

Financial Statements of

INTRINSYC SOFTWARE INC.
(formerly ITC Microcomponents Inc.)

Year ended August 31, 1997

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheet of Intrinsic Software Inc. (formerly ITC Microcomponents Inc.) as at August 31, 1997 and 1996 and the statements of operations and deficit and changes in financial position 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 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 financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles. As required by the Company Act (British Columbia), we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

KPMG, Chartered Accountants

Vancouver, Canada

October 10, 1997

INTRINSYC SOFTWARE INC.

(formerly ITC Microcomponents Inc.)

Balance Sheet

August 31, 1997, with comparative figures for 1996

	1997	1996
Assets		
Current assets:		
Cash	\$ 349,067	\$ 122,483
Funds held in trust	—	239,990
Accounts receivable	96,988	37,637
Prepaid expenses	25,890	2,636
Share subscriptions receivable	98,530	—
	<u>570,475</u>	<u>402,746</u>
Capital assets (note 3)	149,846	40,551
Other assets	407,487	—
	<u>\$ 1,127,808</u>	<u>\$ 443,297</u>

Liabilities and Shareholders' Deficiency

Current liabilities:		
Accounts payable and accrued liabilities	\$ 461,611	\$ 282,604
Advances from shareholders (note 4)	80,000	—
Funds received in advance of the issuance of shares	597,316	239,990
Shareholders' deficiency:		
Share capital (note 5)	3,133,777	995,360
Deficit	(3,144,896)	(1,074,657)
	<u>(11,119)</u>	<u>(79,297)</u>
Commitments (note 6)		
Subsequent events (note 8)		
	<u>\$ 1,127,808</u>	<u>\$ 443,297</u>

See accompanying notes to financial statements.

On behalf of the Board:

Derek Spratt

Director

William Yu

Director

INTRINSYC SOFTWARE INC.

(formerly ITC Microcomponents Inc.)

Statement of Operations and Deficit

Year ended August 31, 1997, with comparative figures for 1996

	1997	1996
Sales	\$ 69,036	\$ 82,472
Cost of sales:		
Opening inventory	—	54,065
Purchases	35,368	203
Reduction in inventory to net realizable value	—	47,104
	35,368	101,372
Ending inventory	—	—
	35,368	101,372
Gross profit (loss)	33,668	(18,900)
Expenses:		
Marketing and sales (schedule)	381,695	102,884
Administration (schedule)	833,787	287,577
Research and development (schedule)	888,425	193,567
	2,103,907	584,028
Loss for the year	2,070,239	602,928
Deficit, beginning of year	1,074,657	471,729
Deficit, end of year	\$ 3,144,896	\$ 1,074,657
Loss per share	\$ 0.16	\$ 0.09

See accompanying notes to financial statements.

INTRINSYC SOFTWARE INC.

(formerly ITC Microcomponents Inc.)

Statement of Changes in Financial Position

Year ended August 31, 1997, with comparative figures for 1996

	1997	1996
Cash provided by (used in):		
Operations:		
Loss for the year	\$ (2,070,239)	\$ (602,928)
Items not involving cash		
Depreciation and amortization	179,685	26,771
Reduction in inventory to net realizable value	—	47,104
	<u>(1,890,554)</u>	<u>(529,053)</u>
Change in non-cash operating working capital:		
Accounts receivable	(59,351)	22,185
Inventories	—	6,961
Prepaid expenses	(23,254)	(583)
Accounts payable and accrued liabilities	179,007	121,335
	<u>(1,794,152)</u>	<u>(379,155)</u>
Financing:		
Proceeds from issuance of share capital	2,138,417	522,178
Share subscriptions receivable	(98,530)	—
Funds received in advance of the issuance of shares	357,326	239,990
Advances from shareholders	80,000	(3,738)
	<u>2,477,213</u>	<u>758,430</u>
Investments:		
Purchase of capital assets	(140,966)	(24,734)
Purchase of other assets	(555,501)	—
	<u>(696,467)</u>	<u>(24,734)</u>
Increase (decrease) in cash	(13,406)	354,541
Cash, beginning of year	362,473	7,932
Cash, end of year	<u>\$ 349,067</u>	<u>\$ 362,473</u>

Cash is comprised of cash and funds held in trust.

See accompanying notes to financial statements.

INTRINSYC SOFTWARE INC.

(formerly ITC Microcomponents Inc.)

Notes to Financial Statements

Year ended August 31, 1997

1. Incorporation:

The Company was incorporated on August 31, 1992 under the laws of Alberta. The Company was continued under the Company Act (British Columbia) on July 19, 1995. The Company is a developer of software tools for Microsoft Windows based applications that are deployed in embedded computing markets.

2. Significant accounting policies:

(a) Basis of presentation:

These financial statements have been prepared in accordance with generally accepted accounting principles in Canada.

As at August 31, 1997, the Company had an accumulated deficit of \$2,753,595 and has incurred operating losses for the last four fiscal years. In addition, its current business operations have generated no cash flow and funds will be required to further exploit the technologies. These financial statements are prepared on the basis of accounting principles applicable to a going concern which contemplates the realization of assets and the discharge of liabilities in the normal course of business. The Company's ability to continue as a going concern is dependent upon its ability to raise additional financing and to achieve profitable operations.

(b) Capital assets:

Capital assets are recorded at cost net of applicable tax credits. Depreciation is calculated using the declining-balance method at the following annual rates:

Computers and equipment	30%
Furniture and fixtures	20%

Leasehold improvements are amortized on a straight-line basis over the term of the related lease.

(c) Other assets:

Other assets include technology rights and licenses, which are stated at cost and amortized under the straight-line method over periods not exceeding 40 years. The Corporation continuously evaluates the value of these assets to determine if its unamortized portion has sustained permanent impairment in value. The method used to determine whether there has been a permanent impairment in value is based upon anticipated operating results.

(d) Foreign exchange:

Monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Revenues and expenses are translated at transaction date rates. Any exchange gains or losses are included in the determination of income.

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Year ended August 31, 1997

2. Significant accounting policies (continued):

(e) Research and development:

Expenditures on research and development expenditures are expensed as incurred unless they meet certain restrictive criterion in which case they are capitalized. No amounts have been capitalized to August 31, 1997. Investment tax credits relating to current expenditures are recognized in income when there is reasonable assurance of realization. Tax credits related to capital expenditures reduce the cost of the related asset provided there is reasonable assurance of realization.

(f) Loss per share:

Loss per share has been calculated based on the weighted average number of common shares outstanding during the reporting period, including performance shares which are contingently returnable to treasury (note 5(e)). Fully diluted per share amounts have not been disclosed as the affect of outstanding options and warrants is anti-dilutive.

(g) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management has applied its judgment to the information available at the date of these financial statements in making such judgment. Actual results could differ from estimates made in preparing these financial statements.

3. Capital assets:

			1997	1996
	Cost	Accumulated depreciation	Net book value	Net book value
Computers and equipment	\$ 167,592	\$ 40,843	\$ 126,749	\$ 18,872
Furniture and fixtures	12,231	4,142	8,089	7,776
Leasehold improvements	25,659	10,651	15,008	13,903
	\$ 205,482	\$ 55,636	\$ 149,846	\$ 40,551

4. Advances from shareholders:

	1997	1996
Advances from shareholder are unsecured, non-interest bearing and with no fixed terms of repayment	\$ 80,000	\$ -

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Year ended August 31, 1997

5. Share capital:

(a) Authorized:

99,000,000 common shares without par value

1,000,000 class A preferred shares, non-voting, redeemable and retractable, convertible with a \$0.60 stated par value, 8% cumulative dividend

(b) Issued:

	Number of shares	Amount
Balance, August 31, 1995	5,415,532	\$ 473,182
Issued:		
For cash on public offering	1,737,500	392,115
For cash on private placements for cash	140,000	35,000
Debt settlement	74,040	41,463
For cash on exercise of warrants	134,000	53,600
Balance, August 31, 1996	7,501,072	995,360
Issued:		
For cash on private placements for cash	5,356,667	1,723,455
Debt settlement	21,739	10,000
For cash on exercise of warrants	183,333	60,000
For cash on exercise of options	282,000	154,530
For services rendered	50,000	29,432
For purchase of other assets	2,200,000	161,000
Balance, August 31, 1997	15,594,811	\$ 3,133,777

(c) Warrants:

August 31, 1996	Granted	Exercised	Expired	August 31, 1997	Exercise price	Expiry date
312,500	-	(50,000)	(134,000)	128,500	0.46	April 16, 1998
-	1,845,000	-	-	1,845,000	0.37	February 25, 1998
-	1,666,667	(133,333)	-	1,533,334	0.35	July 22, 1998
312,500	3,511,667	(183,333)	(134,000)	3,506,834		

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Year ended August 31, 1997

5. Share capital (continued):

(d) Stock options:

Stock options are granted at exercise prices determined by reference to the fair value of the shares at the date of grant.

August 31, 1996	Granted	Exercised	Expired	August 31, 1997	Exercise price	Expiry date
590,000	–	(15,000)	(125,000)	450,000	0.40	December 27, 2000
91,500	–	(91,500)	–	–	0.59	April 18, 2001
–	350,000	(100,000)	–	250,000	0.50	October 21, 2001
–	550,000	–	–	550,000	0.66	March 4, 2002
–	575,000	(75,500)	–	499,500	0.59	May 15, 2002
–	226,000	–	–	226,000	0.74	August 21, 1999
681,500	1,701,000	(282,000)	(125,000)	1,975,500		

(e) Performance shares:

Included in the issued and outstanding common shares are 5,670,000 common performance shares which are subject to an escrow agreement. These shares are releasable from escrow on satisfaction of certain predetermined tests set out by regulatory authorities related to the generation of positive cash flow from operations. Shares not released from escrow within 10 years of the date of their issue will be cancelled. Pursuant to the escrow agreement, holders of the performance shares may exercise all voting rights attached thereto except on a resolution to cancel any of the shares, and have waived their rights to receive dividends or to participate in the assets and property of the Company on a winding-up or dissolution of the Company.

Subsequent to year end, these shares were cancelled (note 8(b)).

6. Commitments:

(a) The Company is committed to payments under operating leases as follows.

1998	\$ 46,196
1999	35,580
	<hr/>
	\$ 81,776

(b) The Company has entered into employment contracts with two of its key employees who are also significant shareholders. The term of the contracts are for three years and expire on December 31, 1997. The agreements provide for annual salaries totalling \$103,200 which are to be paid out of revenues generated by the Company.

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Year ended August 31, 1997

7. Income taxes:

The Company has operating losses of approximately \$3,000,000 available to reduce taxable income in future years, the benefits of which have not been recognized in these financial statements.

8. Subsequent events:

Subsequent to year end, the Company entered into the following significant transactions:

- (a) The Company completed a private placement of 1,296,296 shares at \$0.54 per share together with non-transferable share purchase warrants to purchase 648,148 common shares, the warrants of which are exercisable to August 1998 at \$0.54 per share and thereafter to August, 1999 at \$0.63 per share. At August 31, 1997, the Company had received cash of \$597,316 in advance of the completion of this private placement.
- (b) The Company cancelled 5,670,000 escrowed shares.
- (c) The Company granted 226,000 stock options exercisable up to August 21, 002 at a price of \$0.74 per share.

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Schedule of Marketing and Sales, Administration and Research and Development Expenses

Year ended August 31, 1997, with comparative figures for 1996

	1997	1996
Marketing and sales expenses:		
Advertising	\$ 16,730	\$ 20,902
Automobile	4,290	2,518
Entertainment and promotion	4,043	7,740
Office	45,660	—
Premises	22,785	—
Professional fees	33,413	—
Salaries and commissions	206,486	61,853
Telephone	6,931	—
Travel	41,357	9,871
	<u>\$ 381,695</u>	<u>\$ 102,884</u>
Administration expenses:		
Automobile	\$ 12,835	\$ 20,710
Bank charges and interest	40,311	4,287
Depreciation and amortization	31,669	26,771
Investor relations	102,907	48,867
Legal and professional	158,355	24,901
Listing and exchange fees	20,843	4,248
Office	50,234	31,505
Postage	7,731	1,892
Premises	65,268	25,473
Salaries and benefits	277,776	75,407
Telephone	34,347	17,577
Travel	29,106	3,443
Utilities	2,405	2,496
	<u>\$ 833,787</u>	<u>\$ 287,577</u>
Research and development expenses:		
Amortization	\$ 148,014	\$ —
Office	5,372	—
Professional fees	237,648	—
Refundable investment tax credit	—	49,349
Salaries and benefits	260,159	86,025
Software development (note 6(c))	151,255	50,000
Supplies	47,778	8,193
Travel	38,199	—
	<u>\$ 888,425</u>	<u>\$ 193,567</u>

8. Investor Relations is carried out by members of the Company.