Consolidated Financial Statements

Intrinsyc Software International, Inc.

(formerly Intrinsyc Software, Inc.)
August 31, 2004

AUDITORS' REPORT

To the Shareholders of
Intrinsyc Software International, Inc.

We have audited the consolidated balance sheet of **Intrinsyc Software International, Inc.** (formerly Intrinsyc Software, Inc.) as at August 31, 2004 and the consolidated statements of operations and deficit and cash flows for the year 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 audit.

We conducted our audit 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 August 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at August 31, 2003 and for the year ended were reported on by other auditors.

Ernst & Young LLP

Vancouver, Canada,
October 29, 2004.

Chartered Accountants

Intrinsyc Software International, Inc.

CONSOLIDATED BALANCE SHEET

As at August 31

	2004 $	2003 $
ASSETS		
Current		
Cash and cash equivalents *[note 5]*	**4,600,460**	6,920,785
Funds held in trust *[note 4[b]]*	—	461,438
Restricted cash *[note 4[a]]*	—	1,983,661
Accounts receivable	**3,381,271**	3,332,946
Other receivable *[note 11[b]]*	**947,374**	960,282
Inventory	**277,840**	629,931
Prepaid expenses	**334,780**	156,215
Total current assets	**9,541,725**	14,445,258
Capital assets *[note 6]*	**838,268**	1,188,418
Goodwill *[note 7[a]]*	**14,189,478**	11,671,498
Other intangible assets *[note 7[b]]*	**1,442,848**	1,668,786
Total assets	**26,012,319**	28,973,960
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities	**2,031,780**	2,287,062
Deferred revenue	**645,820**	459,803
Future income taxes *[note 10]*	**94,600**	144,600
Guaranteed loan note *[note 4[a]]*	—	1,983,661
Loan note *[note 4[a]]*	—	804,271
Total current liabilities	**2,772,200**	5,679,397
Future income taxes *[note 10]*	**261,433**	356,033
Total liabilities	**3,033,633**	6,035,430
Commitments and contingencies *[note 11]*		
Shareholders' equity		
Share capital *[note 9]*	**52,328,077**	49,512,683
Share purchase warrants *[note 9]*	**163,500**	140,000
Shares to be issued	—	399,560
Cumulative translation adjustment	**(27,792)**	(88,855)
Deficit	**(29,485,099)**	(27,024,858)
Total shareholders' equity	**22,978,686**	22,938,530
Total liabilities and shareholders' equity	**26,012,319**	28,973,960

See accompanying notes to consolidated financial statements

On behalf of the Board:

Director Director

Intrinsyc Software International, Inc.

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

Year ended August 31

	2004 $	2003 $
Revenues *[note 13]*	**15,175,928**	13,879,023
Cost of sales	**8,927,120**	9,082,426
	6,248,808	4,796,597
Expenses		
Administration	**2,450,740**	2,408,045
Marketing and sales	**3,427,404**	4,218,864
Research and development	**1,507,017**	3,659,959
Amortization	**1,097,774**	1,288,863
Restructuring and other costs *[note 14]*	**623,000**	712,393
Less: Technology Partnerships Canada Funding Investment *[note 11[b]]*	**(219,053)**	(1,327,675)
	8,886,882	10,960,449
Loss before other earnings (expense) and income taxes	**2,638,074**	6,163,852
Other expense (earnings)		
Foreign exchange loss (gain) *[note 12]*	**(35,591)**	1,158,692
Interest expense (income)	**(7,971)**	(255,105)
	(43,562)	903,587
Loss before income taxes	**2,594,512**	7,067,439
Income tax expense (recovery) *[note 10]*		
Current	**10,329**	194,782
Future	**(144,600)**	(214,600)
	(134,271)	(19,818)
Loss for the year	**2,460,241**	7,047,621
Deficit, beginning of year	**27,024,858**	19,977,237
Deficit, end of year	**29,485,099**	27,024,858
Loss per share	**0.06**	0.18
Weighted average number of shares outstanding	**41,631,629**	38,403,770

See accompanying notes to consolidated financial statements

Intrinsyc Software International, Inc.

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended August 31

	2004 $	2003 $
OPERATING ACTIVITIES		
Loss for the year	**(2,460,241)**	(7,047,621)
Items not involving cash		
Amortization	**1,097,774**	1,288,863
Unrealized foreign exchange loss on contingent consideration	**58,679**	—
Future income taxes	**(144,600)**	(214,600)
Changes in non-cash operating working capital		
Income taxes payable	**(53,299)**	—
Funds held in trust (current) *[note 4[a]]*	**461,438**	56,262
Restricted cash (current) *[note 4[a]]*	**—**	(2,247,933)
Accounts receivable	**(48,325)**	1,826,422
Other receivable	**12,908**	296,136
Inventory	**352,091**	123,224
Prepaid expenses	**(178,565)**	107,394
Accounts payable and accrued liabilities	**(201,983)**	(1,631,426)
Deferred revenue	**186,017**	20,753
Cash used in operating activities	**(918,106)**	(7,422,526)
INVESTING ACTIVITIES		
IEL acquisition costs	**(102,146)**	—
Loan note	**(862,950)**	—
Funds held in trust (long-term) *[note 4[b]]*	**—**	520,461
Acquisition of intangible assets	**(355,884)**	—
Purchase of capital assets	**(165,802)**	(288,981)
Cash (used in) provided by investing activities	**(1,486,782)**	231,480
FINANCING ACTIVITIES		
Issuance of common shares for cash		
Warrants	**23,500**	—
Options	**—**	51,590
Restricted cash (long-term) *[note 4[a]]*	**—**	5,396,510
Cash guarantee on common shares issued	**—**	(445,435)
Cash provided by financing activities	**23,500**	5,002,665
Foreign exchange effect on cash and cash equivalents	**61,063**	(117,766)
Decrease in cash and cash equivalents	**(2,320,325)**	(2,306,147)
Cash and cash equivalents, beginning of year	**6,920,785**	9,226,932
Cash and cash equivalents, end of year	**4,600,460**	6,920,785
Supplementary information		
Interest paid	**92,367**	2,472
Interest received	**58,837**	270,048
Income taxes paid	**123,277**	56,358
Non-cash investing		
Additional consideration payable in relation to the acquisition of IEL *[note 4[a]]*	**2,392,334**	4,724,461

See accompanying notes to consolidated financial statements

Intrinsyc Software International, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

August 31, 2004

1. ORGANIZATION

The Company was incorporated on August 31, 1992 under the laws of Alberta and continued under the Company Act (British Columbia) on July 19, 1995. Articles of Continuance were filed under the Canada Business Corporations Act on May 1, 2003 to continue the Company federally and change the name of the Company from Intrinsyc Software, Inc. to Intrinsyc Software International, Inc. The Company provides an integrated framework of embedded hardware, software and service solutions for creating, networking and managing specialized intelligent devices.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements are presented in Canadian dollars and have been prepared by management in accordance with Canadian generally accepted accounting principles.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Intrinsyc Software (USA) Inc., Linar Limited and Intrinsyc Europe Ltd. The Company has eliminated all significant intercompany balances and transactions.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that 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 reporting period. Actual results could differ from those estimates used in the preparation of the financial statements.

Cash equivalents

Cash equivalents include short-term deposits, which are all deposits rated R1, term deposits, guaranteed investment certificate deposits or banker's acceptances, with a term to maturity of three months or less when acquired. Short-term deposits are valued at cost.

Inventory

Inventory is valued at the lower of cost and estimated net realizable value with cost being determined on a first-in-first-out basis.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Allowance for doubtful accounts

The Company records an allowance for doubtful accounts related to accounts receivable that are considered to be impaired. The allowance is based on the Company's knowledge of the financial condition of its customers, the aging of the receivables, current business environment and historical experience. A change to these factors could impact the estimated allowance and the provision for bad debts.

Research and development

The Company expenses research costs as they are incurred. Development costs are expensed as incurred unless they meet certain specified criteria for deferral and amortization. No development costs have been deferred in the current period, as the criteria for deferral were not met.

Capital assets

Capital assets are initially recorded at cost. Amortization is subsequently provided on the following basis:

Computers and equipment	30% declining-balance
Computer software	3 years straight-line
Furniture and fixtures	20% declining-balance

Leasehold improvements are amortized on a straight-line basis over the shorter of the initial lease term or their expected useful life.

Leases

Leases are classified as either capital or operating. Those leases, which transfer substantially all the benefits and risks of ownership of the property to the Company are accounted for as capital leases. Capital lease obligations reflect the present value of future lease payments, discounted at the appropriate interest rate.

All other leases are accounted for as operating leases wherein rental payments are charged to income as incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Intellectual property and other intangible assets

Intellectual property is recorded at cost. Intellectual property related to software is amortized on a straight-line basis over six years.

Intangible assets acquired either individually or with a group of other 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 values.

Intangible assets with finite useful lives are amortized over their estimated useful lives. The amortization methods and estimated useful lives of intangible assets are reviewed annually.

Intangible assets with indefinite useful lives are not amortized and are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test compares the carrying amount of the intangible asset with its fair value, and an impairment loss is recognized in income for the excess, if any.

Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the identifiable assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company's reporting unit that are expected to benefit from the synergies of the business combination.

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 the 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. Management tested this first step at September 1, 2002, August 31, 2003 and August 31, 2004. The second step was not required to be carried out as the fair value of the reporting unit exceeded its carrying value.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

The second step has not been required, but would be carried out if the carrying amount of a reporting unit exceeds its fair value, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of the reporting unit's goodwill is determined in the same manner as the value of goodwill is determined in a business combination described in the first paragraph, using the fair value of the reporting unit as if it was the purchase price. When the carrying amount of a reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess and is presented as a separate line item in the earnings statement before extraordinary items and discontinued operations.

Revenue recognition

The Company recognizes revenue from the sale of product and software licenses upon transfer of title, which generally occurs on shipment, unless there are significant post-delivery obligations or collection is not considered probable at the time of sale. When significant post-delivery obligations exist, revenue is deferred until such obligations are fulfilled. Revenue from support obligations is deferred and recognized ratably over the period of the obligation. Revenue from consulting and other services is recorded as the services are performed if there is reasonable certainty as to collectibility.

Revenues from contracts with milestone payments are recognized using the percentage of completion method based on costs incurred relative to total estimated costs to complete. Changes in estimates of contract price, total estimated costs, or estimated losses, if any, are included in the determination of estimated cumulative revenues and expenses in the period the change is determined by management.

Warranty costs

The Company accrues warranty costs based on management's best estimate, with reference to past experience.

Share issue costs

The Company reduces the value of consideration assigned to shares issued by the costs, net of income tax recoveries, of issuing the shares.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Impairment of capital assets

The Company monitors the recoverability of capital assets, based on factors such as future utilization, business climate and the future undiscounted cash flows expected to result from the use of the related assets. The Company's policy is to record an impairment loss in the period when the Company determines that the carrying amount of the asset will not be recoverable. At that time, the carrying amount is written down to the undiscounted future cash flows. To August 31, 2004, the Company has not recorded any such impairment losses.

Translation of foreign currencies

Foreign operations that are considered integrated (financially and operationally dependent on the parent) are translated to Canadian dollars using current rates of exchange for monetary assets and liabilities. Historical rates of exchange are used for non-monetary assets and liabilities and average rates for the period are used for revenues and expenses except for amortization, which is translated at exchange rates used in the translation of the related asset accounts. Gains or losses resulting from these translation adjustments are included in income.

Foreign operations that are considered self-sustaining (financially and operationally independent of the parent) are translated to Canadian dollars using the current rates of exchange for assets and liabilities and using average rates for the year for revenues and expenses. Gains or losses resulting from these translation adjustments are deferred in a separate component of shareholders' equity ("Cumulative translation adjustment") until there is a realized reduction in the parent's net investment in the foreign operation.

Transactions completed in foreign currencies are recorded in Canadian dollars at the rates prevailing at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are recorded in the consolidated financial statements in equivalent Canadian dollars at the rate of exchange prevailing at the balance sheet date.

Stock-based compensation

The Company accounts for all stock-based payments to non-employees, and employee awards that are direct awards of stock, granted on or after September 1, 2002, using the fair value based method. The Company has granted no such awards during the periods presented. The Company uses the settlement method to account for all other stock-based employee compensation awards. Consideration paid by employees on the exercise of stock options is recorded as share capital. The Company discloses the pro forma effect of accounting for these awards under the fair value based method [see note 8].

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Loss per share

The loss per share is calculated by using the weighted average number of common shares outstanding during the period. If in a reporting period the Company has outstanding dilutive equity instruments, the diluted loss per share is calculated using the treasury stock method. Diluted per share amounts have not been disclosed as the effect of outstanding options and warrants is anti-dilutive for all periods presented.

Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases (temporary differences). Changes in the net future tax asset or liability are included in income. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that includes the substantive enactment date. Future income tax assets are evaluated and if their realization is not considered "more likely that not", a valuation allowance is provided.

Comparative figures

The Company has reclassified certain of the figures presented for comparative purposes to conform with the financial statement presentation adopted in the current year.

3. ACCOUNTING CHANGE

Translation of foreign currencies

The Company's reporting currency is the Canadian dollar. From acquisition [note 4[a]], management considered Intrinsyc Europe Ltd. ("IEL") to be a self-sustaining operation and IEL's financial statements were translated to the Canadian dollar using the current rate method. The resulting translation adjustment was recorded directly to the cumulative translation adjustment, a separate component of shareholders' equity. Effective June 1, 2004, the Company changed the status of IEL from a self sustaining operation to an integrated one, as management believes the nature of the subsidiary has changed, and that IEL is an integrated operation within the group. Accordingly, with the financials statements of IEL are now converted into Canadian dollars using the temporal method. Monetary assets and liabilities are remeasured into the Canadian dollar at end-of-period exchange rates with non-monetary assets and liabilities remeasured at historical exchange rates. Revenue and expenses are remeasured at average exchange rates in effect during each period, except for those expenses related to non-monetary assets and liabilities, which are remeasured at historical exchange rates. Gains or losses from foreign currency remeasurement are included in net income or loss. The resulting foreign exchange loss for the period from June 1, 2004 to August 31, 2004 is recorded in income for fiscal 2004 was $1,358. Exchange gains and losses previously deferred and accumulated in cumulative translation adjustment continue to be deferred.

Linar Ltd. remains an integrated operation within the group.

Due to the constant change in currency exposures, and the substantial volatility of currency exchange rates, the effect of exchange rate fluctuations upon future operating results could be significant.

4. ACQUISITIONS

[a] Intrinsyc Europe Ltd.

On June 26, 2002, the Company acquired all of the outstanding shares of Intrinsyc Europe Ltd. ("IEL") (formerly NMI Electronics Ltd.), a U.K.-based company that is a developer of Windows CE-based products, intelligent device applications and smart phone solutions. The acquisition has been accounted for using the purchase method of accounting and the results of operations have been consolidated since the date of acquisition. The purchase agreement contains provisions for additional consideration subject to the achievement of certain performance targets during each of the 12 month periods ended May 31, 2003 and 2004.

4. ACQUISITIONS (cont'd.)

[a] Intrinsyc Europe Ltd. (cont'd.)

The performance criteria for the 12 month period ended May 31, 2003 were achieved, and consequently, additional consideration of $4,724,461 was due and payable and has been recorded as additional goodwill for the year ended August 31, 2003.

During the quarter ended May 31, 2004, a guaranteed loan note of $2,195,023 (£881,500) and a loan note of $862,950 (£357,833) related to the 12 month period ended May 31, 2003 were redeemed (held to guarantee the ability of the Company to meet the guaranteed loan note obligation) including interest of $90,052.

Additional consideration of up to $4,120,182 was previously contingently payable or issuable upon the achievement of certain revenue targets for the 12 months ended May 31, 2004. Based on an amendment to the original agreements, dated May 28, 2004, all contingent and unpaid consideration as at May 28, 2004 is considered to be extinguished in return for the issuance of 4,105,727 common shares. These shares were issued on July 8, 2004 at a value of $2,791,894 based on the closing price of $0.68 of the Company's shares as at May 31, 2004. This issuance satisfies all amounts payable and completes the transaction in its entirety.

The difference between the value of the shares issued and the amount of contingent and future payable consideration previously accrued, ($2,349,181), amounted to $442,713 which was recorded by the Company as an addition to goodwill during the year ended August 31, 2004. There was also $1,949,621 in accruals recorded during the year in relation to the contingent consideration. As a result, total goodwill recorded during the year amounted to $2,392,334.

[b] Linar Ltd.

On January 26, 2001, the Company acquired all of the outstanding shares of Linar Ltd., a U.K.-based company which provides Java-based enterprise connectivity software.

Cash payments of up to US$1,000,000 were payable upon the achievement of specified performance criteria by a certain employee until January 26, 2004 and were recorded as an expense in the period the obligation was incurred. The cash was held in trust pursuant to the acquisition agreement to be paid upon the achievement of the criteria. The final payment of US$333,000 ($461,438), was paid out on January 26, 2004 since the performance criteria were achieved.

Warrants to purchase 25,000 common shares of the Company were issued during the three month period ended November 30, 2003 with an exercise price equal to fair market value on January 26, 2003 based on specified criteria having been met [note 9].

4. ACQUISITIONS (cont'd.)

[c] Consequent Technologies, Inc.

On September 9, 2003, the Company acquired from Consequent Technologies Inc. all of its capital assets, a strategic alliance agreement with Neoteric, Inc. and a non-competition agreement with an employee in return for a cash payment of $330,000. The Company recorded the acquisition of these assets in excess of the fair market value of identifiable assets as a combination of intangible assets.

	$
Fair market value of identifiable capital assets	55,920
Intangible assets	274,080
Total purchase price	330,000

Consequent Technologies, Inc. is considered a related party by virtue of common management and board membership. This acquisition of tangible and intangible assets was reviewed and approved by the directors of the Company who are unrelated and independent of Consequent Technologies, Inc.

5. OPERATING LINE OF CREDIT

The Company has an operating line of credit for borrowings up to $1,000,000, bearing interest at prime rate. Prime rate was 3.75% at August 31, 2004. The line is collateralized by a $1,050,000 Guaranteed Investment Certificate of Deposit. There were no borrowings outstanding against the operating line of credit as at August 31, 2004.

6. CAPITAL ASSETS

	Cost $	Accumulated amortization $	Net book value $
2004			
Computers and equipment	**1,677,234**	**1,189,976**	**487,258**
Computer software	**764,029**	**656,253**	**107,776**
Furniture and fixtures	**748,807**	**584,150**	**164,657**
Leasehold improvements	**295,262**	**216,685**	**78,577**
	3,485,332	**2,647,064**	**838,268**
2003			
Computers and equipment	1,546,912	1,007,132	539,780
Computer software	731,601	503,062	228,539
Furniture and fixtures	705,333	440,813	264,520
Leasehold improvements	283,401	127,822	155,579
	3,267,247	2,078,829	1,188,418

7. GOODWILL AND OTHER INTANGIBLE ASSETS

[a] The changes in the carrying amount of goodwill for the year ended August 31, 2004 is as follows:

	$
Balance, August 31, 2003	11,671,498
Goodwill related to contingent consideration *[note 4[a]]*	2,392,334
Other goodwill additions	125,646
Balance, August 31, 2004	14,189,478

7. GOODWILL AND OTHER INTANGIBLE ASSETS (cont'd.)

[b] Other intangible assets as at August 31, 2004 are as follows:

	Gross carrying amount $	**Accumulated amortization** $	**Total** $
2004			
Intellectual property	**3,151,804**	**1,883,220**	**1,268,584**
Other intangible assets *[note 4[c]]*	**274,080**	**99,816**	**174,264**
	3,425,884	**1,983,036**	**1,442,848**
2003			
Intellectual property	3,070,000	1,401,214	1,668,786

The aggregate amortization expense for the year ended August 31, 2004 was $581,822 [2003 - $715,336].

8. STOCK-BASED COMPENSATION

No compensation expense has been recognized for the Company's fixed stock option plan. Had compensation expense for the Company's stock options granted on or after September 1, 2002 been determined based on the fair value at the applicable grant dates, the Company's loss for the year would have been increased to the pro forma amount indicated below.

	2004 $	**2003** $
Loss:		
As reported	**2,460,241**	7,047,621
Stock based compensation expense	**631,342**	449,204
Pro forma	**3,091,583**	7,496,825
Loss per common share (basic and diluted):		
As reported	**0.06**	0.18
Pro forma	**0.07**	0.20

8. STOCK-BASED COMPENSATION (cont'd.)

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions.

Expected life (in years)	2.62
Risk-free interest rate	2.44-3.51%
Volatility	83.8% - 165.6%
Dividend yield	0.00%

9. SHARE CAPITAL

Authorized

Unlimited number of common shares without par value; and
Unlimited number of preference shares without par value.

Issued

	Number of shares	Amount $
Outstanding, August 31, 2002	38,216,965	48,697,555
Shares issued for cash on:		
Exercise of options	67,000	51,590
Shares issued in connection with the acquisition of IEL *[note 4[a]]*	2,572,283	1,208,973
Share price guarantee *[note 4[b]]*	—	(445,435)
Outstanding, August 31, 2003	40,856,248	49,512,683
Shares issued on exercise of warrants	25,000	23,500
Shares issued in connection with the acquisition of IEL *[note 4[a]]*	4,105,727	2,791,894
Outstanding, August 31, 2004	**44,986,975**	**52,328,077**

9. SHARE CAPITAL (cont'd.)

Share option plan

Under the terms of the Company's employee share option plan, the Board of Directors may grant options to employees, officers and directors. The plan provides for the granting of options at the closing price of the Company's stock prior to the grant date. Options granted on or after May 11, 1999 and before April 5, 2001 generally vest over three years with the first 1/3 vesting at the first anniversary date of the grant and the balance vesting in equal amounts at the end of each quarter thereafter. The Company determines the term of each option at the time it is granted, with options generally having a five year term. The Company has reserved 11,095,774 options for issuance under its employee share option plan of which 4,614,906 have been granted and are outstanding as at August 31, 2004.

A summary of the Company's share option activity for the years ended August 31, 2004 and 2003, is as follows:

	Outstanding options	
	Number of shares	**Weighted average exercise price $**
Outstanding, August 31, 2002	4,471,837	2.26
Options granted	1,979,475	1.07
Options exercised	(67,000)	0.77
Options cancelled	(1,445,305)	1.32
Outstanding, August 31, 2003	4,939,007	1.81
Options granted	1,607,840	1.01
Options cancelled	(1,931,941)	1.79
Outstanding, August 31, 2004	4,614,906	1.54

The following table summarizes the share options outstanding at August 31, 2004:

Options outstanding				**Options exercisable**	
Range of exercise price $	**Number of shares**	**Weighted average remaining contractual life**	**Weighted average exercise price $**	**Number exercisable**	**Weighted average exercise price $**
0.49 - 1.21	3,012,234	3.92	1.05	1,046,438	1.10
1.32 - 2.97	1,141,527	2.01	2.11	836,242	2.38
3.03 - 5.30	461,145	1.51	3.69	445,868	3.71
	4,614,906	3.20	1.54	2,328,548	2.06

9. SHARE CAPITAL (cont'd.)

Share purchase warrants

A summary of the Company's share purchase warrants for the years ended August 31, 2004 and 2003 is as follows:

	Outstanding warrants	
	Number of warrants	Weighted average warrant price $
Outstanding, August 31, 2002	391,669	2.79
Warrants expired	(291,669)	2.65
Outstanding, August 31, 2003	100,000	3.20
Warrants issued	25,000	0.94
Warrants exercised	(25,000)	0.94
Outstanding, August 31, 2004	100,000	3.20

During the year ended August 31, 2002, the Company granted to the agent an agent's warrant to acquire, without additional consideration, an agent's compensation option. The option entitled the agent to purchase 291,669 special warrants at $2.65 per special warrant until July 29, 2003. These warrants expired during the year ended August 31, 2003 and were cancelled.

During the year ended August 31, 2004, 25,000 common share purchase warrants were issued at a purchase price $0.94 with an expiry date of January 26, 2008, as part of the January 26, 2001 Linar acquisition [note 4[b]]. These warrants were exercised during the year ended August 31, 2004. As at August 31, 2004, 100,000 common share purchase warrants are outstanding at a weighted average exercise price of $3.20.

10. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory income tax rates of 36.3% [2003 - 38.3%] to loss before income taxes due to the following:

	2004 $	2003 $
Combined Canadian federal and provincial income taxes at expected rate	**(942,000)**	(2,707,000)
Change in valuation allowance	**(129,000)**	2,214,000
Permanent and other differences	**860,271**	201,218
Foreign income taxed at other rates	**83,000**	45,000
Adjustment to future income tax assets and liabilities for enacted changes in tax laws and rates	**(6,000)**	227,000
	(134,271)	(19,818)

The composition of the Company's future tax assets and liabilities as at August 31, 2004 and 2003 is as follows:

	2004 $	2003 $
Future income tax assets:		
Capital assets	**784,000**	917,000
Loss carry forwards	**7,002,000**	7,351,000
Share issue costs	**196,000**	373,000
SR&ED pool	**1,230,000**	616,000
Other	**585,000**	669,000
	9,797,000	9,926,000
Valuation allowance	**(9,797,000)**	(9,926,000)
Future income tax liability:		
Intellectual property	**(356,033)**	(500,633)
Net future income tax liability	**356,033**	500,633
Current future income tax liability	**(94,600)**	(144,600)
Non-current future income tax liability	**261,433**	356,033

10. INCOME TAXES (cont'd.)

The future income tax assets have not been recognized in these consolidated financial statements, as management does not consider it more likely than not that such assets will be realized in the carry forward period.

As at August 31, 2004, the Company has non-capital loss carry forwards for Canadian purposes aggregating approximately $18,800,000 available to reduce taxable income otherwise calculated in future years. These losses expire as follows:

	$
2005	3,200,000
2006	1,600,000
2007	2,200,000
2008	1,200,000
2009	3,700,000
2010	6,200,000
2011	700,000
	18,800,000

The Company also has approximately $3,400,000 of scientific research and experimental development expenditures that may be carried forward indefinitely to be deducted against future Canadian taxable income, and investment tax credits of approximately $630,000 available to offset future Canadian federal income taxes payable. The investment tax credits expire commencing in 2011 until 2012.

At August 31, 2004, the Company also has non-capital loss carry forwards for UK income tax purposes totaling approximately $1,100,000 that may be carried forward indefinitely to reduce taxable income otherwise calculated in future years.

11. COMMITMENTS AND CONTINGENCIES

[a] The Company has lease commitments for office premises and equipment with remaining terms of up to five years. The minimum lease payments in each of the next five years are approximately as follows:

	$
2005	554,281
2006	758,721
2007	248,714
2008	—
2009	—
	1,561,716

[b] Under agreements with the Government of Canada's Technology Partnerships Canada ("TPC") program, the Company is eligible to receive conditionally repayable research and development funding amounting up to $5,415,648 to support the development of embedded devices and wired and wireless internet-enabled network connectivity. During the year ended August 31, 2004, the Company has claimed $603,074 [2003 - $1,327,675], which has been recorded as a reduction of expenses. The amount recorded is net of a 15% commission that was paid to a consultant for services performed in securing the funding. Under the terms of the agreement, an amount up to a maximum of $13,278,000 is to be repaid by royalties on annual sales, in excess of certain revenue thresholds of specified products, commencing in 2003 through to 2011.

The Company's Technology Partnerships Canada ("TPC") funding agreement expired on March 31, 2004 and all claims up to that date in the amount of $3,187,167, have been completed and filed. During the fiscal year 2004, the Company was notified that, as part of an ongoing audit of the Company's claims totalling $947,374 ($763,127 net of commissions), payment of current outstanding claims would be withheld until the completion of the audit, as permitted in the funding contract.

11. COMMITMENTS AND CONTINGENCIES (cont'd.)

On August 25, 2004 the Company reached a settlement with Industry Canada at the conclusion of their audit. The Company was found to be in breach of its TPC funding agreement due to improper use of an outside consultant. As a result, the Company made a payment of $568,268 to the Government of Canada. This figure represented 15% of amounts claimed from the inception of the funding agreement to April 1, 2004. The Company also settled with the contractor who had provided services related to the TPC filings, and as a result, a total of $184,247 that was previously charged against TPC funding (but not paid) to the contractor in the year ended August 31, 2004 has been reversed in the current period. All claims have therefore been settled and agreed to by the Company and the contractor. The Company expects that the $947,374 receivable from TPC which is outstanding at year end as funds were held pending the outcome of the settlement will be released under the standard terms of the funding agreement.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair values

The carrying amounts of cash and cash equivalents, accounts receivable, other receivable, and accounts payable and accrued liabilities approximate fair values due to their short maturities.

Credit and foreign currency risk

The Company maintains substantially all of its cash and cash equivalents with major financial institutions in Canada. Deposits held with banks may exceed the amount of insurance provided on such deposits. However, as the Company can generally redeem these deposits upon demand, the Company bears minimal risk.

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily accounts receivable. Management is of the opinion that any risk of accounting loss is significantly reduced due to the financial strength of the Company's major customers. The Company performs ongoing credit evaluations of its customers' financial condition and requires letters of credit or other guarantees whenever deemed necessary.

Although substantially all of the Company's revenues are received in US dollars, the Company incurs operating costs and has outstanding indebtedness that is denominated in Canadian dollars. Fluctuations in the exchange rates between these currencies could have a material effect on the business, financial condition and results of operations. The Company attempts to mitigate this risk by denominating many of its payment obligations in US dollars.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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13. SEGMENTED INFORMATION

Operating segments

The Company operates in the sale and service of embedded hardware and software solutions and all sales of the Company's products and services are made in this segment. Management makes decisions about allocating resources based on the one operating segment.

Geographic information

Substantially all of the Company's capital assets are located in Canada. The Company earned revenues attributed to the following countries based on the location of the customer:

	2004 $	**2003** $
United States	**5,475,379**	6,950,726
Canada	**153,529**	567,277
Europe	**8,971,673**	4,963,854
Other	**575,347**	1,397,166
	15,175,928	13,879,023

Significant customers

One customer accounted for more than 10% of sales for the year ended August 31, 2004. There were no customers that amounted to more than 10% of sales for the year ended August 31, 2003.

14. RESTRUCTURING AND OTHER COSTS

During the fiscal year, the Company approved and implemented a further business restructuring which included severance and recruitment costs associated with the reorganization of the management team. Subsequent to year end, all costs were paid.

On April 30, 2003, the Company announced and implemented a business restructuring through a workforce reduction. The Company has substantially completed the implementation of the restructuring at August 31, 2003.

Workforce reduction charges of $717,871 were related to the cost of severance and benefits associated with 22 employees notified of termination. However, management has recorded their best estimate of the potential liability and does not believe that the actual amounts will vary significantly from the estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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15. SUBSEQUENT EVENT

On September 24, 2004 the Company announced that it was proceeding with an offering of 44,986,975 rights to its existing shareholders to subscribe for approximately 11,246,743 common shares of the Company.

The rights offering was completed on October 28, 2004 and was fully subscribed. The rights were exercised for a total of 11,246,743 common shares, with gross proceeds amounting to $5,632,671, at $0.50 per common share.