

# **Versatile Systems Inc.**

(formerly Versatile Mobile Systems (Canada) Inc.)

Consolidated Financial Statements

**June 30, 2006 and 2005**

## **Auditors' Report**

### **To the Shareholders of Versatile Systems Inc.**

We have audited the consolidated balance sheets of **Versatile Systems Inc.** (formerly Versatile Mobile Systems (Canada) Inc.) as at June 30, 2006 and 2005 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at June 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) PricewaterhouseCoopers LLP

### **Chartered Accountants**

Vancouver, British Columbia  
August 4, 2006

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Consolidated Balance Sheets

As at June 30, 2006 and 2005

	2006 \$	2005 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	110,396	183,598
Accounts receivable	11,884,610	13,559,290
Deferred contract costs	3,476,135	3,415,850
Work in progress	31,276	216,066
Prepaid expenses	942,794	517,092
Inventory	1,046,124	1,552,906
Future income tax benefits (note 19)	1,004,108	-
	<hr/> 18,495,443	<hr/> 19,444,802
<b>Deferred contract costs</b>	514,899	381,375
<b>Future income tax benefits</b> (note 19)	3,935,544	-
<b>Capital assets</b> (note 4)	362,450	450,621
<b>Intangible assets</b> (note 5)	2,461,546	4,076,042
<b>Goodwill</b> (note 6)	11,667,357	12,595,561
	<hr/> 37,437,239	<hr/> 36,948,401
<b>Liabilities</b>		
<b>Current liabilities</b>		
Line of credit (note 7)	413,397	376,259
Bank overdraft (note 7)	845,134	144,367
Accounts payable and accrued liabilities (note 8)	11,627,705	13,718,838
Current portion of deferred revenue	5,505,550	5,257,654
Bank term loan (note 7)	-	3,369,497
Promissory notes (note 9)	-	5,964,587
Convertible debenture (note 10)	119,967	-
Current portion of capital lease obligations (note 11)	7,161	6,952
	<hr/> 18,518,914	<hr/> 28,838,154
<b>Deferred revenue</b>	595,112	447,969
<b>Capital lease obligations</b> (note 11)	5,294	13,689
<b>Bank term loan</b> (note 7)	3,065,428	-
<b>Term loan</b> (note 12)	195,125	214,480
	<hr/> 22,379,873	<hr/> 29,514,292
<b>Shareholders' Equity</b>		
<b>Share capital</b> (note 13)	59,729,736	59,779,153
<b>Shares to be issued</b> (note 13)	2,791,260	-
<b>Warrants</b> (note 14)	635,413	458,715
<b>Contributed surplus</b> (note 14)	3,187,649	2,481,183
<b>Deficit</b>	(49,947,475)	(54,716,914)
<b>Foreign currency translation adjustment</b>	(1,339,217)	(568,028)
	<hr/> 15,057,366	<hr/> 7,434,109
	<hr/> 37,437,239	<hr/> 36,948,401

Commitments (note 18)

Approved by the Board of Directors

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"John Hardy" Director

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"Fraser Atkinson" Director

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

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Consolidated Statements of Earnings and Deficit

For the years ended June 30, 2006 and 2005

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	2006 \$	2005 \$
<b>Sales</b>	69,681,974	26,124,930
<b>Cost of sales</b>	54,278,644	19,700,109
	<hr/> 15,403,330	<hr/> 6,424,821
<b>Expenses</b>		
General and administrative	4,934,362	2,974,471
Selling and marketing	6,883,029	3,394,751
Research and development	1,770,898	1,025,177
Stock-based compensation	143,113	137,962
	<hr/> 13,731,402	<hr/> 7,532,361
<b>Earnings (loss) before interest, taxes and amortization</b>	1,671,928	(1,107,540)
Amortization of capital assets	(162,879)	(157,395)
Amortization of intangible assets	(1,223,533)	(230,511)
Interest	(610,637)	(129,529)
	<hr/> (325,121)	<hr/> (1,624,975)
<b>Loss before income taxes</b>	(325,121)	(1,624,975)
Future income tax benefit	5,133,870	-
Current income tax expense	(39,310)	(1,000)
	<hr/> 4,769,439	<hr/> (1,625,975)
<b>Net earnings (loss) for the year</b>	4,769,439	(1,625,975)
<b>Deficit - Beginning of year</b>	(54,716,914)	(53,090,939)
<b>Deficit - End of year</b>	<hr/> (49,947,475)	<hr/> (54,716,914)
<b>Earnings (loss) per share - basic and diluted</b>	<hr/> 0.05	<hr/> (0.02)

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

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Consolidated Statements of Cash Flows

For the years ended June 30, 2006 and 2005

	2006 \$	2005 \$
<b>Cash flows from operating activities</b>		
Net earnings (loss) for the year	4,769,439	(1,625,975)
Items not affecting cash		
Amortization of capital assets	162,879	157,395
Amortization of intangible assets	1,223,533	230,511
Stock-based compensation	143,113	137,962
Amortization of deferred finance charges	55,123	-
Loss on disposal of capital assets	6,583	-
Future income tax benefit	(5,133,870)	-
	1,226,800	(1,100,107)
Net change in non-cash working capital items	124,239	(1,318,409)
	1,351,039	(2,418,516)
<b>Cash flows from investing activities</b>		
Purchase of net assets including transaction costs	-	(3,480,603)
Cash acquired	-	2,862,027
Proceeds from disposition of capital assets	36,630	-
Additions to capital assets	(176,321)	(60,137)
	(139,691)	(678,713)
<b>Cash flows from financing activities</b>		
Proceeds from issued share capital and warrants	442,692	1,547,292
Share issue costs	(4,560)	-
Subscriptions received for shares to be issued	35,000	-
Proceeds from convertible debenture	4,222,218	-
Convertible debenture issue costs	(388,508)	-
Repayment of the convertible debenture	(600,951)	-
Repayment of capital lease obligations	(6,596)	(9,511)
Proceeds from Commerce bank term loan	-	3,369,497
Repayment of Wachovia bank term loan	-	(3,407,730)
Repayment of VAC note	(817,066)	(408,533)
Repayment of quarterly payment	(257,840)	(84,260)
Repayment of promissory notes	(5,147,521)	-
Proceeds from line of credit	71,092	376,259
Proceeds from bank overdraft	700,767	144,367
	(1,751,273)	1,527,381
<b>Effect of foreign exchange rate on cash</b>	466,723	(276,802)
<b>Decrease in cash and cash equivalents</b>	(73,202)	(1,846,650)
<b>Cash and cash equivalents - Beginning of year</b>	183,598	2,030,248
<b>Cash and cash equivalents - End of year</b>	110,396	183,598
<b>Supplemental cash flow information</b> (note 21)		

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

# **Versatile Systems Inc.**

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

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## **1 Nature of operations**

Versatile Systems Inc. (“Versatile-Canada” or the “company”), which was continued from the Yukon Territories to British Columbia during the current fiscal year, is primarily engaged in software development and sales of computer software, hardware and system integration services related to wired and wireless mobile business solutions through its wholly owned subsidiaries, Versatile Acquisition Corporation (formerly Perfect Order Acquisition Corporation) (“VAC”), Perfect Order, Inc. (“POI”), Versatile Systems, Inc. (formerly Perfect Order Manufacturing, Inc.) (“VSI”), Versatile Mobile Systems, Inc. (“VMS-US”) and Versatile Mobile Systems (Europe) Ltd. (“VMS-Europe”). The wholly owned subsidiaries, 596327 B.C. Ltd. and EvolutionB Information Inc. (“EvolutionB”) are inactive.

## **2 Significant accounting policies**

### **Basis of presentation**

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the company and all its wholly owned subsidiaries - VAC, POI, VSI, VMS-US, VMS-Europe, 596327 B.C. Ltd. and EvolutionB. The operations of VAC, POI and VSI have been included in these consolidated financial statements from April 26, 2005 to June 30, 2005 for the comparative period. All intercompany accounts and transactions are eliminated on consolidation.

All amounts are expressed in Canadian dollars, unless otherwise stated.

### **Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit and highly liquid short-term interest bearing securities with maturities at the date of purchase of three months or less. Interest earned is recognized immediately into income.

### **Inventory**

Inventory consists of handheld devices and peripherals used in sales force automation systems held for resale. Inventory is valued at the lower of cost and net realizable value, determined on a first-in, first-out basis.

### **Deferred service contract costs**

Deferred service contract costs are amortized on a straight line basis over the life of the contracts, which range from three months to three years. These deferred amounts relate to third party maintenance costs for third party equipment installed at customers, which have been paid for in advance.

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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## Research and development

Research costs are expensed as incurred. Development costs are charged as an expense in the period incurred unless the company believes that a development project meets certain criteria under generally accepted accounting principles for deferral and amortization. The company has not capitalized any development costs during the year.

## Capital assets

The company records capital assets at acquisition cost. The capital assets are amortized using the straight-line method at the following rates:

Automobiles	20% per annum
Computer and office equipment	20% - 33-1/3% per annum
Computer software	33% - 1/3% per annum
Demonstration equipment	33% - 1/3% per annum
Tenant improvements	straight-line over remaining term of lease

## Goodwill and intangible assets

Goodwill represents the excess of the purchase price of an acquired business over the fair values of the identifiable net assets acquired.

Intangible assets acquired, either individually or with a group of assets, are initially recognized and measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination that meet the specified criteria for recognition apart from goodwill, is allocated to the individual assets acquired based on their relative fair value. Intangible assets with finite lives are amortized over their estimated useful lives using the straight-line method at the following rates:

Purchase technology	3 years
Customers	5 years
Intellectual property	1 1/2 years
Licences	4 years

The amortization method and estimated useful lives of intangible assets are reviewed annually.

Goodwill is not amortized and is tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of a reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary.

# **Versatile Systems Inc.**

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

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The second step would be required if the carrying amount of the reporting unit exceeds its fair value, in which case the implied fair value of a reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss. When the carrying amount of a reporting unit's goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to the excess and is presented as a separate line item in the statement of earnings before extraordinary items and discontinued operations.

## **Income taxes**

The company follows the liability method of accounting for income taxes. Under the liability method of tax allocation, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities and are measured using substantively enacted tax rates expected to be in effect when the differences are expected to be reversed. A valuation allowance is recorded against any future tax asset to the extent that it is more likely than not that the future income tax asset will not be realized.

During the current fiscal year, the company determined that VSI, POI, VAC and VMS are generating sufficient profits that it is more likely than not that the losses will be fully utilized and the deductions attributable to these companies will be substantially utilized. Consequently, the valuation allowance has been reduced accordingly. The difference between the value of these tax benefits less the valuation allowance is the amount of the future income tax asset that is recorded by the company. During the current year the company recorded \$5,133,870 for the income tax benefit related to the recognition of future income tax assets. To the extent that the company expects to generate sufficient profits in the following fiscal period, that portion has been classified as current.

## **Foreign currency translation**

Foreign monetary assets and liabilities are translated into Canadian dollars at the rates of exchange in effect at the balance sheet date. Foreign non-monetary items are translated at rates in effect on the dates the assets were acquired or liabilities assumed. Revenue and expenses are translated using the rate in effect on the date of the transaction, except amortization of capital assets which is translated at the same rates as the assets to which it applies. Gains and losses on translation are taken into income when incurred.

Assets and liabilities of self-sustaining foreign operations are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Revenue and expense items are translated at average exchange rates prevailing during the period. Any corresponding foreign exchange gains and losses are deferred and disclosed separately as part of shareholders' equity.

## **Revenue recognition**

Revenue on sales of hardware products is recognized when delivered to the customer. The company recognizes revenue from the sale of software products on delivery of the product or performance of the services if persuasive evidence of an agreement with the customer exists, the price is fixed and determinable, collection is probable, and there are no ongoing obligations of the company to provide future services.

# **Versatile Systems Inc.**

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Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

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Revenue from projects which include significant modification or customization of software is recognized using the percentage of completion method of accounting, whereby revenue and profit in the period are based on the ratio of costs incurred to total estimated costs of the project. Costs include all direct costs and certain indirect costs related to the projects. A provision is made for the entire amount of future estimated losses, if any, on contracts in progress.

Revenue from professional services are recognized on a percentage of completion basis.

Maintenance revenue is recognized ratably over the term of the related agreement.

Deferred revenues represent amounts invoiced in excess of revenues recognized.

The company also sells products and services containing multiple elements, which may include a combination of the above. These revenues are recognized in accordance with EIC 142 "Revenue Arrangements with Multiple Elements." Revenues earned from these sales are recognized upon delivery based on the relative fair values of the products and services.

## **Warranty costs**

Warranty costs that are not otherwise covered by suppliers are accrued upon the recognition of the related revenue, based on the company's best estimate, with reference to past experience.

## **Use of estimates**

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

## **Loss per share**

Loss per common share is computed using the weighted average number of common shares outstanding during the year, being 97,075,682 in the current year (2005 - 91,805,178). Diluted loss per common share has not been disclosed as the effect of common shares issuable upon the exercise of options or warrants would be anti-dilutive.

## **Stock-based compensation**

The company has an employee stock option plan ("Option Plan"). The company records the estimated fair value of the grants as compensation expense over the benefit period with a corresponding credit to contributed surplus. Upon issuance of shares under the Option Plan the company records a credit to share capital for the amount paid.

# **Versatile Systems Inc.**

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

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The company recognizes the stock-based compensation expense for all employee and non-employee stock-based compensation transactions using a fair value based method. The fair value of stock-based payments to non-employees is periodically re-measured until the earlier of: completion of the services provided a firm commitment to complete the services or the vesting date and any change therein is recognized over the service period. For stock options exercised, consideration paid plus the fair value of options previously recorded as contributed surplus is recorded as share capital on exercise of the options.

During the current fiscal year the company recognized \$143,113 (2005 - \$137,962) in compensation expense and additional contributed surplus for stock options granted to employees. A description of the company's stock-based compensation plan is disclosed in note 15.

### **3 Acquisition of Perfect Order business**

On April 26, 2005, the company acquired all of the issued and outstanding shares of two privately held companies, Perfect Order, Inc. and Versatile Systems, Inc. (formerly Perfect Order Manufacturing, Inc.) (collectively "Perfect Order"), which were under common control (the "Acquisition"). Perfect Order is based in Mechanicsburg, Pennsylvania and provides information technology services for the implementation, maintenance and security of mission-critical computing environments. The transaction was conducted through the company's newly incorporated subsidiary, VAC.

On closing, the company paid the vendors cash consideration of \$2,488,000 (U.S. \$2,000,000), issued Promissory Notes to pay \$1,244,000 (U.S. \$1,000,000), which at the time were due on June 30, 2005 (the "VAC Notes"), issued secured Promissory Notes to pay \$5,244,800 (U.S. \$4,200,000) on April 26, 2006 (the "Promissory Notes") and agreed to make four quarterly payments of \$85,525 (U.S. \$68,750) each commencing June 10, 2005, September 10, 2005, December 10, 2005 and March 10, 2006. The VAC Notes, Promissory Notes and quarterly payments have all been paid in full.

The Promissory Notes bear interest at the rate of 3.1% per annum and the Vendors had an option to convert up to one-half of their Promissory Notes on or before February 26, 2006, into shares of Versatile at the rate of one common share for each \$0.425 (U.S. \$0.34) of the Promissory Note. None of the Vendors elected to convert their Promissory Notes. In addition, the company issued 750,000 Common Share purchase warrants to the Vendors on the closing. One Warrant entitles the holder thereof to purchase one common share at \$0.345 per share on or before April 26, 2007.

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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The acquisition was accounted for under the purchase method of accounting. Total consideration, including costs of acquisition, was allocated based on the estimated fair values of the acquired assets on the date of acquisition as follows:

	\$
Net cash acquired	
Cash and cash equivalents	2,862,027
Accounts receivable	9,817,874
Deferred contract costs	3,735,793
Other current assets	417,252
Capital assets	332,749
Intellectual Property	561,355
Intangible assets	29,809
Customers	2,186,154
Purchased technology	1,507,689
Goodwill	8,951,053
Accounts payable and accrued liabilities	(10,511,722)
Deferred revenue	(5,328,200)
Term loan	(217,700)
Wachovia Bank Term Loan	(3,407,730)
	<hr/>
Fair value of net assets acquired	10,936,403
	<hr/>
	\$
Total consideration is comprised of	
Cash payments on closing	2,488,000
Quarterly payments	342,100
POAC Notes	1,244,000
Promissory Notes	5,224,800
Other payments	497,600
Value assigned to the Versatile warrants	37,500
Estimated costs of the transaction	1,102,403
	<hr/>
Total consideration as at the date of acquisition	10,936,403
	<hr/>

The above purchase price allocation was based on the estimated fair values of the assets and liabilities acquired.

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

## 4 Capital assets

	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Automobiles	4,460	4,460	-
Computer and office equipment	1,873,090	1,595,283	277,807
Demonstration equipment	116,338	43,041	73,297
Computer software	108,823	105,946	2,877
Tenant improvements	49,921	41,452	8,469
	<b>2,152,632</b>	<b>1,790,182</b>	<b>362,450</b>
			<b>2005</b>
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Automobiles	29,196	21,114	8,082
Computer and office equipment	1,887,204	1,536,270	350,934
Demonstration equipment	107,870	50,862	57,008
Computer software	118,675	103,062	15,613
Tenant improvements	76,965	57,981	18,984
	<b>2,219,910</b>	<b>1,769,289</b>	<b>450,621</b>

As at June 30, 2006, assets under capital lease with a cost of \$33,862 (2005 - \$33,862) and accumulated amortization of \$33,862 (2005 - \$29,159) are included in capital assets.

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

## 5 Intangible assets

The carrying amounts of the amortized intangible assets for the years ended June 30, 2006 and 2005 are as follows:

	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Customers	1,959,455	457,201	1,502,254
Purchased technology	1,351,345	525,526	825,819
Intellectual property	503,144	370,738	132,406
Other intangibles	3,751	2,684	1,067
Licences	640,256	640,256	-
	<b>4,457,951</b>	<b>1,996,405</b>	<b>2,461,546</b>
	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Customers	2,186,154	72,871	2,113,283
Purchased technology	1,507,689	83,761	1,423,928
Intellectual property	561,355	66,519	494,836
Other intangibles	29,809	462	29,347
Licences	640,256	625,608	14,648
	<b>4,925,263</b>	<b>849,221</b>	<b>4,076,042</b>

# Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

## 6 Goodwill

The carrying amounts of the goodwill for the years ended June 30, 2006 and 2005 are as follows:

	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Goodwill			
Perfect Order	8,022,849	-	8,022,849
VMS - US	14,578,033	10,933,525	3,644,508
	<u>22,600,882</u>	<u>10,933,525</u>	<u>11,667,357</u>
	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Goodwill			
Perfect Order	8,951,053	-	8,951,053
VMS - US	14,578,033	10,933,525	3,644,508
	<u>23,529,086</u>	<u>10,933,525</u>	<u>12,595,561</u>

No amortization for goodwill has been recorded for 2006 or 2005. During the current fiscal year ended June 30, 2006, the company performed an assessment of the carrying value of the goodwill recorded in connection with the acquisition of VMS-US and Perfect Order. The assessment showed that no impairment charge was required for the year ended June 30, 2006.

## 7 Line of credit, bank overdraft and bank term loan

On April 26, 2005, the company obtained a credit line facility for up to \$3,345,000 (U.S. \$3,000,000), which is limited to 70% of eligible accounts receivable of certain U.S. subsidiaries from a U.S. based financial institution. The line of credit bears interest at the State of New York prime rate of lending and is secured with a first charge on the assets of VAC, VSI and POI. As at June 30, 2006 the company had utilized its line of credit for \$413,397 (2005 - \$376,259) and had a bank overdraft of \$845,134 (2005 - \$144,367).

# **Versatile Systems Inc.**

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On April 26, 2005 the company obtained a term loan in the amount of \$3,483,200 (U.S. \$2,800,000) from the same U.S. based financial institution, bearing interest at the State of New York prime rate plus 1% and secured with a first charge on the assets of VAC, VSI and POI. The term loan was repayable on April 26, 2006 but during the year was extended to October 6, 2007. At June 30, 2006, the amount of the term loan is \$3,065,428 (U.S. \$2,749,263). Monthly repayments consist of interest only with the principal due at the end of the term. During the current fiscal year the interest on the term loan amounted to \$262,874 (2005 - \$26,420).

The amount that may be advanced under the credit line is limited to 70% of eligible accounts receivable of VAC, POI and VSI less than 90 days from invoice date and less the outstanding balance of the term loan, which amounted to \$2,271,776 at June 30, 2006. At June 30, 2006 the financial covenants for these companies included requirements for debt coverage of 1.5, minimum Tangible Net worth of \$3,000,000 and minimum working capital of \$1,000,000. These companies did not meet the minimum working capital requirement at June 30, 2006. Subsequent to year-end, these companies obtained a waiver from the bank that excluded the minimum working capital requirements from the financial covenants

## **8 Accounts payable and accrued liabilities**

Included in accounts payable and accrued liabilities is \$4,919,128 (U.S. \$4,411,774) owing to a major supplier, which is secured by a second charge on the accounts receivable and other assets of VSI and is subordinated to the bank term loan and line of credit. The supplier has provided the company with a line of credit of U.S. \$5,000,000.

## **9 Promissory notes**

On April 26, 2005, as part of the consideration for the acquisition of Perfect Order, the company issued unsecured promissory notes to pay \$1,244,000 (U.S. \$1,000,000) bearing interest at the rate of 3% per annum (the "VAC Notes"). On June 30, 2005 the company repaid one of the VAC Notes for \$408,533 (U.S. \$333,333) plus interest and the balance of \$817,066 (U.S. \$666,667) was paid on November 10, 2005. During the current fiscal year interest on the VAC Notes amounted to \$17,753 (2005 - \$3,590).

On April 26, 2005, as part of the consideration for the acquisition of Perfect Order, the company issued secured promissory notes to pay \$5,244,800 (U.S. \$4,200,000) bearing interest at the rate of 3.1% per annum and due on April 25, 2006 (the "Promissory Notes"), which have been repaid in full. The Vendors had the option to convert up to one-half of their Promissory Notes on or before February 25, 2006, into shares of Versatile at the rate of one common share for each \$0.425 of the Promissory Notes. None of the Vendors elected to convert their Promissory Notes. The Promissory Notes were not split into their debt and equity components as the equity component was not considered significant. During the current fiscal year interest on the Promissory Notes amounted to \$113,971 (2005 - \$29,379).

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## 10 Convertible debenture

On April 10, 2006 the company issued a convertible debenture for proceeds of \$4,222,218 (U.S. \$3,617,700) from a U.S. based institution. As part of the consideration for this transaction, the company also issued 1,411,808 warrants expiring on March 31, 2009 with an exercise price of \$0.38, 1,411,808 warrants expiring on March 31, 2009 with an exercise price of \$0.414 and 1,411,808 warrants expiring on March 31, 2011 with an exercise price of \$0.569. The debenture bears interest at the prime rate of lending plus 2%, is secured by a first charge on the assets of Versatile Mobile Systems, Inc. as well as a general security interest on the company and is due on March 31, 2009. On June 30, 2006, \$3,345,000 (U.S. \$3,000,000) of the debenture was converted into 8,789,633 common shares of the company leaving a balance of \$119,967 (U.S. \$107,594) at June 30, 2006.

The convertible debenture was not split into its debt and equity components as the equity component and related accretion were not considered significant as the debenture was converted into common shares on June 30, 2006.

## 11 Capital lease obligations

The company leases certain computer and office equipment under capital leases, which are collateralized by the assets financed by these leases. The future minimum lease payments of assets under capital leases are as follows:

	2006 \$	2005 \$
2006	-	9,142
2007	8,317	9,142
2008	5,545	6,094
	<hr/>	<hr/>
	13,862	24,378
Less: Amount representing interest at 12.5% (2005 - 12.5%) per annum	<hr/>	<hr/>
	(1,407)	(3,737)
	<hr/>	<hr/>
	12,455	20,641
Less: Current portion	<hr/>	<hr/>
	(7,161)	(6,952)
	<hr/>	<hr/>
	5,294	13,689
	<hr/>	<hr/>

Interest expense on capital lease obligations for the year ended June 30, 2006 is \$2,710 (2005 - \$3,175).

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## 12 Term loan

The Note payable to Ben Franklin Technology Partners for \$195,125 (U.S. \$175,000) bears interest at the rate of 4.75% per annum, is unsecured and is due on July 17, 2007. During the current fiscal year, the interest amounted to \$9,666 (2005 - \$1,847).

## 13 Share capital

Authorized

Unlimited common shares without par value

Issued and outstanding

	<b>Number of shares</b>	<b>Amount \$</b>
Balance - June 30, 2004	90,672,134	58,378,832
Shares issued for cash	5,135,413	1,283,854
Shares issued for financial services	313,713	109,800
Shares issued for exercised stock options	66,666	6,667
	<hr/>	<hr/>
Balance - June 30, 2005	96,187,926	59,779,153
Shares issued for cash - net of \$4,560 share issue costs	1,646,000	341,100
Escrow shares returned to Treasury	(690,000)	(424,014)
Shares issued for exercised stock options	249,768	31,192
Contributed surplus related to the exercised stock options	-	2,305
	<hr/>	<hr/>
Balance - June 30, 2006	97,393,694	59,729,736

On August 10, 2005, the company closed a non-brokered private placement and issued 1,646,000 Units at a price of \$ 0.25 per Unit for gross proceeds of \$411,500. Each Unit consisted of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one common share of the company for a period of 24 months after the closing date at a price of \$0.30 per common share. The company assigned a value of \$0.21 to each common share and \$0.04 to each warrant.

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On August 12, 2005, 690,000 shares held in escrow were returned to Treasury and cancelled. These shares have been held in trust for employees of VMS-Europe pursuant to a trust agreement in 1993 which provided, among other things, that these shares could not be released from the trust until a prescribed amount of earnings had been generated and then only after payment to the company by the beneficial holders of \$1 per share. These conditions were not met. As a result, share capital has been reduced by \$424,014 and after offsetting a related receivable for \$22,800 the balance of \$401,214 has been recorded as contributed surplus.

On April 22, 2005, the company closed a non-brokered private placement and issued 5,135,413 Units at a price of \$ 0.30 per Unit for gross proceeds of \$1,540,625. Each Unit consisted of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one common share of the company for a period of 24 months after the closing date at a price of \$0.35 per common share. The company assigned a value of \$0.25 to each common share and \$0.05 to each warrant.

	Number of shares	Amount \$
Shares to be issued:		
Conversion of debenture - net of issue costs of \$588,740	8,789,633	2,756,260
Exercised stock options	350,000	35,000
	9,139,633	2,791,260

## 14 Warrants and contributed surplus

The following warrants were outstanding:

Expiry date	Exercise price \$	Balance - June 30, 2005	Expired	Issued	Balance - June 30, 2006	
					Number of warrants	Amount \$
August 10, 2007	0.30	-	-	1,646,000	1,646,000	65,840
March 31, 2009	0.38	-	-	1,411,808	1,411,808	120,004
March 31, 2009	0.414	-	-	1,411,808	1,411,808	84,708
March 31, 2011	0.569	-	-	1,411,808	1,411,808	70,590
September 17, 2005	0.40	4,111,110	(4,111,110)	-	-	-
April 22, 2007	0.35	5,131,413	-	-	5,131,413	256,771
April 25, 2007	0.345	750,000	-	-	750,000	37,500
		9,992,523	(4,111,110)	5,881,424	11,762,837	635,413

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Expiry date	Exercise price \$	Balance - June 30, 2004	Expired	Issued	Balance - June 30, 2005	
					Number of warrants	Amount \$
March 17, 2005	0.40	822,222	(822,222)	-	-	-
June 4, 2005	0.37	2,485,713	(2,485,713)	-	-	-
September 17, 2005	0.40	4,111,110	-	-	4,111,110	164,444
April 22, 2007	0.35	-	-	5,135,413	5,131,413	256,771
April 25, 2007	0.345	-	-	750,000	750,000	37,500
		<u>7,419,045</u>	<u>(3,307,935)</u>	<u>5,885,413</u>	<u>9,992,523</u>	<u>458,715</u>

On March 31, 2006 as part of the consideration for the issuance of the convertible debenture the company issued 1,411,808 warrants expiring on March 31, 2009 with an exercise price of \$0.38, 1,411,808 warrants expiring on March 31, 2009 with an exercise price of \$0.414 and 1,411,808 warrants expiring on March 31, 2011 with an exercise price of \$0.569. Each warrant entitles the holder to acquire one common share of the company. The company assigned values to these warrants of \$0.085, \$0.06 and \$0.05 respectively.

On August 10, 2005, the company issued 1,646,000 warrants expiring on August 10, 2007 with an exercise price of \$0.30. Each warrant entitles the holder to purchase one common share of the company. The company assigned a value of \$0.21 to each common share and \$0.04 to each warrant.

The company issued 5,135,413 warrants pursuant to a private placement on April 22, 2005. One warrant entitles the holder to purchase one common share at a price of \$0.35 per share on or before April 22, 2007. In addition, as part of the consideration for the acquisition of Perfect Order the company issued 750,000 warrants. One warrant entitles the holder thereof to purchase one common share at \$0.345 per share on or before April 25, 2007.

Contributed surplus consists of the following:

	\$
Balance - June 30, 2004	2,186,046
Expiration of warrants	157,175
Stock based compensation	<u>137,962</u>
Balance - June 30, 2005	2,481,183
Expiration of warrants	164,444
Escrow shares cancelled	401,214
Stock-based compensation	143,113
Stock-based compensation for exercised stock options	<u>(2,305)</u>
Balance - June 30, 2006	<u>3,187,649</u>

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During the year ended June 30, 2006, 4,111,110 warrants expired (2005 - 3,307,935), resulting in their ascribed value of \$164,444 (2005 - 157,175) being recorded as contributed surplus. During the year ended June 30, 2005 the company had 822,222 broker warrants and 2,485,713 warrants expire that were issued pursuant to the private placement on December 4, 2003. The amounts assigned to these warrants of \$157,175 were recorded to contributed surplus.

## 15 Stock options

Under the company's stock option plan, the company is authorized to grant stock options to employees, officers and directors to purchase up to 9,700,000 (2005 - 9,000,000) common shares. The exercise price of each option is not less than the market price of the company's stock on the date of grant, and the exercise period is to a maximum term of five years. Options granted under this plan have vesting periods of up to three years.

A summary of stock option activity for the years ended June 30, 2006 and 2005 is presented below:

	<u>2006</u>		<u>2005</u>	
	<b>Number of shares</b>	<b>Weighted average exercise price \$</b>	<b>Number of shares</b>	<b>Weighted average exercise price \$</b>
Outstanding - Beginning of year	7,271,668	0.21	6,978,334	0.46
Granted	1,702,300	0.27	3,920,000	0.30
Exercised	(249,768)	0.12	(66,666)	0.10
Forfeited	(981,300)	0.11	(440,000)	0.16
Expired	-		(3,120,000)	0.89
Outstanding - End of year	<u>7,742,900</u>	0.24	<u>7,271,668</u>	0.21
Options exercisable at year-end	<u>6,726,233</u>	0.23	<u>3,243,333</u>	0.11

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The following table summarizes information about stock options outstanding at June 30, 2006:

Exercise prices \$	Options outstanding			Options exercisable	
	Number outstanding at June 30, 2006	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at June 30, 2006	Weighted average exercise price \$
0.10	2,075,000	0.80	0.10	2,075,000	0.10
0.11	75,000	0.80	0.11	75,000	0.11
0.25	1,012,900	3.47	0.25	946,233	0.25
0.30	4,495,000	2.90	0.30	3,545,000	0.30
0.32	85,000	1.44	0.32	85,000	0.32
	7,742,900	2.38	0.24	6,726,233	0.23

During the year ended June 30, 2006, all of the stock options were granted at an exercise price above the market price of a common share. The options granted in 2006 had a weighted average exercise price of \$0.27 (2005 - \$0.30) and a weighted average fair value of \$0.17 (2005 - \$0.09).

For the year ended June 30, 2006, the company has recognized \$143,113 (2005 - \$137,962) in stock-based compensation for stock options granted to employees. There were no options granted to non-employees during the years ended June 30, 2006 and 2005. The fair value of each stock option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

Dividend yield	0%
Expected volatility	82%
Risk-free interest rate	3%
Expected average option term (months)	9

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## 16 Financial instruments

### a) Credit risk exposure

Financial instruments that potentially subject the company to a significant concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. The company limits its exposure to credit loss by placing its cash and cash equivalents with high credit quality financial institutions. Concentration of credit risk, with respect to accounts receivable is considered to be limited due to the credit quality of the customers comprising the company's customer base. The company performs ongoing credit evaluations of its customers' financial condition to determine the need for an allowance for doubtful accounts. The company has not experienced significant credit losses to date. The maximum amount of credit risk exposure is limited to the carrying amounts of these balances in the consolidated financial statements.

### b) Interest rate risk exposure

Financial instruments that potentially subject the company to interest rate risk consist primarily of its line of credit, bank overdraft, bank term loan, promissory notes and capital lease obligations.

### c) Fair values

The fair values of the company's cash and cash equivalents, accounts receivable, line of credit, bank overdraft, accounts payable and accrued liabilities, bank term loan, convertible debenture, term loan and capital lease obligations approximate their carrying values due to their short-term nature.

## 17 Related party transactions

During the current fiscal year, the following amounts were paid to directors and officers of the company or companies controlled by these directors and officers:

	2006	2005
	\$	\$
Consulting fees and salaries (included with general and administration expense and selling and marketing expense)	841,792	687,948

On August 10, 2005, the company closed a non-brokered private placement and issued 1,646,000 Units at a price of \$ 0.25 per Unit for gross proceeds of \$411,500. An officer and director of the company participated in this placement subscribing for 1,000,000 Units. Each Unit consisted of one common share and one common share purchase warrant.

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On April 22, 2005, the company closed a non-brokered private placement for gross proceeds of \$1,540,625. Three of the officers and directors of the company participated in this placement subscribing for 968,749 Units at a price of \$0.30 per Unit. Each Unit consisted of one common share and one common share purchase warrant.

During the prior fiscal year, the company granted various directors of the company, incentive stock options to acquire a total of 3,200,000 common shares of the company vesting from 4 months to two years and exercisable for a period of up to 4 years with an exercise price of \$0.30 per share.

## 18 Commitments

As at June 30, 2006, future minimum lease payments for premises and equipment are as follows:

	\$
2007	779,334
2008	730,159
2009	737,963
2010	568,686
2011	388,252

## 19 Income taxes

The company has tax losses and deductions available to offset future taxable income in various jurisdictions for the following approximate amounts:

	\$
Canada	13,276,000
United Kingdom	12,078,000
United States	14,248,000

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Tax losses in Canada expire as follows:

	<b>Versatile (Canada) \$</b>	<b>EvolutionB Information Inc. \$</b>
2007	1,236,000	3,828,000
2008	1,691,000	1,800,000
2009	2,642,000	63,000
2010	1,552,000	167,000
2015	297,000	-
	<hr/>	
	7,418,000	5,858,000
	<hr/>	

Tax losses and deductions which may be taken in the United States:

	<b>\$</b>
Net operating losses expire as follows:	
2020	561,000
2021	1,128,000
2022	1,143,000
2023	532,000
2024	1,165,000
2025	1,309,000
Tax deductions which may be taken from 2007 to 2020	8,410,000
	<hr/>
	14,248,000
	<hr/>

VMS, VAC, VSI and POI file a consolidated federal tax return. As these companies have been profitable, the company expects that the Net Operating losses will be utilized in full. Consequently these financial statements reflect the future income tax benefits relating to these losses. Each company files separate State tax returns so these losses are not available to VAC, POI or VSI on the various state tax returns.

The tax deductions which may be taken from 2007 to 2020 relate to the 338 election for the Perfect Order acquisition for the excess values of the assets over their book values primarily representing goodwill. The 338 election was made on the U.S. tax return for the year ending June 30, 2005. This return was filed in December 2005, the election amount may vary once the election has been reviewed by the Internal Revenue Service.

The tax losses in the United Kingdom can be carried forward indefinitely subject to the tax authority's approval. A full valuation allowance has been provided against the potential tax benefits of these losses.

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The following table sets forth a reconciliation of the effective tax rate to the statutory rates:

	2006 \$	2005 \$
Tax at the statutory tax rate of 35% (2005 - 35%)	(113,792)	(575,536)
Foreign tax rate differential	102,272	72,526
Tax liability of foreign exchange gains	26,047	-
Temporary differences	(59,664)	-
Expiry of prior year losses	395,932	271,001
Changes in valuation allowance	(6,118,295)	224,609
Losses not deductible for tax purposes and other	672,940	8,400
	<u>(5,094,560)</u>	<u>1,000</u>
Future income tax benefit	5,133,870	-
Current income tax expense	(39,310)	(1,000)
	<u>5,094,560</u>	<u>(1,000)</u>

The tax effects of temporary differences that give rise to significant portions of future income tax assets and future income tax liabilities at the statutory enacted rates are as follows:

	2006 \$	2005 \$
<b>Future income taxes</b>		
Future income tax assets		
Tax losses and deductions	11,794,769	13,232,000
Capital assets	456,957	327,445
Share issuance costs	166,124	51,113
Other	289,922	275,857
	<u>12,707,772</u>	<u>13,886,415</u>
Valuation allowance	(6,990,244)	(13,108,539)
	<u>5,717,528</u>	<u>777,876</u>
Net future income tax asset	5,717,528	777,876
Future income tax liabilities		
Goodwill	(777,876)	(777,876)
	<u>4,939,652</u>	<u>-</u>
Net future income tax asset	4,939,652	-
Less: Current portion	(1,004,108)	-
	<u>3,935,544</u>	<u>-</u>
Non-current portion of net future income tax	<u>3,935,544</u>	<u>-</u>

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is

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dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As management believes there is sufficient uncertainty regarding the realization of future tax assets relating to the UK losses and EvolutionB Information Inc. losses, a full valuation allowance has been provided respectively.

## 20 Segmented information

The company's only reportable segment is the development and sales of computer software, hardware and system integration services.

The company's assets and sales by geographic area are as follows:

	<u>2006</u>		<u>2005</u>	
	<b>Capital assets, intangible assets and goodwill</b>	<b>Revenue</b>	<b>Capital assets, intangible assets and goodwill</b>	<b>Revenue</b>
	\$	\$	\$	\$
VAC, POI and VSI				
United States	10,780,712	57,639,462	13,335,523	12,659,454
Spain	-	16,643	-	54,457
Canada	-	7,512	-	-
Netherlands	-	121,486	-	-
VMS-US, VMS - Europe and VMS - Canada				
United States	3,690,757	11,661,118	3,745,625	13,158,759
United Kingdom	7,488	235,753	17,792	252,260
Canada	12,396	-	23,284	-
	<u>14,491,353</u>	<u>69,681,974</u>	<u>17,122,224</u>	<u>26,124,930</u>

Revenue is attributable to the geographic area dependent on the location of the business responsible for the sale.

During the year ended June 30, 2006, the company did not have any customers with revenue exceeding 10% of the total revenue for the year. During the year ended June 30, 2005 the company earned revenue from one customer of \$2,803,840 representing 10.7% of revenue.

During the year ended June 30, 2006 the company purchased products and services from one vendor for \$38,040,345 (2005 - \$7,255,846) representing 70.1% (2005 - 36.8%) of the cost of sales.

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## 21 Supplemental cash flow information

	2006	2005
	\$	\$
Cash paid for taxes	16,983	1,000
Cash paid for interest	486,247	97,756
<b>Non-cash investing and financing activities</b>		
Conversion of debenture into shares	3,345,000	-
Shares issued for financial services	-	109,800
Warrants issued	275,302	37,500
Promissory notes issued for the acquisition of Perfect Order	-	5,224,800
VAC notes issued for the acquisition of Perfect Order	-	1,224,000
Other payments for the acquisition of Perfect Order	-	839,700

