basic earnings (loss) per share is computed based on weighted average shares

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outstanding and excludes any potential dilution. Diluted earnings (loss) per share reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period.

Options and warrants to purchase 4,036,000, 427,000 and 388,000 shares of common stock were outstanding at June 30, 2001, 2000 and 1999, respectively, but were not included in the computation of diluted earnings per share due to losses for all years, as a result of the options and warrants being antidilutive. Additionally, convertible debentures, which are convertible into 2,200,000 shares at June 30, 2001 were antidilutive.

### Cash and Cash Equivalents

-----

The Company considers all short-term highly liquid investments with a maturity of three months or less when purchased to be cash or cash equivalents.

At June 30, 2001, the Company had cash deposits of \$13,877,660 in excess of federally insured limits.

### Restricted Cash

-----

At June 30, 2001 and 2000, \$5,500,000 of cash has been pledged as collateral on an outstanding bank loan and has been classified as restricted cash on the accompanying balance sheet.

### Fair Value of Financial Instruments

-----

The financial statements include various estimated fair value information at June 30, 2001, 2000 and 1999, as required by Statement of Financial Accounting Standards 107, "Disclosures about Fair Value of Financial Instruments". Such information, which pertains to the Company's financial instruments, is based on the requirements set forth in that Statement and does not purport to represent the aggregate net fair value to the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents: The carrying amount approximates fair value because of the short-term maturity of those instruments.

Accounts receivable and accounts payable: The carrying amounts approximate fair value because of the short maturity of those instruments.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Fair Value of Financial Instruments (Continued)

-----

Investment in sales-type leases and investments, advances and notes to affiliates and related parties: The carrying amount approximates fair value

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because the discounted present value of the cash flow generated by the related parties approximates the carrying value of the amounts due to the Company.

Long-term debt and loans payable: The carrying amounts of debt and loans payable approximate fair value due to the length of the maturities, the interest rates being tied to market indices and/or due to the interest rates not being significantly different from the current market rates available to the Company.

All of the Company's financial instruments are held for purposes other than trading.

### Stock-Based Compensation

-----

The Company accounts for its compensation and stock option plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. In accordance with SFAS No. 123, Accounting for Stock-Based Compensation, the Company provides proforma net income and proforma earnings per share disclosures for employee stock option grants, as if the fair-value-based method defined in SFAS No. 123 had been applied.

Stock-based compensation issued to employees and consultants is valued based on the quoted market price of the common stock at the time of issuance.

### Deferred and Unearned Financing Costs

-----

Financing costs in connection with the May 24, 2001 convertible debenture offering is being amortized over one-year period of the obligation.

### Comprehensive Income (Loss)

-----

Comprehensive income (loss) generally includes all changes in equity during a period, except those resulting from investments by shareholders and distributions to shareholders.

### Computer Software

-----

Effective July 1, 1998, the Company adopted the provisions of SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use", which revises the accounting for software development costs and requires the capitalization of certain costs. No adjustments were required as a result of this adoption.

## FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### Recent Accounting Pronouncements

-----

In fiscal 2001, the Company adopted SFAS No. 133, "Accounting for Derivative

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Instruments and Hedging Activities", SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of SFAS No. 133", and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities an amendment of SFAS No. 133". These statements outline the accounting treatment for all derivative activity and the adoption did not have a significant effect on the Company's consolidated results of operations or financial position.

In fiscal 2001, the Company adopted the Securities and Exchange Commission Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition". SAB 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The adoption of SAB 101 had no effect on the Company's consolidated results of operations or financial position.

### Recent Accounting Pronouncements (Continued)

-----

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Accounting for Business Combinations" and SFAS No. 142, "Accounting for Goodwill and Other Intangible Assets". SFAS No. 141 requires that all business combinations be accounted for using the purchase method of accounting and prohibits the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. According to SFAS No. 142, goodwill, which arises from business combinations after June 30, 2001, cannot be amortized. In addition, SFAS No. 142 requires the discontinuation of goodwill amortization and the amortization of intangible assets with indeterminate lives effective the date the Company adopts the statement, which is expected to be June 30, 2002. The Company has six months from the date it adopts SFAS No. 142 to test for impairment and any impairment charge resulting from the initial application of the new rule must be classified as the cumulative effect of a change in accounting principle. Thereafter, goodwill and intangible assets with indeterminate lives should be tested for impairment annually or as needed.

The Company does not anticipate any significant impact to the consolidated financial statements as the result of the adoption of SFAS No. 142 and expects to continue to amortize all identifiable intangible assets.

### Reclassifications

-----

Certain prior year balances have been reclassified to conform with the current year presentation.

## FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

### NOTE 3 - ACQUISITIONS

#### Affordable Diagnostics, Inc.

-----

On June 30, 1997, the Company's wholly-owned subsidiary consummated the merger of the assets, liabilities and operations of Affordable Diagnostics, Inc. ("Affordable"), a New York corporation, which managed and operated three diagnostic imaging centers and managed one multi-specialty practice in the Bronx and Westchester, New York. The merger was consummated pursuant to a Merger Agreement ("Agreement") effective June 30, 1997, by and among HMCA's wholly-owned subsidiary, HMCM, Inc. ("HMCM"). Pursuant to the agreement, HMCM

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acquired all of the assets and liabilities of Affordable through the issuance of 1,764,000 shares of the Company's common stock, valued at \$3,630,312, and an additional 576,000 shares of the Company's common stock were issued in June of 1998 valued at \$923,442. The additional 576,000 shares were issued in connection with a one-year earnout provision, which was achieved during fiscal 1998.

Affordable Diagnostics, Inc. (Continued)  
-----

The merger was accounted for as a purchase, under which the purchase price was allocated to the acquired assets and assumed liabilities based upon fair values at the date of the merger. The fair value of the management agreement amounted to approximately \$3,719,000 and is being amortized on a straight-line basis over 20 years. The accompanying consolidated financial statements include the operations of Affordable from the date of the acquisition (June 30, 1997).

Concurrent with the above described transactions, HMCM entered into consulting agreements with the shareholders of Affordable. Under such agreements, 400,000 registered shares of FONAR's common stock, valued at \$1,096,000, were issued pursuant to one year consulting agreements with HMCM. The entire \$1,096,000 was charged to operations during the year ended June 30, 1998.

Acquisition of RVDC  
-----

Effective June 30, 1997, FONAR's wholly-owned subsidiary, HMCA, acquired Raymond V. Damadian, M.D. MR Scanning Centers Management Company ("RVDC") and two affiliates, by purchasing all of the issued and outstanding shares of RVDC from Dr. Damadian for 10,000 shares of the common stock of FONAR. The business of RVDC, continued by HMCA, was the management of MRI diagnostics imaging centers in New York, Florida and Georgia.

The Company has accounted for the acquisition in a manner similar to the pooling-of-interests method due to Dr. Damadian's control over both the Company and RVDC.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

NOTE 3 - ACQUISITIONS (Continued)

Central Health Care Management Service, Inc.  
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On January 23, 1998, a wholly-owned subsidiary of HMCA acquired the business and assets of Central Health Care Management Services, Inc. ("Central"), a management service organization ("MSO"), operating in Westchester County, New York. The purchase price was determined based on a multiple of the net positive cash flow from the acquired business over the succeeding twelve-month period. The purchase price was determined to be \$1,454,160, \$601,665 payable in cash, \$551,665 payable in notes, assumption of liabilities aggregating \$25,000, and the balance payable in shares of common stock of FONAR valued at \$275,830.

The acquisition was accounted for as a purchase, under which the purchase price was allocated to the acquired assets and assumed liabilities, based upon fair values at the date of the acquisition. The fair value of the management agreement amounted to \$1,254,160 and is being amortized on a straight-line basis over 20 years. The accompanying consolidated financial statements include the

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operations of Central from the date of the acquisition (January 23, 1998).

In April of 1999, HMCA entered into consulting agreements with the former shareholders of Central. Under such agreements, 202,018 registered shares of FONAR's common stock, valued at \$275,837, were issued pursuant to consulting agreements covering the one-year period commencing April 1999. For the period ended June 30, 2001 \$206,878 was charged to operations related to these agreements.

A&A Services, Inc.  
-----

On March 20, 1998, the Company's physician and diagnostic management subsidiary, HMCA, consummated the acquisition of the common stock of A&A Services, Inc. ("A&A"), a New York corporation, which manages four primary care practices in Queens, New York.

Pursuant to the A&A agreements, HMCA acquired all of the common stock of A&A for \$4,000,000 in cash, a note payable for \$4,000,000 bearing interest at 6.0% per annum, payable in 16 equal quarterly installments of interest and principal, commencing March of 1999, a note payable for \$1,293,000, bearing interest at 6.0% per annum, payable in 60 equal monthly installments of principal and interest, commencing April 20, 1998, a deferred payment obligation face amount of \$2,000,000 and a contingent payment based on the acquired operations achieving certain earnings objectives over the five-year period following the acquisition date.

The promissory notes are collateralized by all of the assets of the acquired operations and are guaranteed by FONAR.

Contemporaneously with the acquisition of the management company, Dr. Damadian acquired 100% of the stock of the medical practices for nominal consideration.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 3 - ACQUISITIONS (Continued)

A&A Services, Inc. (continued)  
-----

The acquisition was accounted for as a purchase, under which the purchase price was allocated to the acquired assets and assumed liabilities based upon fair values at the date of the acquisition. The fair value of the management agreement amounted to approximately \$10,448,000 and is being amortized on a straight-line basis over 20 years. The accompanying consolidated financial statements include the operations of A&A from the date of the acquisition.

Additional consideration is payable to the former shareholders of A&A, if operating income, as defined for the acquired business, exceeds \$2.3 million in any of the five years following the closing as follows: in each year, 75% of operating income, as defined, between \$2.3 million and \$2.8 million; 50% of operating income, as defined, between \$2.8 million and \$3.5 million, and 25% of operating income, as defined, in excess of \$3.5 million. The contingent additional purchase price is not determinable as of June 30, 2001 and, accordingly, has not been included in the allocated purchase price in light of the contingent nature of the arrangement. If the earnings objectives are ultimately achieved, the additional purchase price will be recorded as additional value of the management agreement, subject to amortization over the

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stated period. No additional payments were due under the earnout provision for the years ended June 30, 2001, 2000 and 1999.

Dynamic Health Care Management, Inc.  
-----

On August 20, 1998, the Company's physician and diagnostic management subsidiary, HMCA, consummated the acquisition of the common stock of Dynamic Health Care Management, Inc. ("Dynamic"), a New York corporation, which manages three physician practices on Long Island, New York. The practices consist of internal medicine, physiatry and physical rehabilitation.

Pursuant to the Dynamic agreements, HMCA acquired all of the common stock of Dynamic for \$2,000,000 in cash, a note payable for \$1,216,230 bearing interest at 7.5% per annum, payable in sixty monthly installments, commencing one month following the closing date, a note payable for \$2,870,000 bearing interest at 7.5% per annum payable in three annual installments of principal and interest commencing one year after the closing date, and promissory notes face amount of \$5,490,000, payable in thirty-six monthly installments of principal and interest, commencing two years after the closing date.

The promissory notes are collateralized by all of the assets of the acquired operations and are guaranteed by the Company.

Contemporaneously with the acquisition of the management company, Dr. Damadian acquired 100% of the stock of the medical practices for nominal consideration.

The acquisition was accounted for as a purchase, under which the purchase price was allocated to the acquired assets and assumed liabilities based upon fair values at the date of the acquisition. The fair value of the management agreement amounted to \$8,951,907 and is being amortized on a straight-line basis over 20 years. The accompanying consolidated financial statements include the operations of Dynamic from the date of acquisition, August 20, 1998.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 4 - MARKETABLE SECURITIES

The following is a summary of marketable securities at June 30, 2001 and 2000:

	2001		
	Cost	Unrealized Holding Gain	Fair Market Value
U.S. Government Obligations	\$ 4,128,191	\$ 63,849	\$ 4,192,039
Corporate and government agency bonds	1,872,942	20,285	1,893,227
	\$6,001,132	\$ 84,134	\$ 6,085,266
	=====	=====	=====
	2000		
	----- Unrealized		



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	Cost	Holding Loss	Fair Market Value
	-----	-----	-----
U.S. Government Obligations	\$10,198,273	\$ (210,045)	\$ 9,988,228
Corporate and government agency bonds	1,550,711	(54,763)	1,495,948
	-----	-----	-----
	\$11,748,984	\$ (264,808)	\$ 11,484,176
	=====	=====	=====

All debt securities are due within five years. Of the cost, at June 30, 2001, \$512,110 is due within one year.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 5 - ACCOUNTS RECEIVABLE AND ACCOUNTS RECEIVABLE - RELATED MEDICAL PRACTICES, NET

Accounts receivable and accounts receivable - related medical practices, net are comprised of the following:

	As of June 30, 2001		
	Gross Receivable	Allowance For Doubtful Accounts and Contractual Allowances	Net
	-----	-----	-----
Receivable from equipment sales and service contracts	\$ 1,885,071	\$ 1,033,331	\$ 849,740
Receivable from medical services	-	-	-
	-----	-----	-----
	\$ 1,885,071	\$ 1,033,331	\$ 849,740
	=====	=====	=====
Receivable from related PC's	\$13,718,951	\$ 538,297	\$13,180,654
	=====	=====	=====

	As of June 30, 2000		
	Gross Receivable	Allowance For Doubtful Accounts and Contractual Allowances	Net
	-----	-----	-----
Receivable from equipment sales and service contracts	\$ 2,036,960	\$ 788,331	\$ 1,248,629
Receivable from medical services	533,621	95,439	\$ 438,182
	-----	-----	-----
	\$ 2,570,581	883,770	\$ 1,686,811
	-----	-----	-----

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	=====	=====	=====
Receivable from related PC's	\$13,050,583	\$ 153,732	\$12,896,851
	=====	=====	=====

The Company's customers are concentrated in healthcare industry.

The Company's receivable from the related PC's substantially consists of fees outstanding under management agreements, service contracts and lease agreements with related PC's. Payment of the outstanding fees is based on collection by the PC's of fees from third party medical reimbursement organizations, principally insurance companies and health management organizations.

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 5 - ACCOUNTS RECEIVABLE AND ACCOUNTS RECEIVABLE - RELATED PARTIES, NET  
 (Continued)

The Company's receivables from medical services consist of receivables from patients and third-party payors for medical services provided by the Company's wholly owned Florida multi-specialty practice.

Collection by the Company of its accounts receivable may be impaired by the uncollectibility of medical fees from third party payors, particularly insurance carriers covering automobile no-fault and workers compensation claims due to longer payment cycles and rigorous informational requirements. Approximately 56%, 48% and 33%, respectively, of the medical practices' 2001, 2000 and 1999 net revenues were derived from no-fault and personal injury protection claims. The Company considers the aging of its accounts receivable in determining the amount of allowance for doubtful accounts and contractual allowances. The Company takes all legally available steps, including legally prescribed arbitrations, to collect its receivables. Credit losses associated with the receivables are provided for in the consolidated financial statements and have historically been within management's expectations.

Net revenues from management and other fees charged to the related PC's accounted for approximately 72%, 81% and 82% of the consolidated net revenues for the years ended June 30, 2001, 2000 and 1999, respectively.

Unaudited Financial Information of Unconsolidated Managed Medical Practices  
 -----

Summarized financial information related to the 28 unconsolidated medical practices managed by the Company is not available. Substantially all of these medical practice books and records are maintained on the cash basis, and depreciates its assets on an accelerated tax basis and has a December 31 year end.

During the year ended June 30, 2001, the 28 unconsolidated medical practices had collections of approximately \$36.8 million. As of June 30, 2001, the estimated net realizable value of the medical receivables of these medical practices approximated \$16.2 million.

NOTE 6 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS AND CUSTOMER ADVANCES

1) Information relating to uncompleted contracts as of June 30, 2001 and 2000

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is as follows:

	As of June 30,	
	2001	2000
Costs incurred on uncompleted contracts	\$2,248,706	\$ 829,441
Estimated earnings	560,558	138,718
	2,809,264	968,159
Less: Billings to date	1,392,000	-
	\$1,417,264	\$ 968,159

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 6 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS AND CUSTOMER ADVANCES (Continued)

Included in the accompanying consolidated balance sheets under the following captions:

	As of June 30,	
	2001	2000
Costs and estimated earnings in excess of billings on uncompleted contracts	\$1,768,856	\$ 968,159
Billings in excess of costs and estimated earnings on uncompleted contracts	351,592	-
	\$1,417,264	\$ 968,159

2) Customer advances consist of the following:

	As of June 30,	
	2001	2000
Total advances from customers	\$3,064,522	\$ 582,551
Less: Advances from customers on contracts under construction	1,392,000	-
	\$1,672,522	\$ 582,551

NOTE 7 - INVENTORIES

Inventories included in the accompanying consolidated balance sheets consist of:

As of June 30,  
 -----

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	2001	2000
	-----	-----
Purchased parts, components and supplies	\$3,049,879	\$2,916,753
Work-in-process	675,496	619,416
	-----	-----
	\$3,725,375	\$3,536,169
	=====	=====

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 8 - INVESTMENT IN SALES-TYPE LEASES

During the year ended June 30, 2001, the Company entered into two lease agreements, totaling \$1,895,000, with related parties for MRI scanners, which are considered sales-type leases. The leases are payable in 120 monthly installments of \$12,356 and \$11,903, respectively, including interest at 10% and 8.5% per annum. The lessees can also elect to pay lump sums of \$581,544 and \$580,149, respectively, at the end of the 60-months. If the lease term is extended beyond 60 months, the lease may elect to purchase the scanner at the end of the second 60-month period for a purchase price of \$1.

During the year ended June 30, 2001, the Company entered into a \$1,050,000 lease agreement with an outside party for an MRI scanner, which is considered sales-type lease. The lease is payable in 75 monthly installments of \$18,389 each, plus at the end of the 25-month lease, the lessee can elect to continue the lease for an additional five years, at a monthly payment of \$18,389, including interest at 12.5% per annum, or pay a lump sum of \$200,000.

During the year ended June 30, 2000, the Company entered into a \$935,000 lease agreement with a related party for an MRI scanner which is considered a sales-type lease. The lease is payable in 120 monthly installments of \$12,356, including interest at 10% per annum. The lessee can also elect to pay a lump sum of \$581,544 at the end of 60 months. If the lease term is extended beyond 60 months, the lease may elect to purchase the scanner at the end of the second 60-month period for a purchase price of \$1.

The Company's investment in sales-type lease as at June 30, 2001 and 2000 is as follows:

	As of June 30,	
	2001	2000
	-----	-----
Net minimum lease payments receivable	\$5,029,225	\$1,310,548
Less: Unearned income	1,343,420	380,113
	-----	-----
Net Investment in Sales-type Lease	\$3,685,805	\$ 930,435
	=====	=====
Current portion	\$ 310,853	\$ 57,832
Non-current portion	3,374,952	872,603
	-----	-----
	\$3,685,805	\$ 930,435
	=====	=====

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Future minimum lease payments are as follows:

Years Ended June 30:	
-----	
2002	\$ 310,853
2003	329,883
2004	366,611
2005	981,558
2006	1,417,872
	279,028
	-----
	\$3,685,805
	=====

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 9 - PROPERTY AND EQUIPMENT

Property and equipment, at cost, less accumulated depreciation and amortization, at June 30, 2001 and 2000, is comprised of:

	As of June 30,	
	2001	2000
	-----	-----
Diagnostic equipment under lease	\$ 1,263,181	\$ 1,263,181
Diagnostic equipment	4,485,217	6,776,653
Research, development and demonstration equipment	7,916,447	7,217,601
Machinery and equipment	6,265,041	6,106,145
Furniture and fixtures	3,222,076	3,181,390
Equipment under leases	2,444,947	2,364,088
Leasehold improvements	3,185,611	2,572,728
	-----	-----
	28,782,520	29,431,786
 Less: Accumulated depreciation and amortization	 18,145,123	 18,204,332
	-----	-----
	\$10,637,397	\$11,227,454
	=====	=====

Depreciation and amortization of property and equipment for the years ended June 30, 2001, 2000 and 1999 was \$3,323,516, \$3,237,384 and \$3,139,585, respectively.

The equipment under lease has a net book value of \$1,684,083 and \$1,285,760 at June 30, 2001 and 2000, respectively.

NOTE 10 - OTHER INTANGIBLE ASSETS

Other intangible assets, net of accumulated amortization, at June 30, 2001 and 2000 are comprised of:

	As of June 30,	
	2001	2000
	-----	-----
Capitalized software development costs	\$2,315,744	\$1,560,941
Patents and copyrights	1,125,808	1,125,808

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Deferred financing costs	270,729	-
	-----	-----
	3,712,281	2,686,749
Less: Accumulated amortization	1,858,775	1,650,825
	-----	-----
	\$1,853,506	\$1,035,924
	=====	=====

Capitalized computer software costs are being amortized over 5 years. Patents costs are being amortized over 17 years. Deferred financing costs are being amortized over the life of the related debt agreement (see Note 13).

Amortization of other intangible assets for the years ended June 30, 2001, 2000 and 1999 was \$207,951, \$214,391 and \$292,295, respectively, of which \$141,727, \$148,167 and \$208,098, respectively, relate to amortization expense for software development costs.

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 11 - CAPITAL STOCK

Common Stock  
 -----

Cash dividends payable on the common stock shall, in all cases, be on a per share basis, one hundred twenty percent (120%) of the cash dividend payable on shares of Class B common stock and three hundred sixty percent (360%) of the cash dividend payable on a share of Class C common stock. In addition, as revised pursuant to a legal settlement agreement on April 29, 1997, a special cash dividend shall be payable in an amount equal to 3-1/4% on first \$10 million, 4-1/2% on next \$20 million, and 5-1/2% on amounts in excess of \$30 million of the amount of any cash awards or settlements received by the Company in connection with the enforcement by the Company of United States Patent No. 3,789,832 (Apparatus and Method of Detecting Cancer in Tissue). Pursuant to such dividend entitlement, the Company recorded an obligation of \$2,551,146, or approximately \$.05 per share of common stock, during fiscal 1997, which was paid during 1998 and 1999.

Class B Common Stock  
 -----

Class B common stock is convertible into shares of common stock on a one-for-one basis. Class B common stock has 10 votes per share. During the year ended June 30, 2000, 1,000 shares of Class B common stock were converted to common stock leaving 4,211 of such shares outstanding as of June 30, 2000 and 2001.

Class C Common Stock  
 -----

On April 3, 1995, the shareholders ratified a proposal creating a new Class C common stock and authorized the exchange offering of three shares of Class C common stock for each share of the Company's outstanding Class B common stock. The Class C common stock has 25 votes per share, as compared to 10 votes per share for the Class B common stock and one vote per share for the common stock. The Class C common stock was offered on a three-for-one basis to the holders of the Class B common stock. Although having greater voting power, each share of Class C common stock has only one-third of the rights of a share of Class B

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common stock to dividends and distributions. Class C common stock is convertible into shares of common stock on a three-for-one basis. During the year ended June 30, 1996, approximately 3.2 million shares of Class B common stock were converted to Class C common stock.

### Class A Non-Voting Preferred Stock

-----

On April 3, 1995, the shareholders ratified a proposal consisting of the creation of a new class of Class A non-voting preferred stock with special dividend rights and the declaration of a stock dividend on the Company's common stock consisting of one share of Class A non-voting preferred stock for every five shares of common stock. The stock dividend was payable to holders of common stock on October 20, 1995. Class A non-voting preferred stock issued pursuant to such stock dividend approximates 7.8 million shares.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 11 - CAPITAL STOCK (Continued)

#### Class A Non-Voting Preferred Stock (continued)

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The Class A non-voting preferred stock is entitled to a special dividend equal to 3-1/4% of first \$10 million, 4-1/2% of next \$20 million and 5-1/2% on amount in excess of \$30 million of the amount of any cash awards or settlements received by the Company in connection with the enforcement of five of the Company's patents in its patent lawsuits, less the revised special dividend payable on the common stock with respect to one of the Company's patents. Pursuant to such dividend entitlement, the Company recorded an obligation of \$5,086,695, or \$.65 per share of Class A preferred stock, during fiscal 1997 and \$217,226, or \$.03 per share of Class A preferred stock, during fiscal 1996. During fiscal 1998 and 1999, these dividend obligations were paid.

The Class A non-voting preferred stock participates on an equal per share basis with the common stock in any dividends declared and ranks equally with the common stock on distribution rights, liquidation rights and other rights and preferences (other than the voting rights).

The above described features essentially enable the holders of the Class A non-voting preferred stock to share in the earnings potential of the Company on substantially the same basis as the common stock. Accordingly, the Company has classified the Class A non-voting preferred stock as a common stock equivalent. Earnings per share and weighted average shares outstanding have been restated to reflect the Class A non-voting preferred stock dividend.

#### Options

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The Company has stock option plans which provide for the awarding of incentive and non-qualified stock options to employees, directors and consultants who may contribute to the success of the Company. The options granted vest either immediately or ratably over a period of time from the date of grant, typically three or four years, at a price determined by the Board of Directors or a committee of the Board of Directors, generally the fair value of the Company's common stock at the date of grant. The options must be exercised within ten years from the date of grant.

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Stock option share activity and weighted average exercise prices under these plans and grants for the years ended June 30, 2001, 2000 and 1999 were as follows:

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 11 - CAPITAL STOCK (Continued)

Options (continued)

-----

	Number of Shares	Weighted Average Exercise Price
	-----	-----
Outstanding, June 30, 1998	182,735	\$ 4.62
Granted	205,000	1.23
Exercised	-	-
Forfeited	-	-
	-----	-----
Outstanding, June 30, 1999	387,735	4.62
Granted	413,000	1.52
Exercised	(374,000)	1.15
Forfeited	-	-
	-----	-----
Outstanding, June 30, 2000	426,735	2.83
Granted	672,896	1.52
Exercised	(24,000)	1.18
Forfeited	-	-
	-----	-----
Outstanding, June 30, 2001	1,075,631	\$ 2.05
	=====	=====
Exercisable at:		
June 30, 1999	387,735	\$ 4.62
June 30, 2000	426,735	\$ 2.83
June 30, 2001	402,735	\$ 2.93

The exercise price for options outstanding as of June 30, 2001 ranged from \$0.75 to \$5.00.

On March 10, 1997, HMCA adopted the 1997 Incentive Stock Option Plan, pursuant to which HMCA authorized the issuance of up to 2,000,000 shares (as adjusted for the 8,000-for-1 stock split effective December 15, 1998) of the common stock of HMCA. Options to purchase 1,600,000 shares at an option price of \$0.10 per share (as adjusted) were granted on March 10, 1997. One half of the options granted will not become exercisable unless and until the earlier of such time as HMCA successfully completes a public offering of its securities, or HMCA recognizes at least \$10,000,000 in revenues for two consecutive fiscal quarters. The remainder of the options will not become exercisable until one year thereafter. The options will expire on March 9, 2007. No options have vested as of June 30, 2001.

On December 16, 1998, HMCA adopted the 1998 Non-Statutory Stock Option Plan, pursuant to which HMCA authorized the issuance of up to 500,000 shares of the common stock of HMCA. Options to purchase 500,000 shares at an option price of \$1.00 per share were granted on December 16, 1998. The options granted will not become exercisable unless and until such time as HMCA successfully completes a public offering of its securities. The options will expire on December 15, 2008.



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No options have vested as of June 30, 2001.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 11 - CAPITAL STOCK (Continued)

##### Options (Continued)

-----

On December 16, 1998, HMCA adopted the 1998 Incentive Stock Option Plan, pursuant to which HMCA authorized the issuance of up to 2,000,000 shares of the common stock of HMCA. Options to purchase 670,000 shares at an option price of \$1.00 per share were granted on December 16, 1998. 470,000 of the options granted will not become exercisable unless and until such time as HMCA successfully completes a public offering of its securities, and 200,000 of the options will not become exercisable until one year thereafter. The options will expire on December 15, 2008. No options have vested as of June 30, 2001.

Stock option share activity and weighted average exercise prices under the HMCA plans and grants for the three years ended June 30, 2001, 2000 and 1999 were as follows:

	Number of Shares	Weighted Average Exercise Price
	-----	-----
Outstanding - June 30, 2000 and 1999	2,770,000	\$ .48
Granted - June 30, 2001	-	-
	-----	-----
Outstanding - June 30, 2001 and 2000	2,770,000	\$ .48
	=====	=====
Exercisable at June 30, 2001, 2000 and 1999	-	\$ -
	=====	=====

The Company accounts for its stock option plans under APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for these plans been determined consistent with FASB Statement No. 123, the Company's net loss and loss per share would have been effected for the years ended June 30, 2001, 2000 or 1999 as follows:

	2001	2000	1999
	-----	-----	-----
Net Loss:			
As reported	\$(15,183,862)	\$(10,955,987)	\$ 14,215,763
Proforma	\$(15,183,862)	\$(11,059,237)	\$ 14,256,763
Loss Per Share:			
As reported	\$(0.22)	\$(0.17)	\$(0.22)
Proforma	\$(0.23)	\$(0.17)	\$(0.22)

The fair value of the options granted under all plans is estimated at \$0.52, \$0.20 and \$0.46, respectively, on the date of grant using the Black-Scholes option-pricing model based on the following assumptions for the years ended June 30, 2001, 2000 and 1999:

	2001	2000	1999
	-----	-----	-----
All Plans:			
Dividend yield	0%	0%	0%
Expected volatility	98%	33%	33%
Expected life (years)	3	3	3

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FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 11 - CAPITAL STOCK (Continued)

Options (Continued)

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The risk-free interest rates were based upon a rate with maturity equal to expected term. U.S. Treasury instruments were utilized. The weighted average interest rate amounted to 5.0%.

Stock Bonus Plans

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On October 1, 2000 and May 9, 1997, the Board of Directors adopted Stock Bonus Plans. Under the terms of the Plans, 5,000,000 shares of common stock are available for the issuance under each plan as bonus or compensation. The stock bonuses may be awarded no later than September 30, 2010 for the 2000 Plan and March 31, 2007 for the 1997 Plan.

During fiscal 2001, 2000 and 1999, 3,001,060, 2,148,429 and 826,359 shares, respectively, were issued under the stock bonus plans, of which 1,636,602, 234,677 and 161,180 shares, respectively, were charged to operations as compensation expense, 435,976, 490,000 and 463,161 shares, respectively, were issued for professional services, 5,000, 19,332 and -0- shares, respectively, were issued in exchange for notes, 923,482, 1,403,420 and 202,018 shares, respectively, were issued in connection with consulting agreements, and -0-, 1000 and -0- shares, respectively, were issued upon conversion of Class B to Class A common stock.

Warrants

-----

In connection with the convertible debenture financing completed in May of 2001 (Note 13), the Company granted to the investor and the placement agent warrants to purchase a total of 959,501 common shares at an exercise price of \$1.801 per share. The warrants are exercisable over a five-year period. The fair value of the warrants is estimated at \$1.14 on the date of grant using the Black-Scholes pricing model. In addition, the Company granted to the investor callable warrants to purchase a total of 2,000,000 shares of common stock at fluctuating prices (Note 13).

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 12 - LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES

Long-term debt, notes payable and capital leases consist of the following:

As of June 30,

-----

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	2001 -----	2000 -----
Construction loan converted into a capital lease obligation during August 1998. The obligation requires equal monthly payments aggregating \$13,097, including interest at 13.2% per annum, through August 2003. The obligation is collateralized by the related equipment.	\$ 274,931	\$ 387,580
Promissory note payable to a bank, collateralized by \$5 million certificate of deposit, requiring monthly payments of interest only, at a variable rate based on the bank's prime rate (4.56% at June 30, 2001) with payment of the entire principal due on March 20, 2003.	5,000,000	5,000,000
Note payable to the former shareholders of A&A Services, Inc. The note calls for 16 quarterly payments of \$300,044, including interest at a rate of 6%, commencing March 20, 1999. The note is collateralized by all of the assets of the acquired business and guaranteed by FONAR.	1,709,406	2,767,060
Note payable to the former shareholder of A&A Services, Inc. The note calls for 60 equal monthly installments of principal and interest of \$25,000, including interest at a rate of 6% per annum, commencing April 20, 1998. The note is collateralized by all of the assets of the acquired business and guaranteed by FONAR.	497,199	758,788
Note payable calling for monthly payments of \$9,034, including interest at a rate of 8.875% through July 2002. The loan is collateralized by equipment located in Ellwood, Pennsylvania.	101,779	205,262
Note payable to the former shareholders of Dynamic Health Care Management, Inc. The note calls for three annual payments of principal, including interest at a rate of 6%, commencing August 20, 1999. The note is collateralized by all of the assets of the acquired business and guaranteed by FONAR.	972,824	1,877,776

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 12 - LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES (Continued)

	As of June 30,	
	----- 2001 -----	----- 2000 -----
Note payable to the former shareholders of Dynamic Health Care Management, Inc. The note calls for monthly installments of principal and		

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interest of \$65,417 for the first eight installments, followed by \$16,667 for the remaining 52 installments. The installments include interest at a rate of 7.5% per annum. The note is collateralized by all of the assets of the acquired business and guaranteed by FONAR.

\$ 399,881      \$ 564,341

Deferred payment obligation, aggregating \$5,490,000, payable to the former shareholders of Dynamic Health Care Management, Inc. The obligation is payable over three years, commencing August 20, 2000, with interest at 7.5% per annum. The obligation has been recorded, net of discount of \$739,324, representing the value of the two-year interest-free provision of this obligation. A \$100,000 principal payment was made in November 1998. The obligation is collateralized by all of the assets of the acquired business and guaranteed by FONAR.

3,842,057      5,337,913

Deferred payment obligation, aggregating \$2,000,000, payable to the former shareholder of A&A Services, Inc. The obligation is payable over four years, commencing December 20, 2000, with interest at 6% per annum. The obligation has been recorded, net of a discount of \$220,000, representing interest imputed at a rate of 6% over two years. The obligation is collateralized by all of the assets of the acquired business and guaranteed by FONAR.

1,277,770      2,000,000

Four promissory notes payable to the former shareholders of Central Health Care Management Services, LLC. Each note calls for two equal annual installments of \$11,458, plus interest at prime rate, plus 2%, per annum (11.50% at June 30, 2000), commencing April 2000. The obligations under each note are guaranteed by FONAR.

18,197      68,749

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 12 - LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES (Continued)

As of June 30,	
2001	2000

Four promissory notes payable to the former shareholders of Central Health Care Management Services, LLC. Each note calls for two equal annual installments of \$57,500, plus interest at prime rate, plus 2% per annum (11.50% at June 30, 2000), commencing March 2000. The obligations under each note are guaranteed by

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FONAR.	\$ 127,119	\$ 283,247
Capital lease requiring monthly payments of \$28,997, including interest at a rate of 9.95% per anum through April 2004. The loan is collateralized by the related equipment.	856,055	-
Note payable in monthly installments of \$15,686, including interest at a rate of 9.25% per anum through February 2003.	289,697	-
Promisory note payable to a bank, collateralized by \$500,000 certificate of deposit, requiring monthly payments of interest only, at a variable rate based on the bank's prime rate (6.75% at June 30, 2001) with a payment of the entire princiapl due on July 2, 2001.	500,000	-
Capital lease requiring monthly payments of \$12,595, including interest at a rate of 9% through October 1, 2002. The loan is collateralized by related equipment.	112,479	247,824
Capital lease dated October 13, 1995 - \$513,692, due \$11,173 per month, commencing October 1995, including interest of 11% for 60 months. The lease is collateralized by the related equipment.	-	183,243
Capital lease dated June 4, 1996 - \$412,550, due \$8,972 per month, commencing July 1996, including interest of 11% for 60 months. The lease is collateralized by the related equipment.	-	174,407

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 12 - LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES (Continued)

	As of June 30,	
	2001	2000
	-----	-----
Other (including capital leases for property and equipment)	764,755	1,112,996
	-----	-----
	16,744,149	20,969,186
Less: Current maturities	6,634,863	6,224,727
	-----	-----
	\$10,109,286	\$14,744,459
	=====	=====

The maturities of long-term debt, including debt in arrears, over the next five years and thereafter are as follows:

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Years Ended June 30, -----	
2002	\$ 6,634,863
2003	9,518,656
2004	548,156
2005	40,900
2006	1,574
	-----
	\$16,744,149
	=====

NOTE 13 - CONVERTIBLE DEBENTURES

Pursuant to a securities purchase agreement, dated May 24, 2001, between the Company and an investor group, the Company issued and sold to the investor group on that date for an aggregate purchase price of \$4.5 million:

4% convertible debentures due June 30, 2002 in the aggregate principal amount of \$4.5 million, convertible into shares of the Company's common stock at a conversion price of \$2.047 per share, subject to adjustment.

Purchase warrants to purchase an aggregate of 959,501 shares of the Company's common stock at an initial exercise price of \$1.801 per share, subject to adjustment; and

Callable warrants to purchase an aggregate of 2,000,000 shares of the Company's common stock at a fluctuating exercise price which will vary depending on the market price for the Company's common stock.

In connection with the issuance of the debentures, the Company paid a placement fee in the amount of \$157,500. In addition, the Company issued 300,000 purchase warrants to the placement agent.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 13 - CONVERTIBLE DEBENTURES (Continued)

The debentures are convertible at the option of the holder at a price of \$2.047 per share. If the holders decide not to convert, the debenture is payable in ten monthly installments of \$450,000 commencing October 1, 2001. At the option of the Company, the principal installments can be either in cash or shares of the Company's common stock, valued at the lesser of: a) 90% of the average of the four lowest closing bid prices during the preceding month, or b) the average of the four lowest closing bid prices during the preceding calendar month, less \$0.125. By amendment dated October 25, 2001, however, the payments originally due October 1, 2001 and November 1, 2001, have been extended to November 5, 2001, and for those payments, the stock would be valued at the average of the two lowest closing bid prices for October, 2001 less \$0.25.

The purchase warrants cover 959,501 shares of common stock and have an exercise price of \$1.801 per share, subject to adjustment. The exercise period extends to May 24, 2006.

The callable warrants cover 2,000,000 shares of common stock and have a variable exercise price. Subject to a maximum price of \$6.00 per share and a minimum

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price of \$2.00 per share, which is subject to adjustment, pursuant to the terms of the warrants, the exercise price will be equal to the average closing bid price of the Company's common stock for the full calendar month preceding the date of exercise. The exercise period extends to May 24, 2004.

The Company has the option of redeeming up to 200,000 callable warrants per month at a price of \$0.01 per underlying warrant share, if the average closing bid price of its common stock is greater than 115% of the warrant price in effect for five consecutive trading days in any calendar month.

The debentures and warrants provide for proportionate adjustments in the event of stock splits, stock dividends and reverse stock splits. In addition, the conversion and exercise prices will be reduced, with certain specified exceptions, if the Company issues shares at lower prices, then the debenture conversion or warrant exercise prices, or less than market price for its common stock.

The terms of the registration rights agreement with the investor requires the Company to register approximately two times the number of shares necessary to repay the debentures in common stock at the lower of the market price, as computed under the agreement, or the conversion price, plus the number of shares underlying the warrants.

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 14 - INCOME TAXES

Components of the provision (benefit) for income taxes are as follows:

	2001 -----	2000 -----	1999 -----
Current:			
Federal	\$ -	\$ -	\$ -
State and local	39,996	43,677	203,876
	-----	-----	-----
	39,996	43,677	203,876
	-----	-----	-----
Deferred:			
Federal	-	-	(659,794)
State and local	-	-	(134,000)
	-----	-----	-----
	-	-	(793,794)
	-----	-----	-----
Totals	\$ 39,996	\$ 43,677	\$ (589,918)
	=====	=====	=====

A reconciliation of the federal statutory income tax rate to the Company's effective tax rate as reported is as follows:

	2001 -----	2000 -----	1999 -----
Taxes at federal statutory Rate	(34.0)%	(34.0)%	(34.0)%
State and local income taxes, net of federal benefit	0.3	0.4	0.3

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Permanent differences	0.7	1.1	0.8
Unutilized net operating losses and tax credits	33.3	32.9	28.9
	-----	-----	-----
Effective income tax rate	0.3 %	0.4%	(4.0)%
	=====	=====	=====

As of June 30, 2001, the Company has net operating loss carryforwards of approximately \$52,392,000 that will be available to offset future taxable income at various dates through June 2020. Additionally, for federal income tax purposes, the Company has research and development tax credit carryforwards aggregating \$2,142,081, which are accounted for under the flow-through method. The tax credit carryforwards expire as follows:

June 30:	
-----	
2006	\$ 101,334
2007	258,200
2008	172,207
2016	70,145
2017	402,590
2018	432,195
2019	378,193
2020	327,217
	-----
	\$2,142,081
	=====

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 14 - INCOME TAXES (Continued)

In addition, for New York State income tax purposes, the Company has tax credit carryforwards aggregating \$1,070,000, which are accounted for under the flow-through method. The tax credit carryforwards expire during the years 2007 to 2016.

Significant components, tax effected, of the Company's deferred tax assets and liabilities at June 30, 2001 and 2000 are as follows:

	2001	2000
	-----	-----
Deferred tax assets:		
Allowance for doubtful accounts	\$ 1,045,768	\$ 1,022,807
Non-deductible accruals	772,072	621,067
Net operating carryforwards	20,675,405	9,896,000
Tax credits	3,211,726	3,136,906
Inventory capitalization for tax purposes	84,000	84,000
	-----	-----
Valuation allowance	25,788,970	14,760,780
	(24,393,453)	(13,924,203)
	-----	-----
Net deferred tax assets	1,395,517	836,577
	-----	-----
Deferred tax liabilities:		



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Fixed assets and depreciation	974,462	661,019
Capitalized software costs	421,055	175,558
	-----	-----
Gross deferred tax liabilities	1,395,517	836,577
	-----	-----
Net deferred tax liabilities	\$ -	\$ -
	=====	=====

The net change in the valuation allowance for deferred tax assets increased by approximately \$10,469,000.

NOTE 15 - OTHER CURRENT LIABILITIES

Included in other current liabilities are the following:

	2001	2000
	-----	-----
Unearned revenue on service contracts	\$ 906,602	\$ 775,032
Accrued bonuses	397,012	729,546
Accrued payroll taxes	250,475	282,158
Accrued interest	140,309	259,224
Accrued salaries and commissions	764,146	684,663
Accrued professional fees	224,882	653,102
Litigation judgements	268,091	2,440,037
Excise and sales taxes	2,655,678	1,847,805
Other	568,562	1,109,362
	-----	-----
	\$6,175,757	\$8,780,929
	=====	=====

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 16 - COMMITMENTS AND CONTINGENCIES

Leases

-----

The Company rents its operating facilities and certain equipment pursuant to operating lease agreements expiring at various dates through February 2009. The leases for certain facilities contain escalation clauses relating to increases in real property taxes as well as certain maintenance costs.

Future minimum lease commitments consisted of the following at June 30, 2001:

Year Ended	Facilities	
June 30,	and	
	Equipment	Capital
	-----	-----
2002	\$ 2,949,273	\$ 730,801
2003	2,628,258	591,688
2004	2,383,492	312,611
2005	1,563,482	18,432
2006	1,505,441	-
Thereafter	5,143,688	-
	-----	-----
Total minimum obligations	\$16,173,634	1,653,532

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	=====
Less: Amount representing interest	(222,163)
	-----
Present value of net minimum lease obligations	\$ 1,431,369
	=====

Rent expense for operating leases approximated \$3,307,000, \$3,235,000 and \$3,266,000 for the three years ended June 30, 2001, 2000 and 1999, respectively.

Litigation  
-----

On April 27, 2000, Beal Bank, S.S.B. filed a motion for summary judgement against Melville Magnetic Resonance Imaging, P.C. ("Melville Magnetic") and the Company in a litigation in the New York Supreme Court, Suffolk County. The summary judgement motion sought recovery of the principal, plus accrued interest on a promissory note executed by Melville Magnetic and guaranteed by the Company. The court subsequently granted Beal Bank's motion and entered judgement against Melville Magnetic and the Company in the amount of \$1.4 million. On February 5, 2001, the Company paid the judgement in full in order to stop the accrual of interest. On February 6, 2001, Melville Magnetic and the Company filed an appeal from the judgement. The Company has charged back Melville Magnetic \$754,000 related to this payment. Such amount is included in notes receivable as of June 30, 2001. Included in accrued liabilities at June 30, 2000 was \$650,000 related to this judgement. No additional charge to earnings was necessary for the year ended June 30, 2001.

During the quarter ended March 31, 2001, the Company settled its Kivitz judgement litigation for a payment of \$1.225 million. The full amount of the judgement was accrued for as of June 30, 2000. No additional charge to earnings was necessary for the year ended June 30, 2001.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 16 - COMMITMENTS AND CONTINGENCIES (Continued)

License Agreement and Self-Insurance  
-----

The Company has license agreements with two separate companies, which require the Company to pay a royalty on the Company's future sales of certain NMR imaging apparatus. Royalty expense charged to operations for the years ended June 30, 2001, 2000 and 1999 approximated \$33,000, \$36,000 and \$50,000, respectively.

The Company is self-insured with respect to product liability. During the fiscal years ended June 30, 2001, 2000 and 1999, no material claims arose.

In July 2000, the Company entered into a license agreement, pursuant to which it licensed certain of its intellectual assets on a non-exclusive basis. Remuneration payable to the Company under this agreement is \$11.7 million, of which \$9.0 million was received in September of 2000 and \$2.7 million in January of 2001. The license fee of \$11.7 million is being recognized as income ratably over the five-year period ending June 30, 2005.

Employment Agreements

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-----

On March 20, 1998, an affiliate of HMCA entered into two employment agreements with the former owners of A&A. Each agreement provides for a base annual salary of \$150,000 for the first five years and \$315,000 per annum for each year thereafter and shall be increased by 5% per annum up to a minimum base salary of \$500,000 per annum. Additionally, each agreement provides for a bonus commencing in the sixth year of the contract, contingent upon meeting certain thresholds of net income. The employment agreements expire fifteen years from March 20, 1998.

On August 20, 1998, a wholly-owned subsidiary of HMCA entered into two employment agreements with the former owners of Dynamic. Each agreement provides for base compensation of \$150,000 during the first year with annual cost of living increases for the first five years. Each agreement also provides for an increase in base compensation of \$100,000 per annum commencing in the sixth year. In addition, the agreements provide for bonus compensation contingent upon pretax earnings of Dynamic. The employment agreements expire ten years from August 20, 1998.

Minimum annual payments, excluding bonuses, incentives and cost of living increases under these contracts are as follows:

Years Ended June 30, -----	
2002	\$ 600,000
2003	683,000
2004	1,097,000
2005	1,190,000
2006	1,220,000
Thereafter	2,613,000
	-----
	\$7,403,000
	=====

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 16 - COMMITMENTS AND CONTINGENCIES (Continued)

Employee Benefit Plans  
-----

The Company has a non-contributory 401(k) plan (the "Plan"). The Plan covers all non-union employees who are at least 21 years of age with no minimum service requirements. There were no employer contributions to the Plan for the years ended June 30, 2001, 2000 and 1999.

The shareholders of the Company approved the 2000 Employee Stock Purchase Plan ("ESPP") at the Company's annual shareholders' meeting in April 2000. The ESPP provides for eligible employees to acquire common stock of the Company at a discount, not to exceed 15%. The Plan has not been put into effect as of June 30, 2001.

Letters of Credit  
-----

At June 30, 2001, the Company had outstanding letters of credit with a commercial bank for \$390,000 for purposes of collateralizing the Company's

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obligation to a third party for the purchase of inventory.

In connection with various operating leases for its operating facilities, the Company is required to maintain standby letters of credit with a commercial bank of approximately \$68,000 for purposes of collateralizing future lease payments under the respective lease agreements.

NOTE 17 - OTHER INCOME (EXPENSE) AND SUPPLEMENTARY PROFIT AND LOSS DATA

Other income (expense) consists of:

	For the Years Ended June 30,		
	2001	2000	1999
Other income	\$ 101,725	\$ 93,425	\$ 32,950
Gain on sale of subsidiary/ partnership interest	712,781	1,021,950	-
Gain on settlement of various legal disputes and other claims	-	3,540,000	1,618,169
Gain on sale of property	150,000	-	-
Litigation provision	-	-	(650,000)
	-----	-----	-----
	\$ 964,506	\$4,655,375	\$1,001,119
	=====	=====	=====

In October 1999, the Company sold the stock of its subsidiary, Medical SNI. Medical SNI, based in Haifa, Israel, designs and develops products for the medical imaging and archiving industry. The effects of the sale include the removal of liabilities of approximately \$1 million and a pretax gain of \$1,021,950. The Company has a non-exclusive, perpetual, royalty-free worldwide license to use and sublicense the then existing technology.

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 17 - OTHER INCOME (EXPENSE) AND SUPPLEMENTARY PROFIT AND LOSS DATA  
(Continued)

In October 2000, the Company sold its interest in the partnership of AMD Southfield Michigan Limited Partnership for \$750,000. AMD Southfield operates an MRI Scanning Center in Michigan. The Company recognized a pre-tax gain of \$750,000.

In June 2001, HMCA sold the stock of its subsidiary, Medical Specialties, Inc. and Diagnostic Services, Inc. for a promissory note for \$50,000, resulting in a loss of \$37,000.

Advertising expense approximated \$2,022,000, \$2,140,000 and \$2,191,000 for the years ended June 30, 2001, 2000 and 1999, respectively. Maintenance and repair expenses totalled approximately \$905,000, \$758,000 and \$491,000 for the years ended June 30, 2001, 2000 and 1999, respectively. Royalty expenses approximated \$33,000, \$36,000 and \$49,000 for the years ended June 30, 2001, 2000 and 1999, respectively. Amortization of intangible assets was approximately \$1,427,000, \$1,433,000 and \$1,518,000 for the years ended June 30, 2001, 2000 and 1999, respectively.

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NOTE 18 - SUPPLEMENTAL CASH FLOW INFORMATION

During the years ended June 30, 2001, 2000 and 1999, the Company paid \$1,261,379, \$1,596,931 and \$1,768,481 for interest, respectively. During the years ended June 30, 2001, 2000 and 1999, the Company paid \$39,997, \$20,144 and \$201,388 for income taxes, respectively.

During the year ended June 30, 1999, the Company acquired the assets and assumed the liabilities of various entities. The transaction had the following non-cash impact on the balance sheet:

Accounts receivable	\$1,900,000
Equipment	60,000
Intangibles	9,356,067
Accrued liabilities	1,000,000
Notes payable to sellers	(9,388,572)
Equity	(275,830)
	-----
Net Cash Used for Acquisitions	\$2,651,665
	=====

Non-Cash Transactions

-----  
 During the year ended June 30, 2001:

- a) The Company issued 415,976 shares of common stock for professional services of \$625,500.
- b) Property and equipment, costing \$636,504, was acquired under a capital lease obligation.

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 18 - SUPPLEMENTAL CASH FLOW INFORMATION (Continued)

Non-Cash Transactions (continued)

- 
- c) The Company issued 20,000 shares of its common stock, valued at \$28,438, in connection with the repayment of note payable of \$115,000.
  - d) The Company issued 923,482 shares of its common stock, valued at \$1,632,980 for consulting services.
  - e) The Company issued 183,924 shares of its common stock, valued at \$344,839, for research and development expenses.
  - f) The Company acquired equipment of \$176,480 under equipment notes payable obligations.

During the year ended June 30, 2000:

- a) The Company issued 490,000 shares of common stock for professional services of \$742,372.

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- b) Property and equipment, costing \$215,086, was acquired under a capital lease obligation.
- c) In connection with the sale of its foreign subsidiary, the Company issued a note payable aggregating \$115,000.
- d) The Company issued 19,332 shares of its common stock, valued at \$61,753, in connection with the repayment of long-term debt incurred with the acquisition of Central.

During the year ended June 30, 1999:

- a) The Company issued 463,161 shares of common stock for professional services of \$664,656.
- b) Property and equipment costing \$741,663 was acquired under a capital lease obligation.
- c) The Company sold equipment to a related party costing \$96,427 in consideration of a note receivable aggregating \$150,000.
- d) The Company converted a current liability aggregating \$303,000 to long-term debt.
- e) The Company issued 202,018 shares of its common stock valued at \$275,830 in connection with the acquisition of Central.
- f) The Company issued 202,018 shares of its common stock valued at \$275,837, pursuant to consulting contracts with the former shareholders of Central.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 19 - GOVERNMENT REGULATIONS

The healthcare industry is highly regulated by numerous laws, regulations, approvals and licensing requirements at the federal, state and local levels. Regulatory authorities have very broad discretion to interpret and enforce these laws and promulgate corresponding regulation. The Company believes that its operations under agreements pursuant to which it is currently providing services are in material compliance with these laws and regulations. However, there can be no assurance that a court or regulatory authority will not determine that the Company's operations (including arrangements with new or existing clients) violate applicable laws or regulations.

If the Company's interpretation of the relevant laws and regulations is inaccurate, the Company's business and its prospects could be materially and adversely affected. The following are among the laws and regulations that affect the Company's operations and development activities; corporate practice of medicine; fee splitting; anti-referral laws; anti-kickback laws; certificates of need, regulation of diagnostic imaging; no-fault insurance; worker's compensation; and proposed healthcare reform legislation.

#### NOTE 20 - ADVANCES AND NOTES TO RELATED PARTIES

Effective December 1, 1993, Albany Magnetic Imaging Center, P.C. ("Albany Center"), a Georgia professional corporation, of which Raymond V. Damadian is

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the sole stockholder, purchased the scanner being utilized at its site from the Company for a purchase price of \$1,128,844. In June of 1997, the payment terms for the outstanding balance of \$344,766 were restructured to provide for 60 equal monthly payments (including interest at the rate of 10% per annum) of \$7,325 each, commencing July 1997. The balance due under this note as of June 30, 2001 was \$96,419.

Effective December 1, 1993, RVDC assigned its purchase option under the lease to Daytona Beach Magnetic Resonance Imaging, P.A., a Florida professional association, of which Raymond V. Damadian is the sole shareholder, director and president ("Daytona Beach Center") and the Daytona Beach Center exercised the option and purchased the scanner from the Company for a purchase price of \$1,416,717. In May 1999, the payment terms for the outstanding balance of \$1,001,507 were restructured to provide for 84 equal monthly payments (including interest at the rate of 10% per annum) of \$16,626 each, commencing May 1999. During fiscal 2001, the Company took back the scanner in satisfaction of the outstanding indebtedness. The Daytona Beach Center then purchased a new QUAD scanner under a sales-type lease from the Company for a purchase price of \$960,000, which is payable with interest rate of 8.5% per annum, in 59 monthly payments of \$11,903 each, commencing May 2001, and one final installment of \$850,149.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 20 - ADVANCES AND NOTES TO RELATED PARTIES (Continued)

During 1994, Melville MRI, P.C. ("Melville Center"), a New York professional corporation, of which Raymond V. Damadian is the sole shareholder, director and president, purchased an MRI scanner from the Company for a purchase price of \$1,011,431. Of the purchase price, \$900,000 is to be paid by the assumption and payment of the Company's indebtedness to the lender secured by the scanner, pursuant to a note, bearing interest at 14% per annum, and providing for 60 monthly payments of \$20,700 each. The remaining \$111,431 of the purchase price was to be paid concurrently with the payments to the lender. The payment terms for the principal balance, plus accrued interest (in the aggregate amount of \$139,290), were restructured to provide for 60 equal monthly payments (including interest at the rate of 10% per annum) of \$2,959.50 each, commencing July 1998. In fiscal 2001, the balance outstanding on the obligation was paid in full by the Company as guarantor of the indebtedness due to the lender. This resulted in a balance of \$893,606 owing to the Company by the Melville Center. The \$2,959.50 monthly payment to the Company has been increased by an additional principal payment of \$10,000 per month to be applied toward the balance due.

Canarsie MRI Associates ("Canarsie"), a joint venture partnership, of which MRI Specialties, Inc. ("Specialties") is an owner, is a party to a service agreement for its scanner with the Company at an annual fee of \$70,000. In addition, during fiscal 2001, Canarsie entered into an agreement to purchase a QUAD MRI scanner from the Company, recognizing on a percentage-of-computation basis revenue of \$636,121. The agreement provides for a purchase price of \$850,000, payable as follows: (1) \$400,000 downpayment (received April 2001); (2) \$450,000 in 84 equal monthly installments, including interest at 6%, pursuant to a promissory note to be executed upon acceptance of the scanner. Timothy Damadian, the son of Raymond V. Damadian, is the sole stockholder, Director and President of Specialties.

Pompano MRI Associates ("Pompano"), a joint venture partnership, of which Guardian MRI, Inc. ("Guardian") is an owner, is a party to a service agreement

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for its scanner with the Company at an annual fee of \$70,000. In addition, during September 2001, Pompano entered into an agreement to purchase a stand-up MRI. The agreement calls for a purchase price of \$1.4 million payable as follows: (1) \$420,000 downpayment (received during September 2001); (2) \$980,000 in progress payments to be received upon acceptance on completed sub-assemblies. The Company will account for the sale under the percentage-of-completion method. For the year ended June 30, 2001, revenue recognized was \$-0-. Timothy Damadian, the son of Raymond V. Damadian, is a stockholder, Director and President of Pompano.

As at June 30, 2001 and 2000, the aggregate indebtedness of Specialties and Canarsie to the Company was \$22,476 and \$22,476, respectively, and the aggregate indebtedness of Guardian and Pompano to the Company was \$18,550 and \$18,550, respectively.

During fiscal 2001, the Company entered into an agreement with Tallahassee MRI, PA, a Florida professional association, of which Raymond V. Damadian is the sole stockholder, director and president, agreed to purchase a QUAD 12000 MRI scanner recognizing, on a percentage-of-completion basis, revenue of \$379,485. The agreement provides for a purchase price of \$975,000, to be payable upon acceptance of completed sub-assemblies.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 20 - ADVANCES AND NOTES TO RELATED PARTIES (Continued)

During fiscal 2001, the Company entered into an agreement with Damadian MRI in Orlando P.A., a Florida professional association, of which Raymond V. Damadian is the sole stockholder, director and president to purchase a stand-up MRI. The agreement calls for a purchase price of \$1.350 million, payable as follows: (1) \$405,000 downpayment (received during June 2001); (2) \$945,000 in progress payments to be received upon acceptance on completed sub-assemblies. The Company will account for the sale under the percentage-of-completion method. As of June 30, 2001, revenue recognized was \$-0-.

During fiscal 2001, the Company entered into an agreement with Damadian MRI at Islandia, P.C., a New York professional corporation, of which Raymond V. Damadian is the sole stockholder, director and president, to purchase a stand-up MRI recognizing, on a percentage-of-completion basis, revenue of \$116,959. The agreement calls for a purchase price of \$1.350 million, payable as follows: (1) \$405,000 downpayment (received during June 2001); (2) \$945,000 in progress payments to be received upon acceptance of completed sub-assemblies.

During fiscal 2001, the Company entered into an agreement with Damadian MRI at Elmhurst, P.C., a New York professional corporation, of which Raymond V. Damadian is the sole stockholder, director and president, to purchase an Echo MRI scanner recognizing, on a percentage-of-completion basis, revenue of \$399,180. The agreement calls for a purchase price of \$565,000, payable upon acceptance of completed sub-assemblies. The Company will account for the sale under the percentage-of-completion method.

During fiscal 2001, the Company entered into an agreement with Black Bear, LLC, a New York limited liability company, to purchase a stand-up MRI recognizing, on a percentage-of-completion basis, revenue of \$216,449. The agreement calls for a purchase price of \$1.4 million, payable as follows: (1) \$280,000 downpayment (received during April 2001); (2) \$1,120,000 in progress payments to be received upon acceptance of completed sub-assemblies.



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During fiscal 2001, the Company entered into an agreement with Deerfield Magnetic Resonance Imaging, P.A., a Florida professional association, of which Raymond V. Damadian is the sole shareholder, director and president, to purchase a new QUAD scanner under a sales-type lease for a purchase price of \$935,000, which is payable with interest rate of 10.0% per annum, in 120 monthly payments of \$12,356.09 each, commencing August 2000 the lessee can also elect to pay a lump sum of \$581,544 at the end of 60 months.

During fiscal 2000, the Company entered into an agreement with Damadian MRI in Garden City, a New York professional corporation, of which Raymond V. Damadian is the sole shareholder, director and president, to purchase a new QUAD scanner under a sales-type lease for a purchase price of \$935,000, which is payable with interest rate of 10.0% per annum, in 120 monthly payments of \$12,356.09 each, commencing August 2000 the lessee can also elect to pay a lump sum of \$581,544 at the end of 60 months.

### FONAR CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2001

#### NOTE 21 - SEGMENT AND RELATED INFORMATION

Effective July 1, 1998, the Company adopted the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". SFAS No. 131 establishes standards for the way public enterprises report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports issued to stockholders.

The Company operates in two industry segments - manufacturing and the servicing of medical equipment and management of physician practices, including diagnostic imaging services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. All intersegment sales are market-based. The Company evaluates performance based on income or loss from operations.

Summarized financial information concerning the Company's reportable segments is shown in the following table:

	Medical Equipment	Physician Management Services	Totals
	-----	-----	-----
Fiscal 2001:			
Net revenues from external customers	\$ 10,497,839	\$ 31,775,462	\$ 42,273,301
Intersegment net revenues	\$ 1,039,499	\$ -	\$ 1,039,499
Operating (loss) income	\$(17,205,614)	\$ 990,997	\$(16,214,617)
Depreciation and amortization	\$ 2,203,591	\$ 2,509,176	\$ 4,712,767
Compensatory element of stock issuances	\$ 1,684,136	\$ 2,360,690	\$ 4,044,826
Total identifiable assets	\$ 45,938,960	\$ 38,961,453	\$ 84,900,413
Capital expenditures	\$ 3,039,866	\$ 1,082,385	\$ 4,122,251

Fiscal 2000:

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Net revenues from external customers	\$ 5,971,064	\$ 30,183,733	\$ 36,154,797
Intersegment net revenues	\$ 1,227,075	\$ -	\$ 1,227,075
Operating (loss) income	\$(17,984,534)	\$ 2,477,962	\$(15,506,572)
Depreciation and amortization	\$ 1,817,547	\$ 2,638,529	\$ 4,456,076
Compensatory element of stock issuances	\$ 926,421	\$ 1,003,285	\$ 1,929,706
Total identifiable assets	\$ 43,045,691	\$ 41,367,346	\$ 84,413,037
Capital expenditures	\$ 2,081,551	\$ 940,795	\$ 3,022,346

Fiscal 1999:

Net revenues from external customers	\$ 5,723,955	\$ 27,565,089	\$ 33,289,044
Intersegment net revenues	\$ 845,834	\$ -	\$ 845,834
Operating (loss) income	\$(18,688,341)	\$ 3,122,286	\$(15,566,055)
Depreciation and amortization	\$ 1,847,216	\$ 2,810,603	\$ 4,657,819
Compensatory element of stock issuances	\$ 190,851	\$ 84,391	\$ 275,242
Total identifiable assets	\$ 56,310,557	\$ 41,150,611	\$ 97,461,168
Capital expenditures	\$ 4,180,447	\$ 1,299,392	\$ 5,479,839

FONAR CORPORATION AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2001

NOTE 21 - SEGMENT AND RELATED INFORMATION (Continued)

Export Sales  
 -----

The Company's areas of operations are principally in the United States. There are no export sales for the year ended June 30, 2001. The Company had export sales of medical equipment amounting to 2.8% and 3.4% of consolidated net revenues for the years ended June 30, 2000 and 1999, respectively.

The sales were made principally to the following locations:

	2001	2000	1999
	-----	-----	-----
Spain	-	2.8%	3.2%
Saudi Arabia	-	-	.2
	-----	-----	-----
	- %	2.8%	3.4%
	=====	=====	=====

The Company does not have any material assets outside of the United States.

Concentration of Credit Risk  
 -----

Net revenues from related parties accounted for approximately 78%, 86% and 83% of the consolidated net revenues for the years ended June 30, 2001, 2000 and 1999, respectively.

NOTE 22 - PROFORMA INFORMATION (UNAUDITED)

The Company's consolidated financial statements for the year ended June 30, 1999 do not include the results of operations of Dynamic for the period July 1, 1998

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through August 20, 1998. The following summarizes the unaudited proforma results of operations for the years ended June 30, 1999 assuming the foregoing acquisition had occurred on June 30, 1999 (in thousands, except per share data):

	1999
	-----
	(Unaudited)
Revenue, net	\$ 37,624
Loss from operations	\$ (15,447)
Loss before income taxes	\$ (14,344)
Basic and diluted net loss per share	\$ (.22)

FONAR CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2001

NOTE 23 - QUARTERLY FINANCIAL DATA (UNAUDITED)

(000's omitted, except per share data)

Quarter Ended:	Sept. 30, 2000	Dec. 31, 2000	March 31, 2001	June 30, 2001
	-----	-----	-----	-----
Total Revenues - Net	\$ 9,091	\$ 9,946	\$ 11,978	\$11,259
Total Costs and Expenses	13,090	13,904	14,804	16,690
Loss from Operations	(3,999)	(3,958)	(2,826)	(5,432)
Net Loss	(3,907)	(3,014)	(2,801)	(5,422)
Basic and Diluted Net Loss Per Share	\$ (0.06)	\$ (0.04)	\$ (0.04)	\$ (0.08)

Quarter Ended:	Sept. 30, 1999	Dec. 31, 1999	March 31, 2000	June 30, 2000
	-----	-----	-----	-----
Total Revenues - Net	\$ 8,872	\$ 9,020	\$ 8,927	\$ 9,336
Total Costs and Expenses	12,086	12,856	12,866	13,853
Loss from Operations	(3,214)	(3,836)	(3,939)	(4,518)
Net Loss	(3,343)	(2,664)	(3,963)	(986)
Basic and Diluted Net Loss Per Share	\$ (0.05)	\$ (0.04)	\$ (0.06)	\$ (0.02)

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Directors serve from the date of their election until the next annual meeting of stockholders and until their successors are elected and qualify. With the exception of Dr. Raymond V. Damadian, who does not receive any fees for

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servicing as a director, each director receives \$20,000 per annum for his or her service as a director. Officers serve at the discretion of the Board of Directors.

The officers and directors of the Company are set forth below:

Raymond V. Damadian, M.D.	65	President, Chairman of the Board and a Director
David B. Terry	54	Vice President and Secretary
Claudette J.V. Chan	64	Director
Robert J. Janoff	74	Director
Charles N. O'Data	65	Director

Raymond V. Damadian, M.D. has been the Chairman of the Board and President of FONAR since its inception. Dr. Damadian was employed by the State University of New York, Downstate Medical Center, New York, as an Associate Professor of Biophysics from 1967 until September 1979. Dr. Damadian received an M.D. degree in 1960 from Albert Einstein College of Medicine, New York, and a B.S. degree in mathematics from the University of Wisconsin in 1956. In addition, Dr. Damadian conducted post-graduate work at Harvard University, where he studied extensively in the fields of physics, mathematics and electronics. Dr. Damadian is the author of numerous articles and books on the nuclear magnetic resonance effect in human tissue, which is the theoretical basis for the FONAR MRI scanners. Dr. Damadian is a 1988 recipient of the National Medal of Technology and in 1989 was inducted into the National Inventors Hall of Fame, for his contributions in conceiving and developing the application of magnetic resonance technology to medical applications including whole body scanning and diagnostic imaging. Dr. Damadian is the President and director of HMCA.

David B. Terry is the Vice President of Administration and Secretary of the Company. Mr. Terry has been serving as Vice President since December 1998 and as Secretary since May, 1990. Previously, he served as Treasurer from May 1990 to December, 1998, as Secretary from July 1978 through June 1987 and as Treasurer from August 1981 through June 1987. From July 1978 through June 1987, he was also a Director of the Company. Between July 1987 and January 1990, Mr. Terry was a co-owner and actively engaged in the business of Carman-Terry Realty, a real estate brokerage firm. In January 1990, Mr. Terry resumed his employment with the Company. Mr. Terry is the brother-in-law of Raymond V. Damadian and uncle of Timothy R. Damadian.

Claudette J.V. Chan has been a Director of FONAR since October 1987. Mrs. Chan has been employed since 1992 by Raymond V. Damadian, M.D. MR Scanning Centers Management Company as "site inspector," in which capacity she is responsible for supervising and implementing standard procedures and policies for MRI scanning centers. From 1989 to 1994 Mrs. Chan was employed by St. Matthew's and St. Timothy's Neighborhood Center, Inc., as the director of volunteers in the "Meals on Wheels" program, a program which cares for the elderly. In approximately 1983, Mrs. Chan formed the Claudette Penot Collection, a retail mail-order business specializing in women's apparel and gifts, of which she was the President until she stopped operating the business in approximately 1989. Mrs. Chan practiced and taught in the field of nursing until 1973, when her son was born. She received a bachelor of science degree in nursing from Cornell University in 1960. Mrs. Chan is the sister of Raymond V. Damadian and aunt of Timothy R. Damadian.

Robert J. Janoff has been a Director of FONAR since February, 1989. Mr. Janoff has been a self-employed New York State licensed private investigator for more

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than thirty-five years and was a Senior Adjustor in Empire Insurance Group for more than 15 years until retiring from that position on July 1, 1997. Mr. Janoff also served, from June 1985 to June 1991, as President of Action Data Management Strategies, Ltd., a supplier of computer programs for use by insurance companies. Mr. Janoff is a member of the Board of Directors of Harmony Heights of Oyster Bay, New York, which is a nonprofit residential school for girls with learning disabilities.

Charles N. O'Data has been a Director of FONAR since February, 1998. From 1968 to 1997, Mr. O'Data was the Vice President for Development for Geneva College, a liberal arts college located in western Pennsylvania. In that capacity, he acted as the College's chief investment officer. His responsibilities included management of the College's endowment fund and fund raising. In July 1997, Mr. O'Data retired from Geneva College after 36 years of service to assume a position of National Sales Executive for SC Johnson Company's Professional Markets Group (a unit of SC Johnson Wax), and specialized in healthcare and education sales, a position he held until the spring of 1999. In his capacity with SC Johnson he was responsible for sales to the nation's three largest Group Purchasing Organizations which included some 4,000 hospitals. Mr. O'Data acts an independent financial consultant to various entities. Mr. O'Data served on the board of the Medical Center, Beaver, Pennsylvania (now a part of Heritage Valley Health System), a 500 bed acute care facility, for 22 years, three as its Chair. Mr. O'Data also served on the board of the Hospital Council of Western Pennsylvania, a shared-services and group purchasing organization covering seven states. He founded The Beaver County Foundation, a Community Foundation, in 1992, and serves as its President. Mr. O'Data is listed as a finance associate in the Middle States Association, Commission on Higher Education. The commission is the formal accrediting body for higher education in the eastern region of the country. In this capacity he evaluates the financial aspects of educational organizations.

ITEM 11. EXECUTIVE COMPENSATION.

With the exception of the Chief Executive Officer, the compensation of the Company's executive officers is based on a combination of salary and bonuses based on performance. The Chief Executive Officer's compensation consists only of a salary which has remained constant for more than the past three fiscal years.

The Board of Directors does not have a compensation Committee: Dr. Raymond V. Damadian, President, Chief Executive Officer and Chairman of the Board, is the only executive officer who is a member of the Board of Directors. Dr. Damadian participates in the determination of executive compensation for the Company's officers.

The Board of Directors has established an audit committee. The members of the committee are Robert J. Janoff and Charles N. O'Data.

There is set forth in the following Summary Compensation Table the compensation provided by the Company during fiscal 2001 to its Chief Executive Officer. There is set forth in the following Option Grant Table and Option Exercise Table any stock options granted and exercised by Dr. Damadian during fiscal 2001.

I. SUMMARY COMPENSATION TABLE

Annual Compensation	Long Term Compensation	
	Awards	Payouts

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(a) Name and Principal Position	(b) Year	(c) Salary (\$)	(d) Bonus (\$)	(e) Other Annual Compen- sation (\$)	(f) Restricted Stock Award(s) (\$)	(g) Options SARs (#)	(h) LTIP Payouts (\$)	(i) All Other Compen- sation (\$)
Raymond V. Damadian, CEO	2001 2000 1999	\$86,799.96 \$86,799.97 \$86,799.96	- - -	- - -	- - -	- - -	- - -	- - -

II. OPTION/SAR GRANTS IN LAST FISCAL YEAR

(a) Name	(b) Options/ SARs Granted (#)	Individual Grants			Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term		(h) Alternative to (f) and (g): Grant Date Value
		(c) % of Total Options/ SARs Granted to Employees in Fiscal Year	(d) Exercise or Base Price (\$/Sh)	(e) Expiration Date	(f) 5% (\$)	(g) 10% (\$)	
Raymond V. Damadian, President & CEO	0	-	-	-	-	-	-

III. OPTION/SAR EXERCISES AND YEAR-END VALUE TABLE

Aggregated Options/SAR Exercises in Last Fiscal Year, and FY-End Option/Sar Value

(a) Name	(b) Shares Acquired on Exercise (#)	(c) Value Realized (\$)	(d) Number of Unexercised Options/SARs at FY-End (#)	(e) Value of Unexercised In-the-Money Options/SARs at FY-End (\$)
Raymond V.	0	-	0	-

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Damadian,  
President  
and CEO

### EMPLOYEE COMPENSATION PLANS

FONAR's 1993 Incentive Stock Option Plan, adopted on March 26, 1993, is intended to qualify as an incentive stock option plan under Section 422A of the Internal Revenue Code of 1954, as amended. The 1993 Incentive Stock Option Plan permits the issuance of stock options covering an aggregate of 1,500,000 shares of Common Stock of FONAR. The options have an exercise price equal to the fair market value of the underlying stock on the date the option is granted, are nontransferable, are exercisable for a period not exceeding ten years and expire upon the voluntary termination of employment. The 1993 Stock Option Plan will terminate on March 25, 2003. As of June 30, 2001, options to purchase 311,830 shares of Common Stock were available for future grant under the plan.

FONAR's 1997 Nonstatutory Stock Option Plan, adopted on May 9, 1997, permits the issuance of stock options covering an aggregate of 5,000,000 shares of Common Stock of FONAR. The options may be issued at such prices and upon such terms and conditions as are determined by FONAR. The 1997 Nonstatutory Stock Option Plan will terminate on May 8, 2007. As of June 30, 2001, options to purchase 3,900,369 shares of Common Stock of FONAR were available for future grant.

FONAR's 1997 Stock Bonus Plan, adopted on May 9, 1997, permits FONAR to issue an aggregate of 5,000,000 shares of Common Stock of FONAR as a bonus or compensation. FONAR selects the persons to whom bonus stock will be issued, the number of shares to be awarded and such other terms and conditions as it deems advisable. The 1997 Stock Bonus Plan will terminate on May 8, 2007. As of June 30, 2001, no shares of Common Stock of FONAR were available for future grant.

FONAR's 2000 Stock Bonus Plan, adopted on October 1, 2000, permits FONAR to issue on aggregate of 5,000,000 shares of Common Stock of FONAR as bonus or compensation. FONAR selects the persons to whom bonus stock will be issued, the number of shares to be awarded and such other terms and conditions as it deems advisable. The 2000 Stock Bonus Plan will terminate on September 30, 2010. As of June 30, 2001, 4,012,284 shares of Common Stock of FONAR were available for future grant.

HMCA's 1997 Incentive Stock Option Plan, adopted on March 10, 1997, is intended to qualify as an incentive stock option plan under Section 422A of the Internal Revenue Code of 1954, as amended. The 1997 Incentive Stock Option Plan permits the issuance of stock options covering an aggregate of 2,000,000 shares of Common Stock of HMCA. The options have an exercise price equal to the fair market value of the underlying stock on the date the option is granted, are nontransferable, are exercisable for a period not exceeding ten years and expire upon the voluntary termination of employment. The exercisability of the options granted to date is contingent upon the successful completion by HMCA of a public offering of its securities or the recognition by HMCA of at least \$10 million in revenues for at least two consecutive fiscal quarters. The 1997 Stock Option Plan will terminate on March 9, 2007. As of June 30, 2001, options to purchase 400,000 shares of HMCA Common Stock were available for future grant under the plan.

HMCA's 1998 Incentive Stock Option Plan, adopted on December 16, 1998, is intended to qualify as an incentive stock option plan under Section 422A of the Internal Revenue Code of 1954, as amended. The 1998 Incentive Stock Option Plan permits the issuance of stock options covering an aggregate of 2,000,000 shares of Common Stock of HMCA. The options have an exercise price equal to the fair market value of the underlying stock on the date the option is granted, are

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nontransferable, are exercisable for a period not exceeding ten years and expire upon the voluntary termination of employment. The excessability of the options granted to date is contingent upon the successful completion by HMCA of a public offering of its securities. The 1998 Stock Option Plan will terminate on December 15, 2008. As of June 30, 2001, options to purchase 1,330,000 shares of HMCA Common Stock were available for future grant under the plan.

HMCA's 1998 Nonstatutory Stock Option Plan, adopted on December 16, 1998, permits the issuance of stock options covering an aggregate of 500,000 shares of Common Stock of HMCA. The options may be issued at such prices and upon such terms and conditions as are determined by HMCA. The exercisability of the options granted to date is contingent upon the successful completion by HMCA of a public offering of its securities. The 1998 Nonstatutory Stock Option Plan will terminate on December 15, 2008. As of June 30, 2001, options to purchase 100,000 shares of Common Stock were available for future grant.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth the number and percentage of shares of the Company's securities held by each director, by each person known by the Company to own in excess of five percent of the Company's voting securities and by all officers and directors as a group as of September 24, 2001.

Name and Address of Beneficial Owner (1)	Shares Beneficially Owned	Percent of Class
Raymond V. Damadian, M.D. c/o FONAR Corporation Melville, New York Director, President CEO, 5% + Stockholder		
Common Stock	2,488,274	4.14%
Class C Stock	9,561,174	99.98%
Class A Preferred	477,328	6.09%
Claudette Chan Director		
Common Stock	2,648	*
Class A Preferred	800	*
Robert J. Janoff Director		
Common Stock	50,000	*
Class A Preferred	1,999	*
Charles N. O'Data Director		
Common Stock	700	*
All Officers and Directors as a Group (5 persons) (2) (3)		
Common Stock	2,548,220	4.24%
Class C Stock	9,561,174	99.98%
Class A Preferred	480,165	6.13%

-----  
\* Less than one percent

1. Address provided for each beneficial owner owning more than five percent of the voting securities of the Company.



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2. Includes 101 shares of the Company's Common Stock and 19 shares of the Company's Class A Non-voting Preferred Stock held by an officer jointly with his wife and 192 shares of the Company's Common Stock and 38 shares of the Company's Class A Non-voting Preferred Stock held in trust by an officer for his children.

3. Includes options to purchase 6,286 shares of Common Stock held by an officer.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

#### Background.

On April 7, 1989, at a time when the Company lacked both the financing and working capital to establish its own centers, Donna Damadian, the wife of Raymond V. Damadian, M.D., Chairman and President of the Company, purchased from FONAR a scanner for a purchase price of \$1,508,000 (the price paid by FONAR's customers for like equipment). \$1.2 million was paid in cash, providing a much needed cash infusion for the Company, and the balance was paid over time with interest pursuant to a promissory note of even date. The scanner was leased to Macon Magnetic Resonance Imaging, P.C., a Georgia professional corporation wholly-owned by, and of which Dr. Damadian is, the President. Thereafter, between 1990 and 1996, Raymond V. Damadian, M.D. MRI Scanning Centers Management Company, a Delaware corporation of which Dr. Damadian was the sole stockholder, director and President ("RVDC"), purchased and leased scanners from FONAR to establish a network of professional corporations operating MRI scanning centers ("Centers"), including the Macon Center, in New York, Florida, Georgia and other locations. Dr. Damadian was the owner, director and President of each of these professional corporations. RVDC provided the necessary management and the scanners to the Centers, although in certain situations, a Center would acquire the scanner directly from FONAR.

#### ACQUISITION OF RVDC.

Effective June 30, 1997, FONAR's wholly-owned subsidiary, Health Management Corporation of America ("HMCA"), formerly known as U.S. Health Management Corporation, acquired RVDC by purchasing all of the issued and outstanding shares of RVDC from Dr. Damadian for 10,000 shares of the Common Stock of FONAR. The transactions can be rescinded by Dr. Damadian, however, in the event of a change of control in FONAR or the bankruptcy of FONAR. There is no time limit on the right to rescind. In connection with the transaction, FONAR granted RVDC a nonexclusive royalty free license to FONAR's patents and software. These licenses may be terminated by FONAR in the event of the bankruptcy of RVDC or a change in control of RVDC.

In connection with and immediately prior to the sale of RVDC to HMCA, certain leases and sales of scanners to RVDC were terminated. The scanners were then leased directly to the Centers at which they were installed pursuant to new scanner leases between HMCA and the Centers.

#### NEW AGREEMENTS WITH HMCA.

Effective July 1, 1997, immediately following the effective date of the acquisition of RVDC by HMCA, all previous management arrangements between RVDC and the Centers were terminated and new management agreements were entered into by the Centers and HMCA ("Management Agreements").

Pursuant to the Management Agreements, HMCA is providing comprehensive management and administrative services and office facilities, including billing and collection of accounts, payroll and accounts payable processing, supplies and utilities to the Centers. Under the Management Agreements, HMCA provides service through FONAR for the scanners at the Centers, eliminating the need for

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the Centers to have separate service agreements for their scanners. In total, 15 of the Centers previously managed by RVDC and three additional Centers opened after the acquisition, have Management Agreements with HMCA.

With respect to the scanners at 9 of the 18 Centers, the lease or sales agreement between RVDC (or the Center in some cases) and FONAR were terminated. In substitution for the previous arrangements, HMCA, effective as of July 1, 1997, entered into new scanner leases ("Scanner Leases") with these Centers pursuant to which the scanners are provided to the Centers.

The fees payable to HMCA are on a per procedure basis, which currently range from \$250 to \$760 per MRI scan. These fees are reviewed and subject to adjustment on an annual basis by mutual agreement. The agreements have a one year term which automatically renews unless notice of termination is given. Dr. Damadian is the owner of all of the Centers.

During the fiscal years ended June 30, 2001 and June 30, 2000 the net revenues received by HMCA from the Centers owned by Dr. Damadian were approximately \$14.8 million and \$17.2 million respectively.

Effective December 1, 1993, one of the Centers, Albany Magnetic Resonance Imaging, P.C. (the "Albany Center"), a Georgia professional corporation of which Raymond V. Damadian is the sole shareholder, director and President, purchased the scanner being utilized at its site from the Company for a purchase price of \$1,128,844, which in Fonar's opinion represented a fair market price based on sales of like equipment by Fonar to its customers. Of the purchase price, \$574,077 was paid by the assumption and payment of the Company's indebtedness to the lender secured by the scanner. Such indebtedness to the lender was retired pursuant to a new equipment finance lease between the lender and the Albany Center, guaranteed by the Company, providing for 18 monthly payments of \$35,000 each. Following payment of the lease, the remaining \$554,767 of the purchase price due to the Company was required to be paid pursuant to a promissory note, with interest at 10% per annum, over an 18 month term (17 payments of \$35,000 each and one final payment of \$2,454.08). In June, 1997, the payment terms for the outstanding balance of \$344,766 were restructured to provide for 60 equal monthly payments (including interest at the rate of 10% per annum) of \$7,325.27 each commencing July, 1997.

Effective December 1, 1993, Daytona Beach Magnetic Resonance Imaging, P.A. (the "Daytona Beach Center"), a Florida professional association of which Raymond V. Damadian is the sole shareholder, director and President, purchased the scanner being utilized at its site from the Company for a purchase price of \$1,416,717, which in Fonar's opinion represented a fair market price based on sales of like equipment by Fonar to its customers. Of the purchase price, \$328,044 was paid by the assumption and payment of the Company's indebtedness to the lender secured by the scanner. Such indebtedness to the lender was retired pursuant to a new equipment finance lease between the lender and the Daytona Beach Center, guaranteed by the Company, providing for 18 monthly payments of \$20,000 each. The remaining \$1,088,673 of the purchase price due to the Company was required to be paid pursuant to a promissory note, with interest at 10% per annum. In May, 1999, the payment terms for the outstanding balance of \$1,001,507 were restructured to provide for 84 equal monthly payments (including interest at the rate of 10% per annum) of \$16,626.20 each commencing May 1999. During fiscal 2001, FONAR took back the scanner in satisfaction of the outstanding indebtedness. The Daytona Beach Center then purchased a new QUAD 12000 MRI scanner from FONAR for a purchase price of \$960,000, which is payable with interest a rate of 8.5% per annum in 59 monthly payments of \$11,902.62 each and one final installment of \$580,148.53.

On June 30, 1994, Melville MRI, P.C. (the "Melville Center"), a New York professional corporation of which Raymond V. Damadian is the sole shareholder, director and President, purchased the scanner being utilized at its site from

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the Company for a purchase price of \$1,011,431.12, which in Fonar's opinion represented a fair market price based on sales of like equipment by Fonar to its customers. Of the purchase price, \$900,000 is to be paid by the assumption and payment of the Company's indebtedness to the lender secured by the scanner pursuant to a note bearing interest at 14% per annum and providing for 60 monthly payments of \$20,700 each. The remaining \$111,431.12 of the purchase price was to be paid concurrently with the payments to the lender. The payment terms for the principal balance, plus accrued interest (in the aggregate amount of \$139,290) were restructured to provide for 60 equal monthly payments (including interest at the rate of 10% per annum) of \$2,959.50 each commencing July, 1998. In fiscal 2001, following the payment in full by FONAR, as guarantor, of the indebtedness due to the lender, there was as a result a balance of \$893,606 then owing to FONAR by the Melville Center. The \$2,959.50 monthly payment to FONAR has been increased by an additional principal amount of \$10,000 per month to be applied toward the balance due.

### ACQUISITION OF THE AFFORDABLE COMPANIES.

Effective June 30, 1997, HMCA acquired a group of several interrelated corporations, limited liability companies and a partnership engaged in managing three diagnostic imaging centers and one multi-specialty practice in New York State (the "Affordable Companies") pursuant to a series of transactions concluding with a merger between a wholly-owned subsidiary of HMCA and Affordable Diagnostics, Inc. Concurrently with the acquisition, Raymond V. Damadian purchased three New York professional corporations to which the Affordable Companies were providing their services under several agreements. Dr. Damadian is the sole stockholder, director and President of these professional corporations (the "Affordable Professional Corporations"). During the fiscal year ended June 30, 2001, the net revenues from the Affordable Professional Corporations were approximately \$2.9 million.

### ACQUISITION OF A & A SERVICES.

Effective March 20, 1998, HMCA acquired A & A Services, Inc. ("A & A Services"), an management company managing four primary care practices in Queens County, New York. Concurrently with the acquisition, Raymond V. Damadian purchased the four New York professional service corporations under contract with A & A Services (the "A & A Professional Corporations"). During the fiscal year ended June 30, 2001, the net revenues from the A & A Professional Corporations were \$3.1 million.

### ACQUISITION OF DYNAMIC HEALTH CARE MANAGEMENT

Effective August 20, 1998, HMCA acquired Dynamic Health Care Management, Inc. ("Dynamic"), an MSO managing three physician practices in Nassau and Suffolk Counties on Long Island, New York. Concurrently with the acquisition, Raymond V. Damadian purchased two professional service corporations under contract with Dynamic (the "Dynamic Professional Corporations"). During the fiscal year ended June 30, 2001, the net revenues from the Dynamic Professional Corporations were \$8.0 million.

HMCA performs management services for Superior Medical Services, P.C. ("Superior"), a New York professional corporation of which Raymond V. Damadian is the sole stockholder, director and President. Superior conducts multi-specialty practices at locations in Yonkers, Elmont, Elmhurst and Riverdale, New York. During the fiscal year ended June 30, 2001, the net revenues from Superior were \$5.1 million.

The agreements with the A&A Professional Corporations, the Dynamic Professional Corporations and Superior provide for fixed monthly fees which are adjusted annually. Historically, the adjustments have been on the basis of changes in HMCA's costs plus a percentage. Currently, the monthly fees under the

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agreement range from approximately \$53,850 to \$272,500. These agreements have a term of twenty years.

Pursuant to an agreement dated March 31, 1993, RVDC agreed to purchase the Company's general partnership interest (approximately 92% of the partnership) in a partnership owning and operating an MRI scanning center in Bensonhurst (Brooklyn), New York. Robert Janoff, a director of the Company, is a limited partner in the partnership. The partnership is also party to a service agreement with the Company. The current annual rate is \$50,000 for the one year service contract from July 1, 2001 to July 30, 2002. The rate in effect during the prior year was also \$50,000.

Pursuant to an agreement dated September 30, 1993, AMD sold its interests in a partnership operating an MRI scanning center in Melbourne, Florida to Melbourne Magnetic Resonance Imaging, P.A. (the "Melbourne Facility"), for a purchase price of \$150,000. The purchase price is payable, with interest at 10% per annum, over a period of fifteen months commencing September 1, 1995 as follows: \$13,500 per month for the first fourteen months and \$1,185.60 for the fifteenth month. The Melbourne Facility is a Florida professional corporation of which Raymond V. Damadian is the sole stockholder, director and President. The partnership is presently inactive.

Pursuant to an agreement dated September 30, 1993, AMD sold to Dade County MRI, P.A. its interests in a partnership which had formerly operated an MRI scanning center in Miami, Florida. The purchase price of \$100,000 is payable, with interest at 10% per annum, in sixty (60) equal consecutive monthly installments of principal and interest (including interest accrued from September 30, 1993), commencing 90 days after the scanner is placed in service. The partnership is presently inactive. Dade County MRI, P.A. is a Florida professional association of which Raymond V. Damadian is the sole stockholder, director and President. This indebtedness has been written off by the Company as uncollectable.

Pursuant to a sales agreement dated April 1, 1996, RVDC agreed to purchase an MRI scanner with certain upgrades from the Company which RVDC then contributed to Orlando MRI Associates, Limited Partnership (the "Orlando Partnership"), a limited partnership. The Orlando Partnership is utilizing the scanner at a site located in Orlando, Florida. The sales agreement provides for a purchase price of \$400,000 payable in installments as follows: (1) \$40,000 down payment within thirty (30) days of execution and (2) \$360,000 in 84 monthly installments of \$5,611.04 each (inclusive of interest at 8% per annum) pursuant to a promissory note executed by RVDC upon acceptance of the scanner. The Orlando Partnership is party to a service agreement for its scanner with the Company at an annual fee of \$50,000 for the period from April 8, 2001 through April 7, 2002. The price in effect for the prior year was also \$50,000. Timothy Damadian, the son of Raymond V. Damadian, is a limited partner in Orlando.

Pursuant to an agreement dated March 1, 1999, Dublin Magnetic Resonance Imaging, P.C., ("Dublin"), a Georgia professional corporation which Raymond V. Damadian is the sole stockholder, director and President, agreed to lease a used Fonar Beta 3000M Mobile MRI Scanner from the Company at a monthly rental of \$4,840.08 commencing on September 1, 1999 and continuing for thirty-six (36) months. At the conclusion of the lease period Dublin will have the option to purchase the scanner for a price of \$1.00.

Pursuant to an agreement dated December 1, 1999, Damadian MRI in Garden City, P.C. ("Garden City") a New York professional corporation of which Raymond V. Damadian is the sole stockholder, director and President, agreed to lease a Fonar QUAD 12000 MRI Scanner from the Company for a term of five years at a monthly rental of \$12,356.09. Upon the conclusion of the five year term, Garden City may elect to purchase the scanner for \$581,544.42 or extend the lease for an additional five year period at the same monthly rental. If the lease term is

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extended, then Garden City will have the option to purchase the scanner at the end of the second five year period for a purchase price of \$1.00. The term of the lease commenced on June 12, 2000 upon acceptance of the scanner. Payments are due on the twelfth of the month commencing June 12, 2000.

Pursuant to an agreement dated February 1, 2000, Deerfield Magnetic Resonance Imaging, P.A. ("Deerfield"), a Florida professional association of which Raymond V. Damadian is the sole stockholder, director and President, agreed to lease a Fonar QUAD 12000 MRI Scanner from the Company for a term of five years at a monthly rental of \$12,356.09. Upon the conclusion of the five year term, Deerfield may elect to purchase the scanner for \$581,544.42 or extend the lease for an additional five year period at the same monthly rental. If the lease term is extended, then Deerfield will have the option to purchase the scanner at the end of the second five year period for a purchase price of \$1.00. The term of the lease commenced on July 18, 2000 upon the acceptance of the scanner. Lease payments are due on the first of the month, commencing August 1, 2000.

Canarsie MRI Associates ("Canarsie"), a joint venture partnership of which MRI Specialties, Inc. ("Specialties") is an owner, is party to a service agreement for its scanner with the Company at an annual fee of \$70,000 for the period from September 1, 2001 through August 31, 2002. The price in effect during the prior year was also \$70,000. In addition, during fiscal 2001, Canarsie entered into an agreement to purchase a QUAD 12000 MRI scanner from FONAR for a purchase price of \$850,000. Timothy Damadian, the son of Raymond V. Damadian, is the sole stockholder, director and President of Specialties.

Pompano MRI Associates ("Pompano"), a joint venture partnership of which Guardian MRI, Inc. ("Guardian") is an owner, is party to a service agreement for its scanner with the Company at an annual fee of \$70,000 for the period from October 1, 2000 through September 30, 2001. The price in effect during the prior year was also \$70,000. In addition, during fiscal 2002, Pompano entered into an agreement to purchase a Stand-Up MRI scanner from FONAR for a purchase price of \$1,400,000. Timothy Damadian, the son of Raymond V. Damadian, is a stockholder, director and officer of Guardian.

During fiscal 2001, Tallahassee MRI, P.A. ("Tallahassee"), a Florida professional association of which Raymond V. Damadian is the sole stockholder, director and President, agreed to purchase a QUAD 12000 MRI scanner from FONAR for a purchase price of \$975,000.

During fiscal 2001, Damadian MRI in Orlando, P.A. ("Orlando MRI"), a Florida professional association of which Raymond V. Damadian is the sole stockholder, director and President, agreed to purchase a Stand-Up MRI scanner from FONAR for a purchase price of \$1,350,000.

During fiscal 2001, Damadian MRI at Islandia, P.C. ("Islandia") a New York professional corporation of which Raymond V. Damadian is the sole stockholder, director and President, agreed to purchase a Stand-Up MRI scanner from FONAR for a purchase price of \$1,350,000.

During fiscal 2001, Damadian MRI at Elmhurst, P.C. ("Elmhurst"), a New York professional corporation of which Raymond V. Damadian is the sole stockholder, director and President, agreed to purchase an Echo MRI scanner from FONAR for a purchase price of \$565,000.

During fiscal 2001, Black Bear Management LLC, a New York limited liability company of which TRD Services, Inc. ("TRD") is a member, agreed to purchase a Stand-Up MRI scanner from FONAR for a purchase price of \$1,400,000. Timothy Damadian, the son of Raymond V. Damadian, is the stockholder, director and President of TRD.

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As at June 30, 2001, the indebtedness of Canarsie to the Company was \$22,476 and the aggregate indebtedness of Pompano to the Company was \$18,550.

### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

##### a) FINANCIAL STATEMENTS AND SCHEDULES

The following consolidated financial statements are included in Part II, Item 8.

Report of Independent Certified Public Accountants.

Consolidated Balance Sheets as at June 30, 2001 and 2000.

Consolidated Statements of Operations for the Three Years Ended June 30, 2001, 2000 and 1999.

Consolidated Statements of Stockholders' Equity for the Three Years Ended June 30, 2001, 2000 and 1999.

Consolidated Statements of Cash Flows for the Three Years Ended June 30, 2001, 2000 and 1999.

Notes to Consolidated Financial Statements.

Schedule II Valuation and Qualifying Accounts for the Three Years Ended June 30, 2001, 2000 and 1999 follows:

#### FONAR CORPORATION AND SUBSIDIARIES

##### SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Description	Balance June 30, 1998	Additions	Deductions
Receivables from equipment sales and service contracts	\$ 789,749		\$ 1,000
Receivables from medical Services	-	-	-
Receivables from related PC's Advance and notes to related Parties	-	(1) \$ 628,836	628,836
Notes receivable	904,000		
	477,456		

Description	Balance June 30, 1999	Additions	Deductions
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Receivables from equipment sales and service contracts	\$	788,749		\$	418
Receivables from medical Services		-			-
Receivables from related PC's Advance and notes to related Parties		-	(1)	177,162	23,430
Notes receivable		904,000			
		477,456			

Description	Balance June 30, 2000		Additions		Deductions
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Receivables from equipment sales and service contracts	\$ 788,331	(1)	\$ 245,000		\$ -
Receivables from medical Services	-		-		-
Receivables from related PC's Advance and notes to related Parties	153,732	(1)	387,505		2,940
Notes receivable	904,000	(1)	287,456		875,421
	477,456	(1)	-		477,456

(1) Included in bad debt expense

b) REPORTS ON FORM 8-K

None.

c) EXHIBITS

3.1 Certificate of Incorporation, as amended, of the Company incorporated herein by reference to Exhibit 3.1 to the Registrant's registration statement on Form S-1, Commission File No. 33-13365.

3.2 Article Fourth of the Certificate of Incorporation, as amended, of the Company incorporated by reference to Exhibit 4.1 to the Registrant's registration statement on Form S-8, Commission File No. 33-62099.

3.3 By-Laws, as amended, of the Company incorporated herein by reference to Exhibit 3.2 to the Registrant's registration statement on Form S-1, Commission File No. 33-13365.

4.1 Specimen Common Stock Certificate incorporated herein by reference to Exhibit 4.1 to the Registrant's registration statement on Form S-1, Commission File No. 33-13365.

4.2 Specimen Class B Common Stock Certificate incorporated herein by reference to Exhibit 4.2 to the Registrant's registration statement on Form S-1, Commission File No. 33-13365.

10.1 License Agreement between FONAR and Raymond V. Damadian incorporated herein by reference to Exhibit 10 (e) to Form 10-K for the fiscal year ended June 30, 1983, Commission File No. 0-10248.

10.2 1983 Nonstatutory Stock Option Plan incorporated herein by reference

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to Exhibit 10 (a) to Form 10-K for the fiscal year ended June 30, 1983, Commission File No. 0-10248, and amendments thereto dated as of March 7, 1984 and dated August 22, 1984, incorporated herein by referenced to Exhibit 28 (a) to Form 10-K for the year ended June 30, 1984, Commission File No. 0-10248.

10.3 1984 Incentive Stock Option Plan incorporated herein by reference to Exhibit 28 (c) to Form 10-K for the year ended June 30, 1984, Commission File No. 0-10248.

10.4 1986 Nonstatutory Stock Option Plan incorporated herein by reference to Exhibit 10.7 to Form 10-K for the fiscal year ended June 30, 1986, Commission File No. 0-10248.

10.5 1986 Stock Bonus Plan incorporated herein by reference to Exhibit 10.8 to Form 10-K for the fiscal year ended June 30, 1986, Commission File No. 0-10248.

10.6 1986 Incentive Stock Option Plan incorporated herein by reference to Exhibit 10.9 to Form 10-K for the fiscal year ended June 30, 1986, Commission File No. 0-10248.

10.7 Lease Agreement, dated as of August 18, 1987, between FONAR and Reckson Associates incorporated herein by reference to Exhibit 10.26 to Form 10-K for the fiscal year ended June 30, 1987, Commission File No. 0-10248.

10.8 1993 Incentive Stock Option Plan incorporated herein by reference to Exhibit 28.1 to the Registrant's registration statement on Form S-8, Commission File No. 33-60154.

10.9 1993 Non-Statutory Stock Option Plan incorporated herein by reference to Exhibit 28.2 to the Registrant's registration statement on Form S-8, Commission File No. 33-60154.

10.10 1993 Stock Bonus Plan incorporated herein by reference to Exhibit 28.3 to the Registrant's registration statement on Form S-8, Commission File No. 33-60154.

10.11 1994 Non-Statutory Stock Option Plan incorporated herein by reference to Exhibit 28.1 to the Registrant's registration statement on Form S-8, Commission File No. 33-81638.

10.12 1994 Stock Bonus Plan incorporated herein by reference to Exhibit 28.2 to the Registrant's registration statement on Form S-8, Commission File No. 33-81638.

10.13 1995 Non-Statutory Stock Option Plan incorporated herein by reference to Exhibit 28.1 to the Registrant's registration statement on Form S-8, Commission File No. 33-62099.

10.14 1995 Stock Bonus Plan incorporated herein by reference to Exhibit 28.2 to the Registrant's registration statement on Form S-8, Commission File No. 33-62099.

10.15 1997 Non-Statutory Stock Option Plan incorporated herein by reference to Exhibit 28.1 to the Registrant's registration statement on Form S-8, Commission File No.: 333-27411.

10.16 1997 Stock Bonus Plan incorporated herein by reference to Exhibit 28.2 to the Registrant's registration statement on Form S-8, Commission File No: 333-27411.

10.17 Stock Purchase Agreement, dated July 31, 1997, by and between U.S.



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Health Management Corporation, Raymond V. Damadian, M.D. MR Scanning Centers Management Company and Raymond V. Damadian, incorporated herein by reference to Exhibit 2.1 to the Registrant's Form 8-K, July 31, 1997, commission File No: 0-10248.

10.18 Merger Agreement and Supplemental Agreement dated June 17, 1997 and Letter of Amendment dated June 27, 1997 by and among U.S. Health Management Corporation and Affordable Diagnostics Inc. et al., incorporated herein by reference to Exhibit 2.1 to the Registrant's 8-K, June 30, 1997, Commission File No: 0-10248.

10.19 Stock Purchase Agreement dated March 20, 1998 by and among Health Management Corporation of America, FONAR Corporation, Giovanni Marciano, Glenn Muraca et al., incorporated herein by reference to Exhibit 2.1 to the Registrant's 8-K, March 20, 1998, Commission File No: 0-10248.

10.20 Stock Purchase Agreement dated August 20, 1998 by and among Health Management Corporation of America, FONAR Corporation, Stuart Blumberg and Steven Jonas, incorporated herein by reference to Exhibit 2 to the Registrant's 8-K, September 3, 1998, Commission File No. 0-10248.

21. Subsidiaries of the Registrant. See Exhibits.

### SIGNATURES

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

#### FONAR CORPORATION

Dated: October 30, 2001

By: /s/ Raymond Damadian  
Raymond V. Damadian, President

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

Signature	Title	Date
/s/ Raymond Damadian Raymond V. Damadian	Chairman of the Board of Directors, President and a Director (Principal Executive Officer)	October 30, 2001
/s/ Claudette J.V. Chan Claudette J.V. Chan	Director	October 30, 2001
/s/ Robert J. Janoff Robert J. Janoff	Director	October 30, 2001
/s/ Charles N. O'Data Charles N. O'Data	Director	October 30, 2001

CORPORATE INFORMATION

Corporate Headquarters

110 Marcus Drive  
Melville, NY 11747  
(631) 694-2929

Investor Relations

FONAR Corporation  
110 Marcus Drive  
Melville, NY 11747  
(631) 694-2929

Stock Transfer Agency

Computershare Trust Company, Inc.  
350 Indiana Street, Suite 800  
Golden, Colorado 80401

Auditors

Grassi & Co., CPAs, P.C.  
New York, New York

Board of Directors

Raymond V. Damadian, M.D.  
Chairman of the Board

Claudette Chan, Director

Robert Janoff, Director

Charles O'Data, Director

Officers

Raymond V. Damadian, M.D.  
President, Chief Executive Officer and Treasurer

David B. Terry  
Vice President of Administration and Secretary