
Versatile Systems Inc.
Consolidated Financial Statements
September 30, 2006

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Versatile Systems Inc.**Consolidated Balance Sheets**

(Unaudited - prepared by management)

Expressed in U.S. dollars

September 30, 2006June 30, 2006

(Restated - Note 2)

ASSETS

Current Assets

Cash and cash equivalents	\$ 935,725	\$ 99,010
Accounts receivable	8,341,497	10,658,843
Current portion of deferred contract costs	4,075,817	3,117,610
Work in progress	34,648	28,050
Prepaid expenses	863,455	845,556
Inventory	971,049	938,229
Future income tax benefits (note 7)	1,236,699	900,546
	<u>16,458,889</u>	<u>16,587,844</u>
Deferred contract costs	486,322	461,793
Capital Assets	359,053	325,067
Intangible assets	1,947,528	2,207,665
Future income tax benefits (note 7)	3,519,869	3,529,635
Goodwill	10,463,118	10,463,997
	<u>\$ 33,234,780</u>	<u>\$ 33,576,001</u>

LIABILITIES

Current Liabilities

Line of credit	\$ -	\$ 370,760
Bank Overdraft	114,695	757,968
Accounts payable and accrued liabilities	9,704,344	10,428,436
Current portion of deferred revenue	6,090,014	4,937,709
Convertible debenture	-	107,594
Current portion of capital lease obligations	6,423	6,422
	<u>15,915,476</u>	<u>16,608,889</u>
Term Loan	175,000	175,000
Deferred Revenue	559,977	533,733
Bank Term Loan	2,749,263	2,749,263
Capital Lease Obligations	3,216	4,748
	<u>19,402,932</u>	<u>20,071,633</u>

SHAREHOLDERS' EQUITY

Common Shares (note 4)	47,140,818	44,473,680
Subscriptions received for shares to be issued (note 4)	-	2,502,079
Warrants (note 5)	538,144	538,144
Contributed surplus	2,418,091	2,392,030
Deficit	(36,505,091)	(36,642,671)
Foreign currency translation adjustment	239,886	241,106
	<u>13,831,848</u>	<u>13,504,368</u>
	<u>\$ 33,234,780</u>	<u>\$ 33,576,001</u>

APPROVED BY THE DIRECTORS:

DIRECTOR: "John Hardy"

DIRECTOR: "Fraser Atkinson"

See Notes to Consolidated Financial Statements

Versatile Systems Inc.**Consolidated Statements of Operations and Deficit**

(Unaudited - prepared by management)

<i>Expressed in U.S. dollars</i>	Three months ended September 30	
	2006	2005
		(Restated - Note 2)
SALES	\$ 14,504,692	\$ 13,969,405
COST OF SALES	11,526,009	11,086,778
	2,978,683	2,882,627
EXPENSES		
General and administrative	983,869	1,093,713
Selling and marketing	1,528,090	1,357,703
Research and development	212,021	388,736
Stock-based compensation	26,061	28,640
	2,750,041	2,868,792
EARNINGS BEFORE INTEREST, TAXES AND AMORTIZATION	228,642	13,835
Interest	94,454	110,296
Amortization of capital assets	48,924	54,112
Amortization of intangible assets	271,825	271,803
NET EARNINGS (LOSS) BEFORE INCOME TAXES	(186,561)	(422,376)
Current income tax expense	(800)	(2,676)
Future income tax benefit	324,941	404,175
NET EARNINGS (LOSS) FOR THE PERIOD	137,580	(20,877)
DEFICIT, BEGINNING OF PERIOD	(36,642,671)	(40,701,226)
DEFICIT, END OF PERIOD	(36,505,091)	(40,722,103)
NET EARNINGS (LOSS) PER SHARE:	\$0.00	(\$0.00)

See Notes to Consolidated Financial Statements

Versatile Systems Inc.
Consolidated Statements of Cash Flows

(Unaudited - Prepared by Management)

	Three months ended September 30	
	2006	2005
	(Restated - Note 2)	
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES		
Net earnings (loss) for the period	\$ 137,580	\$ (20,877)
Items not affecting cash		
Amortization of capital and intangible assets	320,749	325,915
Stock-based compensation	26,061	28,640
Future income tax benefit	(324,941)	(404,175)
Cash flow from (used in) operations before other items	159,449	(70,497)
Net change in non-cash working capital items	1,623,563	1,255,897
	<u>1,783,012</u>	<u>1,185,400</u>
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Proceeds from disposition of capital assets	1,540	-
Additions to capital assets	(96,111)	(48,398)
	<u>(94,571)</u>	<u>(48,398)</u>
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Proceeds from issuance of shares	165,059	337,900
Repayment of the line of credit	(370,760)	(307,000)
Reduction of the bank overdraft	(643,273)	(117,793)
Payment of the Quarterly Payment	-	(68,750)
Repayment of capital lease obligations	(1,532)	(2,211)
	<u>(850,506)</u>	<u>(157,854)</u>
Effect of foreign exchange rate on cash	(1,220)	(6,457)
Increase in cash and cash equivalents	836,715	972,691
CASH and cash equivalents, beginning of period	99,010	149,803
CASH and cash equivalents, end of period	<u>\$ 935,725</u>	<u>\$ 1,122,494</u>
Supplementary information		
Cash paid for interest expense	79,017	64,395
Cash paid for income taxes	41,813	2,676

See Notes to Consolidated Financial Statements

Versatile Systems Inc.
Notes to Consolidated Financial Statements
For the period ended September 30, 2006

(Unaudited - Prepared by Management)

1. Consolidated financial statement presentation:

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's annual financial statements for the year ended June 30, 2006. These financial statements were prepared by management and have not been audited or reviewed by the Company's auditors.

The results of operations for the three month period ended September 30, 2006 are not necessarily indicative of the results for the full year ending June 30, 2007. All amounts herein, including the comparative figures, have been expressed in United States dollars unless otherwise noted.

2. Accounting Changes:

The accounting policies applied in these interim financial statements are consistent with those applied in the Annual financial statements.

Change in functional and reporting currency:

Effective July 1, 2006, the Company changed its functional currency to the U.S. dollar from the Canadian dollar in order to more accurately represent the currency of the economic environment in which it operates. Concurrent with the change in its functional currency, the Company adopted the U.S. dollar as its reporting currency. The consolidated financial statements of the Company for the comparative periods ended on or before June 30, 2006 which were based on a Canadian functional currency have been translated into the U.S. reporting currency using the current rate method as follows: assets and liabilities using the rate of exchange prevailing at the balance sheet date; shareholders' equity using the applicable historic rate; and revenue and expenses using a weighted average rate of exchange for the respective periods. Translation gains and losses have been included as part of the cumulative foreign currency translation adjustment which has been reported as a component of shareholders' equity.

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee ("EIC") of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency".

3. Bank term loan

On April 26, 2005 the Company obtained a term loan in the amount of \$2,749,263 from the Commerce Bank. The term loan is repayable on October 6, 2007, bears interest at the State of New York prime rate plus 1% and is secured with a first charge on the assets of certain U.S. subsidiaries. Monthly repayments consist of interest only with the principal due at the end of the term.

Versatile Systems Inc.
Notes to Consolidated Financial Statements
For the period ended September 30, 2006

(Unaudited - Prepared by Management)

4. Common Shares

Authorized
 Unlimited common shares without par value

Issued and outstanding

	Number	Amount
Issued and outstanding - June 30, 2006	97,393,694	\$ 44,473,680
Shares issued on conversion of debenture, net of share issue costs	8,789,633	2,471,983
Shares issued for exercised stock options	2,125,250	195,155
	108,308,577	\$ 47,140,818

5. Warrants

Issued and outstanding:

Expiry date	Exercise Price	Number of Warrants	Cost
	(CDN)		
April 22, 2007	\$ 0.35	5,135,413	\$ 206,408
April 25, 2007	\$ 0.345	750,000	30,145
August 10, 2007	\$ 0.30	1,646,000	54,684
March 31, 2009	\$ 0.38	1,411,808	107,627
March 31, 2009	\$ 0.414	1,411,808	75,971
March 31, 2011	\$ 0.569	1,411,808	63,309
Balance - September 30, 2006		11,766,837	\$ 538,144

6. Stock Options

	Number of Shares	Weighted average exercise price
		(CDN)
Balance - June 30, 2006	7,742,900	\$ 0.24
Granted during the quarter	2,325,000	\$ 0.92
Expired during the quarter	(4,050)	\$ 0.25
Exercised during the quarter	(2,125,250)	\$ 0.11
Balance - September 30, 2006	7,938,600	\$ 0.47

Versatile Systems Inc.
Notes to Consolidated Financial Statements
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7. Income taxes

Canadian GAAP requires a valuation allowance to be 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. This is also the Company's stated accounting policy.

Historically, the Company has determined that it has not met this test so the Company has recorded a full valuation allowance against the potential value of all of its tax losses and deductions available to be taken against future years' income tax returns. As a result there has been no future income tax asset.

During the 2006 fiscal year, the Company determined that the U.S. subsidiaries were generating sufficient profits that they were more likely than not to utilize the the losses and deductions attributable to these U.S. subsidiaries. Consequently, Canadian GAAP and the Company's stated policy requires that the valuation allowance be reduced accordingly. The difference between the total 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 quarter the Company recorded a \$324,941 non-cash income tax benefit related to the recognition of future income tax assets.