

# **Versatile Systems Inc.**

Consolidated Financial Statements  
**June 30, 2007 and 2006**  
(expressed in U.S. dollars)

## **Auditors' Report**

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

We have audited the consolidated balance sheets of **Versatile Systems Inc.** as at June 30, 2007 and 2006 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, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

### **Chartered Accountants**

Vancouver, British Columbia  
August 31, 2007

# Versatile Systems Inc.

## Consolidated Balance Sheets

As at June 30, 2007 and 2006

(expressed in U.S. dollars)

	2007 \$	2006 \$ (Restated)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	3,369,087	99,010
Accounts receivable (note 4)	15,200,919	10,658,843
Current portion of deferred contract costs	4,489,111	3,117,610
Work in progress	41,705	28,050
Prepaid expenses	347,023	845,556
Inventory	1,268,682	938,229
Future income tax benefits (note 20)	1,094,579	900,546
	<u>25,811,106</u>	<u>16,587,844</u>
<b>Long term accounts receivable</b> (note 4)	812,000	-
<b>Deferred contract costs</b>	396,423	461,793
<b>Capital assets</b> (note 5)	492,979	325,067
<b>Intangible assets</b> (note 6)	1,335,877	2,207,665
<b>Future income tax benefits</b> (note 20)	4,326,136	3,529,635
<b>Goodwill</b> (note 7)	9,914,350	9,914,350
	<u>43,088,871</u>	<u>33,026,354</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Line of credit (note 8)	3,383	370,760
Bank overdraft (note 8)	170,422	757,968
Accounts payable and accrued liabilities (note 9)	13,720,928	10,428,436
Current portion of deferred revenue	6,299,863	4,937,709
Bank term loan (note 8)	2,749,263	-
Term loan (note 12)	175,000	-
Convertible debenture (note 10)	-	107,594
Current portion of capital lease obligations (note 11)	4,748	6,422
	<u>23,123,607</u>	<u>16,608,889</u>
<b>Term loan</b> (note 12)	-	175,000
<b>Deferred revenue</b>	487,416	533,733
<b>Bank term loan</b> (note 8)	-	2,749,263
<b>Capital lease obligations</b> (note 11)	-	4,748
	<u>23,611,023</u>	<u>20,071,633</u>
<b>Shareholders' Equity</b>		
<b>Share capital</b> (note 13)	51,643,963	44,473,680
<b>Subscription received for shares to be issued</b>	-	2,502,079
<b>Warrants</b> (note 14)	382,650	538,144
<b>Contributed surplus</b> (note 15)	2,998,798	2,392,030
<b>Deficit</b>	(35,263,226)	(36,642,671)
<b>Foreign currency translation adjustment</b>	(284,337)	(308,541)
	<u>19,477,848</u>	<u>12,954,721</u>
	<u>43,088,871</u>	<u>33,026,354</u>
<b>Commitments</b> (note 19)		
<b>Subsequent events</b> (note 23)		

Approved by the Board of Directors

"John Hardy" Director

"Fraser Atkinson" Director

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

# Versatile Systems Inc.

## Consolidated Statements of Earnings and Deficit For the years ended June 30, 2007 and 2006

(expressed in U.S. dollars)

	2007 \$	2006 \$ (Restated)
<b>Sales</b>	62,230,275	59,921,368
<b>Cost of sales</b>	47,514,478	46,675,639
	<u>14,715,797</u>	<u>13,245,729</u>
<b>Expenses</b>		
General and administrative	4,597,181	4,243,188
Research and development	1,068,216	1,522,842
Selling and marketing	6,502,051	5,918,898
Stock-based compensation	555,444	123,067
	<u>12,722,892</u>	<u>11,807,995</u>
<b>Earnings before interest, taxes and amortization</b>	1,992,905	1,437,734
Interest	300,918	525,103
Amortization of capital assets	288,291	182,875
Amortization of intangible assets	874,550	1,052,148
	<u>529,146</u>	<u>(322,392)</u>
<b>Earnings (loss) before income taxes</b>	529,146	(322,392)
Current income tax expense	(101,323)	(33,804)
Future income tax benefit	951,622	4,414,751
	<u>1,379,445</u>	<u>4,058,555</u>
<b>Net earnings for the year</b>	1,379,445	4,058,555
<b>Deficit - Beginning of year</b>	<u>(36,642,671)</u>	<u>(40,701,226)</u>
<b>Deficit - End of year</b>	<u>(35,263,226)</u>	<u>(36,642,671)</u>
<b>Earnings per share - basic and diluted</b>	<u>0.01</u>	<u>0.04</u>

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

# Versatile Systems Inc.

## Consolidated Statements of Cash Flows For the years ended June 30, 2007 and 2006

(expressed in U.S. dollars)

	2007 \$	2006 \$
<b>Cash flows from operating activities</b>		
Net earnings for the year	1,379,445	4,058,555
Items not affecting cash		
Amortization of capital and intangible assets	1,162,841	1,235,023
Stock-based compensation	555,444	123,067
Amortization of deferred finance charges	-	47,402
Loss on disposal of capital assets	4,693	5,661
Foreign exchange loss	8,488	44,276
Future income tax benefit	(951,622)	(4,414,751)
	2,159,289	1,099,233
Net change in non-cash working capital items	(1,907,534)	106,836
	251,755	1,206,069
<b>Cash flows from investing activities</b>		
Proceeds from disposition of capital assets	2,640	31,499
Additions to capital and intangible assets	(455,234)	(151,622)
	(452,594)	(120,123)
<b>Cash flows from financing activities</b>		
Proceeds from issuance of shares - net of costs	4,564,059	364,812
Subscriptions received for shares to be issued	-	30,097
Proceeds from convertible debenture	-	3,617,700
Convertible debenture issue costs	-	(323,307)
Repayment of the convertible debenture	(107,594)	(510,106)
(Repayment of) proceeds from line of credit	(367,377)	63,760
(Repayment of) proceeds from bank overdraft	(587,546)	640,175
Repayment of quarterly payment	-	(206,250)
Repayment of VAC note	-	(666,667)
Repayment of promissory notes	-	(4,200,000)
Repayment of capital lease obligations	(6,422)	(5,672)
	3,495,120	(1,195,458)
<b>Effect of foreign exchange rate on cash</b>	(24,204)	58,719
<b>Increase (decrease) in cash and cash equivalents</b>	3,270,077	(50,793)
<b>Cash and cash equivalents - Beginning of year</b>	99,010	149,803
<b>Cash and cash equivalents - End of year</b>	3,369,087	99,010
<b>Supplemental cash flow information</b> (note 22)		

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

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### 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 (“VAC”), Perfect Order, Inc. (“POI”), Versatile Systems, 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 Change in reporting currency

Effective July 1, 2006, the Company adopted the U.S Dollar as its reporting currency. The consolidated financial statements of the Company as at and for the year ended 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 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. All intercompany accounts and transactions are eliminated on consolidation.

All amounts are expressed in U.S. 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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### **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 site, which have been paid for in advance.

### **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	50% per annum
Tenant improvements	straight-line over remaining term of lease

During the current fiscal year the Company reduced the amortization period for Demonstration equipment from three years to two years, which resulted in an additional \$32,522 of amortization being recorded in the current fiscal year.

### **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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements

June 30, 2007 and 2006

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(expressed in U.S. dollars)

Intangible assets acquired, either individually or with a group of assets, are initially recognized and measured at cost. The cost to a Company 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 fair value. Intangible assets with finite lives are amortized over their estimated useful lives using the straight-line method at the following rates:

Purchased 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.

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-US 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 fully 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 \$951,622 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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### **Foreign currency translation**

In conjunction with the change in reporting currency described in note 2, foreign monetary assets and liabilities are translated into United States 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 average rates prevailing during the period, 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 United States 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.

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 is recognized on a percentage of completion basis. Maintenance revenue is recognized 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". For sales involving multiple elements, the Company determines if the elements within the arrangement can be separated amongst its different elements, using guidance under Canadian generally accepted accounting principles. That is, (i) the product or service represents a separate earnings process; (ii) objective, reliable and verifiable evidence of fair value exists; and (iii) the undelivered elements are not essential to the functionality of the delivered elements. Under this guideline, the Company recognizes revenue for each element based on relative fair values.

### **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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### **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.

### **Earnings per share**

Earnings per common share is computed using the weighted average number of common shares outstanding during the year, being 110,705,812 (2006 - 97,075,682) in the current year. Diluted earnings per common share has not been disclosed as the effect of common shares issuable upon the exercise of options or warrants that have exercise prices less than CDN \$0.48 per share would not be significant.

### **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 and the stock based compensation charge that has been previously recorded, if any.

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 are recorded as share capital on exercise of the options.

During the current fiscal year the Company recognized \$555,444 (2006 - \$123,067) 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 16.

## **4 Accounts receivable**

Included with accounts receivable is an amount that the Company has with a customer providing for monthly payments of \$45,111, which commenced on January 31, 2007 continuing until December 31, 2009 and is supported by a promissory note and a security agreement. The total amount of the receivable is carried at fair value of \$1,353,333 of which \$541,333 has been classified as current and the Company is recording interest based on an imputed interest rate of approximately 10% per annum.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements

June 30, 2007 and 2006

(expressed in U.S. dollars)

### 5 Capital assets

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Automobiles	10,005	1,335	8,670
Computer and office equipment	2,048,105	1,631,145	416,960
Demonstration equipment	104,339	104,339	-
Computer software	99,884	88,754	11,130
Tenant improvements	113,625	57,406	56,219
	<b>2,375,958</b>	<b>1,882,979</b>	<b>492,979</b>
	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Automobiles	4,000	4,000	-
Computer and office equipment	1,679,901	1,430,746	249,155
Demonstration equipment	104,339	38,602	65,737
Computer software	97,599	95,019	2,580
Tenant improvements	44,772	37,177	7,595
	<b>1,930,611</b>	<b>1,605,544</b>	<b>325,067</b>

As at June 30, 2007, assets under capital lease with a cost of \$30,369 (2006 - \$30,369) and accumulated amortization of \$30,369 (2006 - \$30,369) are included in capital assets.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

(expressed in U.S. dollars)

### 6 Intangible assets

The carrying amounts of the amortized intangible assets for the years ended June 30, 2007 and 2006 are as follows:

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Customers	1,757,359	761,518	995,841
Purchased technology	1,211,969	875,314	336,655
Intellectual property	451,250	451,250	-
Other intangibles	6,127	2,746	3,381
Licences	522,402	522,402	-
	<b>3,949,107</b>	<b>2,613,230</b>	<b>1,335,877</b>
	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Customers	1,757,359	410,046	1,347,313
Purchased technology	1,211,969	471,324	740,645
Intellectual property	451,250	332,500	118,750
Other intangibles	3,364	2,407	957
Licences	574,221	574,221	-
	<b>3,998,163</b>	<b>1,790,498</b>	<b>2,207,665</b>

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

(expressed in U.S. dollars)

### 7 Goodwill

The carrying amounts of the goodwill for the years ended June 30, 2007 and 2006 are as follows:

	<b>2007</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Goodwill			
Perfect Order	7,195,380	-	7,195,380
VMS-US	10,875,882	8,156,912	2,718,970
	<u>18,071,262</u>	<u>8,156,912</u>	<u>9,914,350</u>
			<b>2006</b>
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Goodwill			
Perfect Order	7,195,380	-	7,195,380
VMS-US	10,875,882	8,156,912	2,718,970
	<u>18,071,262</u>	<u>8,156,912</u>	<u>9,914,350</u>

No amortization for goodwill has been recorded for 2007 or 2006. During the current fiscal year ended June 30, 2007, 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, 2007.

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

The Company has a credit line facility for up to \$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, 2007, the Company had utilized its line of credit for \$3,383 (2006 - \$370,760) and had a bank overdraft of \$170,422 (2006 - \$757,968). During the current fiscal year the interest on the line of credit amounted to \$48,078 (2006 - \$17,382).

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements

June 30, 2007 and 2006

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(expressed in U.S. dollars)

The Company has a term loan in the amount of \$2,749,263 from the same U.S. based financial institution, bearing interest at the State of New York prime rate plus 1%, secured with a first charge on the assets of VAC, VSI and POI and is due on October 6, 2007. 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 \$257,648 (2006 - \$226,050).

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 \$2,749,263 at June 30, 2007. At June 30, 2007, the financial covenants for these facilities included requirements for debt coverage of 1.5 and minimum Tangible Net worth of \$6,000,000.

### 9 Accounts payable and accrued liabilities

Included in accounts payable and accrued liabilities is \$7,707,954 (2006 - \$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 provided special terms of net 90 days on all purchases placed between May 1, 2007 and June 15, 2007. At June 30, 2006, the Company had a line of credit with this supplier for up to \$5,000,000.

### 10 Convertible debenture

On April 10, 2006, the Company issued a convertible debenture for proceeds of \$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 CDN \$0.38, 1,411,808 warrants expiring on March 31, 2009 with an exercise price of CDN \$0.414 and 1,411,808 warrants expiring on March 31, 2011 with an exercise price of CDN \$0.569. The debenture bore 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 was due on March 31, 2009. On June 30, 2006, \$3,000,000 of the debenture was converted into 8,789,633 common shares of the Company leaving a balance of \$107,594 which was repaid during the current fiscal year.

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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### 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:

	2007 \$	2006 \$
2007	-	7,459
2008	4,973	4,973
	<hr/>	<hr/>
	4,973	12,432
Less: Amount representing interest at 12.5% (2006 - 12.5%) per annum	(225)	(1,262)
	<hr/>	<hr/>
	4,748	11,170
Less: Current portion	(4,748)	(6,422)
	<hr/>	<hr/>
	-	4,748
	<hr/>	<hr/>

Interest expense on capital lease obligations for the year ended June 30, 2007 is \$1,262 (2006 - \$2,330).

### 12 Term loan

The note payable to Ben Franklin Technology Partners for \$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 \$8,312 (2006 - \$8,312).

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### 13 Share capital

Authorized

Unlimited common shares without par value

Issued and outstanding

	<b>Number of shares</b>	<b>Amount \$</b>
Balance - June 30, 2005	96,187,926	44,476,236
Shares issued for cash - net of share issue costs	1,646,000	283,306
Escrow shares returned to Treasury	(690,000)	(314,667)
Shares issued for exercised stock options	249,768	26,823
Contributed surplus related to the exercised stock options	-	1,982
	<hr/>	<hr/>
Balance - June 30, 2006	97,393,694	44,473,680
Shares issued on conversion of debenture, net of share issue	8,789,633	2,470,862
Shares issued for cash, net of share issue costs	7,241,380	2,871,165
Shares issued for exercised warrants	4,546,986	1,394,118
Warrant cost related to the exercised warrants	-	182,876
Shares issued for exercised stock options	2,406,250	248,934
Contributed surplus related to the exercised stock options	-	2,328
	<hr/>	<hr/>
Balance - June 30, 2007	120,377,943	51,643,963

On April 16, 2007, the Company closed a brokered private placement and issued 7,241,380 at a price of \$0.5759 (CDN \$ 0.6636) per share for gross proceeds of \$4,170,390 (CDN \$4,805,380). The Company also issued the broker 583,770 warrants. Each common share purchase warrant entitles the holder to purchase one common share of the Company for a period of four years after the closing date at a price of CDN \$0.6636 per common share.

On August 10, 2005, the Company closed a non-brokered private placement and issued 1,646,000 Units at a price of \$0.2076 (CDN \$ 0.25) per Unit for gross proceeds of \$341,777. 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 \$0.2492 (CDN \$0.30) per common share. The Company assigned a value of \$0.1744 (CDN \$0.21) to each common share and \$0.0332 (CDN \$0.04) to each warrant.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

(expressed in U.S. dollars)

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 \$0.7421 (CDN \$1.00) per share. These conditions were not met. As a result, share capital has been reduced by \$314,667 and after offsetting a related receivable for \$16,920 the balance of \$297,747 has been recorded as contributed surplus.

### 14 Warrants and contributed surplus

The following warrants were outstanding:

Expiry date	Exercise price CDN \$	Balance - June 30, 2006		Balance - June 30, 2007		
		Expired	Issued	Number of warrants	Amount \$	
August 10, 2007	0.3000	1,646,000	-	-	1,646,000	54,685
March 31, 2009	0.3800	1,411,808	-	-	1,411,808	107,627
March 31, 2009	0.4140	1,411,808	-	-	1,411,808	75,971
March 31, 2011	0.5690	1,411,808	-	-	1,411,808	63,309
April 22, 2007	0.3500	5,135,413	(5,135,413)	-	-	-
April 25, 2007	0.3450	750,000	(750,000)	-	-	-
April 16, 2011	0.6636	-	-	583,770	583,770	81,058
		11,766,837	(5,885,413)	583,770	6,465,194	382,650

  

Expiry date	Exercise price CDN \$	Balance - June 30, 2005		Balance - June 30, 2006		
		Expired	Issued	Number of warrants	Amount \$	
August 10, 2007	0.3000	-	-	1,646,000	1,646,000	54,685
March 31, 2009	0.3800	-	-	1,411,808	1,411,808	107,627
March 31, 2009	0.4140	-	-	1,411,808	1,411,808	75,971
March 31, 2011	0.5690	-	-	1,411,808	1,411,808	63,309
September 17, 2005	0.4000	4,111,110	(4,111,110)	-	-	-
April 22, 2007	0.3500	5,135,413	-	-	5,135,413	206,407
April 25, 2007	0.3450	750,000	-	-	750,000	30,145
		9,996,523	(4,111,110)	5,881,424	11,766,837	538,144

On April 16, 2007, the Company issued 583,770 warrants expiring on April 16, 2011 with an exercise price of CDN \$0.6636. Each warrant entitles the holder to purchase one common share of the Company. The Company assigned a value of \$0.1389 (CDN \$0.16) to each warrant.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

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 CDN \$0.38, 1,411,808 warrants expiring on March 31, 2009 with an exercise price of CDN \$0.414 and 1,411,808 warrants expiring on March 31, 2011 with an exercise price of CDN \$0.569. Each warrant entitles the holder to acquire one common share of the Company. The Company assigned values to these warrants of \$0.0762 (CDN \$0.085), \$0.0538 (CDN \$0.06) and \$0.0448 (CDN \$0.05) respectively.

On August 10, 2005, the Company issued 1,646,000 warrants expiring on August 10, 2007 with an exercise price of CDN \$0.30. Each warrant entitles the holder to purchase one common share of the Company. The Company assigned a value of \$0.1744 (CDN \$0.21) to each common share and \$0.0332 (CDN \$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 CDN \$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 CDN \$0.345 per share on or before April 25, 2007.

### 15 Contributed surplus

Contributed surplus consists of the following:

	\$
Balance - June 30, 2005	1,849,408
Expiration of warrants	123,790
Escrow shares cancelled	297,747
Stock-based compensation	123,067
Stock-based compensation for exercised stock options	<u>(1,982)</u>
Balance - June 30, 2006	2,392,030
Expiration of warrants	53,652
Stock-based compensation	555,444
Stock-based compensation for exercised stock options	<u>(2,328)</u>
Balance - June 30, 2007	<u>2,998,798</u>

During the year ended June 30, 2007, 1,338,427 (2006 - 4,111,110) warrants expired, resulting in their ascribed value of \$53,652 (2006 - \$123,790) being recorded as contributed surplus.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements

June 30, 2007 and 2006

(expressed in U.S. dollars)

### 16 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 10,800,000 (2006- 9,700,000) 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, 2007 and 2006 is presented below:

	2007		2006	
	Number of shares	Weighted average exercise price \$	Number of shares	Weighted average exercise price \$
Outstanding - Beginning of year	7,742,900	0.24	7,271,668	0.21
Granted	4,060,000	0.94	1,702,300	0.27
Exercised	(2,406,250)	0.12	(249,768)	0.12
Forfeited	(102,750)	0.27	(981,300)	0.11
Expired	-		-	
Outstanding - End of year	9,293,900	0.57	7,742,900	0.24
Options exercisable at year-end	8,013,900	0.59	6,726,233	0.23

The following table summarizes information about stock options outstanding at June 30, 2007:

Exercise prices \$	Options outstanding			Options exercisable	
	Number outstanding at June 30, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price \$	Number exercisable at June 30, 2007	Weighted average exercise price \$
0.25	703,900	2.47	0.25	703,900	0.25
0.30	2,180,000	1.76	0.30	2,080,000	0.30
0.30	1,665,000	2.00	0.30	1,115,000	0.30
0.30	600,000	2.16	0.30	400,000	0.30
0.32	85,000	0.44	0.32	85,000	0.32
0.92	2,325,000	3.23	0.92	1,895,000	0.92
0.96	1,735,000	3.35	0.96	1,735,000	0.96
	9,293,900	2.53	0.57	8,013,900	0.59

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements

June 30, 2007 and 2006

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(expressed in U.S. dollars)

During the year ended June 30, 2007, all of the stock options were granted at an exercise price above the market price of a common share. The options granted in 2007 had a weighted average exercise price of CDN \$0.94 (2006 - CDN \$0.27) and a weighted average value of CDN \$0.18 (2006 - CDN \$0.02).

For the year ended June 30, 2007, the Company has recognized \$555,444 (2006 - \$123,067) in stock-based compensation for stock options granted to employees. There were no options granted to non-employees during the years ended June 30, 2007 and 2006. 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	72%
Risk-free interest rate	3%
Expected average option term (months)	5

### 17 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, 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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### 18 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:

	2007 \$	2006 \$
Consulting fees and salaries (included with general and administration expense)	721,194	723,873

During the current fiscal year the Company granted incentive stock options to directors to acquire 1,735,000 common shares of the Company with an exercise price of CDN \$0.96 per share and incentive stock options to acquire 1,280,000 common shares of the Company with an exercise price of CDN \$0.92 per share.

On August 10, 2005, the Company closed a non-brokered private placement and issued 1,646,000 Units at a price of CDN \$0.25 per Unit for gross proceeds of CDN \$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.

### 19 Commitments

As at June 30, 2007, future minimum lease payments for premises and equipment are as follows:

	\$
2008	742,015
2009	751,083
2010	744,036
2011	586,079
2012	94,227

### 20 Income taxes

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

	\$
Canada	7,767,742
United Kingdom	11,884,800
United States	11,892,284

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

Tax losses in Canada expire as follows:

	<b>Versatile (Canada) CDN \$</b>	<b>EvolutionB Information Inc. CDN \$</b>
2008	1,691,029	1,800,011
2009	2,642,231	62,806
2010	1,551,967	166,780
2015	297,393	-
	<u>6,182,620</u>	<u>2,029,597</u>

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

	\$
Net operating losses expire as follows:	
2021	1,006,359
2022	1,025,046
2023	477,803
2024	1,045,650
2025	1,142,013
2026	110,883
Tax deductions which may be taken from 2008 to 2020	<u>7,084,530</u>
	<u>11,892,284</u>

VMS-US, 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 2008 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 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.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

(expressed in U.S. dollars)

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:

	2007 \$	2006 \$
<b>Future income taxes</b>		
Future income tax assets		
Tax losses and deductions	9,161,889	10,578,268
Capital assets	437,557	409,827
Share issuance costs	653,200	148,990
Other	99,913	260,020
Future income tax assets	10,352,559	11,397,105
Valuation allowance	(4,200,345)	(6,269,277)
Net future income tax asset	6,152,214	5,127,828
Future income tax liabilities		
Goodwill	(731,499)	(697,647)
Net future income tax asset	5,420,715	4,430,181
Less: Current portion	(1,094,579)	(900,546)
Non-current portion of net future income tax	4,326,136	3,529,635

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 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.

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

	2007 \$	2006 \$
Tax at the statutory tax rate of 35% (2006 - 35%)	227,204	(97,852)
Foreign tax rate differential	176,455	87,946
Effect of foreign exchange (losses) gains	(219,391)	22,398
Temporary differences	(38,578)	(51,306)
Permanent differences	(252,633)	578,679
Expiry of prior year losses	1,441,606	340,472
Use of prior year losses	(149,908)	-
Changes in valuation allowance	(2,051,365)	(5,261,284)
Other	16,311	-
	(850,299)	(4,380,947)
Future income tax benefit	951,622	4,414,751
Current income tax expense	101,323	33,804

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

(expressed in U.S. dollars)

### 21 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:

	2007		2006	
	Capital assets, intangible assets and goodwill \$	Revenue \$	Capital assets, intangible assets and goodwill \$	Revenue \$
VAC, POI and VSI				
United States	8,903,390	50,790,706	9,668,800	49,565,694
Spain	-	24,908	-	14,312
Canada	-	2,127	-	6,460
Netherlands	-	348,540	-	104,468
VMS-US, VMS - Europe and VMS - Canada				
United States	2,819,302	9,901,087	2,760,449	10,027,705
United Kingdom	16,678	852,252	6,716	202,729
Canada	3,836	117,524	11,117	-
France	-	188,756	-	-
Other	-	4,375	-	-
	<u>11,743,206</u>	<u>62,230,275</u>	<u>12,447,082</u>	<u>59,921,368</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, 2007, the Company earned revenue from one customer of \$6,616,008 representing 10.6% of revenue.

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, 2007, the Company purchased products and services from one vendor for \$30,902,089 (2006 - \$32,711,621) representing 64.7% (2006 - 70.1%) of the cost of sales.

# Versatile Systems Inc.

## Notes to Consolidated Financial Statements June 30, 2007 and 2006

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(expressed in U.S. dollars)

### 22 Supplemental cash flow information

	2007 \$	2006 \$
Cash paid for taxes	167,045	14,604
Cash paid for interest	321,572	418,133
<b>Non-cash investing and financing activities</b>		
Conversion of debenture into shares	-	3,000,000
Warrants issued	81,058	246,908

### 23 Subsequent events

- a) On July 5, 2007, a director and officer of the Company exercised 1,000,000 warrants to purchase 1,000,000 common shares for gross proceeds of \$282,646 (CDN \$300,000). On July 8, 2007 and July 10, 2007, a total of 446,000 warrants were exercised to purchase 446,000 common shares for gross proceeds of \$127,174 (CDN \$133,800).
- b) On July 18, 2007, the Company repaid the Ben Franklin Technologies Term Loan of \$175,000 and the related interest.

