

CRITICALCONTROL SOLUTIONS CORP.

Consolidated Financial Statements
For the Year Ended December 31, 2006 and 2005



*SOLUTIONS
that
WORK*



AUDITORS' REPORT

To the Shareholders of CriticalControl Solutions Corp.

We have audited the consolidated balance sheets of CriticalControl Solutions Corp. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation'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 Corporation as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
March 30, 2007

Ernst & Young LLP

Chartered Accountants

Consolidated Balance Sheets

As at December 31, 2006 and 2005

(In thousands of Canadian dollars)

	2006	2005
Assets (note 11)		
Current assets:		
Cash & cash equivalents	\$ 158	\$ 1,939
Accounts receivable (notes 3 & 8)	6,690	6,092
Unbilled revenue	1,021	810
Inventory	327	50
Prepaid expenses and other	332	315
	8,528	9,206
Deferred costs	230	278
Property & equipment (note 5)	3,316	3,418
Customer relationships & contracts (note 6)	4,152	3,746
Goodwill (note 7)	5,948	5,581
	\$ 22,174	\$ 22,229
Liabilities and Shareholders' Equity		
Current liabilities:		
Operating line of credit (note 10)	\$ 550	\$ -
Accounts payable and accrued liabilities	2,419	2,596
Unearned revenue	1,263	1,052
Current portion of warranty liability	54	71
Current portion of long-term debt (note 11)	1,697	2,890
	5,983	6,609
Long-term warranty liability	17	25
Long-term debt (note 11)	4,040	3,879
	4,057	3,904
Shareholders' equity:		
Share capital (note 12)	23,537	22,986
Contributed surplus (note 12)	1,709	1,569
Deficit	(13,112)	(12,839)
	12,134	11,716
Commitments and contingencies (note 13)		
Subsequent events (note 15)		
	\$ 22,174	\$ 22,229

See accompanying notes to consolidated financial statements.

On behalf of the Board:

“signed”

William Hammett, Director

“signed”

Alykhan Mamdani, Director



Consolidated Statements of Operations and Deficit

Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

	2006	2005
Revenue	\$ 25,602	\$ 20,087
Cost of revenue	\$ 14,155	\$ 11,700
	11,447	8,387
Operating expenses:		
Selling and administrative expenses	7,712	5,651
Research & development expenses	900	847
Amortization of property & equipment (notes 2 and 5)	1,156	902
Amortization of customer relationships & contracts	471	525
Provision for contract losses (note 8)	-	245
Write-down of goodwill (note 7)	-	125
Loss / (gain) on sale of property & equipment	7	(18)
Gain on settlement of debt (note 11(d))	-	(50)
Loss / (gain) on foreign exchange	46	(30)
Interest - long-term debt	1,379	1,470
Interest - other	49	46
	11,720	9,713
Net loss for the year (note 9)	(273)	(1,326)
Deficit, beginning of year	(12,839)	(11,513)
Deficit, end of year	\$ (13,112)	\$ (12,839)
Net Loss for the year per share: Basic and diluted (note 12(g))	(0.00)	(0.01)
Weighted-average number of shares outstanding:		
Basic and diluted	127,890,482	123,801,722

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

	2006	2005
Cash flows from (used in) operating activities:		
Net loss for the year	\$ (273)	\$ (1,326)
Items not involving cash:		
Amortization of property & equipment	1,156	902
Amortization of customer relationships & contracts	471	525
Provision for contract losses	-	245
Write-down of Goodwill	-	125
Loss (gain) on sale of property & equipment	7	(18)
Gain on settlement of debt	-	(50)
Deferred annual bonus plan (note 12(e))	52	-
Stock-based compensation (note 12(d))	58	112
Non-cash interest	357	419
Amortization of deferred financing costs (note 11)	222	311
	2,050	1245
Change in non-cash working capital balances:		
Accounts receivable	(598)	(1,384)
Unbilled revenue	(211)	(210)
Inventory	(277)	27
Prepaid expenses and other	116	(18)
Deferred Charges	(230)	-
Accounts payable and accrued liabilities	(177)	354
Unearned revenue	211	20
Warranty liability	(25)	(47)
	859	(13)
Cash flows from (used in) financing activities:		
Shares issued for cash	141	4,509
Share issuance costs	-	(413)
Proceeds from Operating line of credit	550	-
Proceeds from long-term debt	-	3,977
Repayment of long term debt	(1,304)	(400)
	(613)	7,673
Cash flows used in investing activities:		
Acquisition of businesses, net of cash acquired (note 4)	(1,350)	(5,707)
Prepaid financing costs	(77)	-
Purchase of property & equipment	(601)	(396)
Proceeds on sale of property & equipment	1	24
	(2,027)	(6,079)
Increase (decrease) in cash and cash equivalents	(1,781)	1,581
Cash and cash equivalents, beginning of year	1,939	358
Cash and cash equivalents, end of year	\$ 158	\$ 1,939
Cash and cash equivalents include the following:		
Cash	\$ 158	\$ 567
Short term investments	-	1,372
	\$ 158	\$ 1,939
Supplemental disclosure of cash flow information:		
Interest paid	\$ 849	\$ 786

See accompanying notes to consolidated financial statements.



Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

1. Incorporation and nature of business:

CriticalControl Solutions Corp. (the “Corporation” or “CriticalControl”) is a technology company that enables its clients with better access to their critical business operational information. CriticalControl’s proprietary products are technologies to allow faster access to and better control of the information required to operate the critical business operations of government and energy sector clients.

2. Significant accounting policies:

(a) Consolidation:

The consolidated financial statements of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Corporation and its wholly-owned subsidiaries.

(b) 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 the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant areas requiring the use of estimates are the determination of percentage of completed projects, warranty liability provision, customer relationships & contracts, the impairment of goodwill and capitalized software development costs. Actual results could differ from these estimates.

(c) Cash and cash equivalents consist of cash on hand, balance with bank and term deposits with terms of maturity of one to three months. Effective rate of interest on the term deposits in 2006 is nil (2005 - 4.5%).

(d) Inventory is valued at lower of cost or market and relates to the hardware installed in the field. The Company determines its allowance for inventory obsolescence based upon expected inventory turnover, inventory aging, and current and future expectations with respect to product offerings. Assumptions underlying the allowance for inventory obsolescence include future sales trends and offerings and the expected inventory requirements and inventory composition necessary to support these future sales offerings. Given the current offering in the Energy sector where these inventory items are used, the company does not have an allowance for inventory obsolescence.

(e) Deferred costs:

The Corporation amortizes deferred financing costs on a straight-line basis over the term of the related financing, and deferred costs on a straight-line basis over the term of the related contract.

(f) Property & equipment:

Property & equipment are amortized over their estimated useful lives using the declining balance method or straight-line method, depending upon asset type, at the following annual rates:

Assets	Rate
Computer software	DB 20% - 50%
Computer hardware	DB 30% - 45%
Office furniture and equipment	DB 20%
Leasehold improvements	SL over the lease term

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

Property & equipment under capital leases are initially recorded at the present value of the minimum lease payments at the inception of the lease. Amortization of the equipment under capital lease is on the same basis as similar property and equipment.

Capitalized costs for computer software include the costs of commercial software applications acquired through business acquisitions and costs incurred to develop commercial software applications. Costs incurred to develop commercial software applications are capitalized only after technological feasibility is established.

The Corporation regularly reviews the carrying value of its property & equipment. If the carrying amount exceeds the estimated recoverable amount, a write-down is charged to the consolidated statement of operations in the period the impairment is identified.

(g) Customer relationships and contracts:

Acquired customer relationships and contracts associated with business acquisitions are initially recorded at fair value and are amortized on a straight-line basis over the terms of the underlying contracts. Acquired customer contracts are assessed for impairment at least on an annual basis by estimating the associated net undiscounted future cash flows. The amount of impairment loss, if any, is the excess of the carrying value over the present value of estimated future cash flows and is charged to the consolidated statement of operations in the period the impairment is identified.

(h) Goodwill:

Goodwill represents the excess of the purchase price of acquired businesses over the fair value of the underlying net identifiable assets acquired or liabilities assumed. The Corporation assesses the carrying value of goodwill for impairment on an annual basis, or more frequently when changes in circumstances indicate that impairment may exist.

(i) Revenue recognition:

The Corporation derives revenues primarily from providing solutions to clients in the Government and energy sectors. The Corporation's solutions for each sector comprise of (i) services, (ii) maintenance & support services, (iii) software licensing and implementation and (iv) hardware and third party software. Each component of the Corporation's solution has specific revenue recognition policies as follows:

(i) Services

Services include the Corporation's document imaging and control business as well as the Corporation's solutions to the Energy sector which are dependant on the Corporation's proprietary ScanGas and NetFlow applications.

Revenue related to services can be on a time and materials basis or a fixed fee basis. For time and materials contracts, revenue is recognized as the services are performed. For fixed fee contracts, revenue is recognized on a percentage of completion basis, generally representing time spent relative to total estimated time. Provisions for estimated losses on contracts, if any, are recorded when identified. Amounts invoiced in advance of work performed are recorded as unearned revenue and revenue recognized in advance of being invoiced is recorded as unbilled revenue.

(ii) Maintenance and support services:

Revenue related to agreements for maintenance and support services is recognized on a straight-line basis over the term of the agreement.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

(iii) Software licensing and implementation:

Revenue related to licensing and implementation of the Corporation's commercial software applications is recognized upon delivery and acceptance of the software, provided that a licensing agreement has been executed, all contractual obligations have been satisfied, revenue is determinable and collection is probable. Where license agreements include multiple elements, revenue from the sale of software licenses is recognized on the same basis as described above, provided the services do not include significant customization to the base product. If significant customization is required, revenue is recognized on a percentage of completion basis over the delivery period.

(iv) Third party hardware and software:

Sales of hardware and third-party software applications are recognized if there is persuasive evidence of acceptance and delivery, revenue is determinable and collection is probable.

(j) Warranty liability:

The Corporation offers warranties on certain services. The warranty liability is estimated based on the Corporation's historical experience and management's estimate of future claims.

(k) Income taxes:

The Corporation follows the liability method of accounting for income taxes. Under the liability method, future tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply in the years in which those temporary differences are expected to reverse. The effect on the future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of substantive enactment. A valuation allowance is recorded to the extent there is uncertainty regarding the utilization of future tax assets.

(l) Investment tax credits:

Investment tax credits earned for qualifying Scientific Research and Experimental Development expenditures are deducted from the related expenditures when there is reasonable assurance they are recoverable.

(m) Foreign currency:

Monetary items denominated in foreign currency are translated to Canadian dollars at the exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets are acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in the consolidated statement of operations.

(n) Stock-based compensation:

The Corporation has stock-based compensation plans described in note 12(d) and (e). The Corporation accounts for stock options using the fair value based method whereby compensation expense is recognized based on the fair value of stock options granted, over the vesting period. The fair value of stock options granted is determined using a Black-Scholes option-pricing model and is recorded as compensation expense in selling and administration and contributed surplus. Contributed surplus is reduced as stock options are exercised and credited to share capital.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

(o) Net loss per share:

The treasury stock method is used in calculating diluted earnings per share. This method assumes that any proceeds from the exercise of stock options and other dilutive instruments would be used to purchase common shares at the average market price during the period. As the Corporation has experienced losses, the issuance of additional common shares upon exercise of warrants and stock options would be anti-dilutive, and therefore all warrants and options outstanding during the years ended December 31, 2006 & 2005 have been excluded from the calculation of diluted net loss per share.

3. Segmented information:

During 2005, the Corporation undertook a review of its operations to focus on identifying key areas of potential growth to increase profitability. The key segments identified were Government and Energy. CriticalControl has reviewed the impact of these changes on its reportable segments and concluded that its segmented disclosure reflect these key segments.

All public company costs, interest and other expenses not directly attributed to the two operating segments are included in corporate and other. Revenue attributed to corporate and other includes revenue from consulting and other services outside the Government and Energy sectors.

In assessing performance of the segments and the allocation of resources to the segments, management of CriticalControl evaluate gross margin and contribution margin, defined as gross margin less selling and administrative expenses directly attributable to the segments.

All of the Corporation's identifiable assets are located in Canada, and the accounting policies of the segments are the same as those described in note 2.

	Government	Energy	Corporate & Other	Year ended December 31, 2006
Revenue	\$ 11,645	\$ 13,081	\$876	\$ 25,602
Cost of revenue	6,671	7,061	423	14,155
Gross margin	4,974	6,020	453	11,447
Selling & administrative expense	1,103	2,506	4,103	7,712
Contribution margin	3,871	3,514	(3,650)	3,735
Research & development expense	-	900	-	900
Amortization of property & equipment	174	617	365	1,156
Amortization of customer relationships & contracts	211	260	-	471
Interest, contract losses & Other Expenses	-	-	1,481	1,481
	385	1,777	1,846	4,008
Net income (loss) for the year	3,486	1,737	(5,496)	(273)
Segment assets	\$7,916	\$13,466	\$792	\$22,174
Capital expenditures	\$300	\$145	\$156	\$601

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

	Government	Energy	Corporate & Other	Year ended December 31, 2005
Revenue	\$ 9,247	\$ 9,005	\$ 1,835	\$20,087
Cost of revenue	5,303	5,045	1,352	11,700
Gross margin	3,944	3,960	483	8,387
Selling & administrative expense	793	1,308	3,550	5,651
Contribution margin	3,151	2,652	(3,067)	2,736
Research & development expense	-	847	-	847
Amortization of property & equipment	295	607	-	902
Amortization of customer relationships & contracts	153	372	-	525
Interest, contract losses & Other Expenses	-	-	1,788	1,788
	448	1,826	1,788	4,062
Net income (loss) for the year	2,703	826	(4,855)	\$ (1,326)
Segment assets	\$7,256	\$11,778	\$ 3,195	\$ 22,229
Capital expenditures	\$ 280	\$ 272	\$ 69	\$ 621

The Corporation earned revenue from sales to customers in the following geographic areas (based on location of the customer):

	Year ended December 31, 2006	Year ended December 31, 2005
Canada	\$24,388	\$ 18,029
United States	1,083	1,500
Other	131	558
	\$ 25,602	\$ 20,087

For the year ended December 31, 2006 the Corporation derived approximately 34% (2005 – 25.4%) of its total revenue from the Government of Alberta. As at December 31 2006, 21.2 % (2005 – 20.4%) of accounts receivable pertained to this customer.

4. Business acquisitions:

- (a) On August 9, 2006, CriticalControl acquired 100% of the outstanding shares of ProTrend Software Inc. (“ProTrend”) for \$1,156 in cash and shares of CriticalControl. \$775 of the purchase price was paid in cash in addition to 1,843,318 common shares of the Corporation valued at a deemed price of \$0.163 per share (discounted from the 3-day average trading price due to the hold periods), transaction costs of \$40 and an additional \$41 working capital adjustment. In addition a deferred payment \$108 will be payable over 3 years based upon meeting certain performance criteria. This component of the purchase price will be recognized as an additional cost of the purchase being assigned to goodwill if and when the contingency is resolved and the additional consideration is issued.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the date of acquisition.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

Fair value of net assets acquired:	
Working capital	\$41
Property & equipment	8
Computer software	430
Customer relationships and contracts	310
Goodwill & trademarks	367
Net assets acquired	\$1,156
Consideration:	
Cash	\$775
1,843,318 common shares	300
Transaction costs	40
Working capital adjustment	41
	\$1,156

The computer software related to the acquisition of ProTrend will be amortized over 5 years reflecting its estimated economic life, while customer relationships and contracts will be amortized over 15 years which reflects the pattern in which the economic benefit of the contracts will be consumed.

- (b) Effective April 28, 2006, the Corporation acquired the Remote Data Acquisition (“RDA”) assets from Crimtech Services Ltd. (“Crimtech”) for \$560, consisting of \$495 of cash, 189,655 common shares of the Corporation valued at a price of \$0.29 per share (based on the 3-day average closing share price prior to the announcement date) and transaction costs of \$10. A deferred payment of \$250 will be payable upon meeting certain performance criteria. This component of the purchase price will be recognized as an additional cost of the purchase being assigned to customer relationships and contracts if and when the contingency is resolved and the additional consideration is issued (see note 15(b)).

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the date of acquisition.

Fair value of net assets acquired:	
Property & equipment	\$22
Customer relationships and contracts	538
Net assets acquired	\$560
Consideration:	
Cash	\$495
189,655 common shares	55
Transaction costs	10
	\$560

The computer software related to the acquisition of RDA will be amortized over 5 years reflecting its estimated economic life, while customer relationships and contracts will be amortized over 15 years which reflects the pattern in which the economic benefit of the contracts will be consumed.

- (c) Effective October 31, 2005, the Corporation acquired all of the issued and outstanding common shares of Deines Microfilm Services Ltd (“Deines”) for cash consideration of \$1,150 and transaction costs of \$100. Deines was a private company offering imaging services to primarily government and energy clients in Western Canada. In December of 2005 the Corporation divested the Deines offices in Vancouver, Regina and Winnipeg for cash proceeds of \$297.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the date of acquisition.

Fair value of net assets acquired:	
Non-cash working capital	\$ 161
Property & equipment	237
Customer relationships and contracts	848
	1,246
Cash	300
Payment of short-term debt	(296)
Net assets acquired	\$ 1,250
Consideration:	
Cash	\$ 1,150
Transaction costs	100
	\$ 1,250

The customer relationships and contracts related to the acquisition of Deines will be amortized over 4 years which reflects the pattern in which the economic benefit of the contracts will be consumed.

- (d) Effective July 1, 2005, the Corporation entered into an asset purchase agreement with Prologic Controls Ltd. to acquire the business and operating assets known as Netflow ("Netflow"). Netflow is an internet-based application enabling oil and gas producers to access real time information from a well site. The Corporation paid total consideration of \$826 including a \$500 cash payment on June 30, 2005 and 2,000,000 Common Shares of the Corporation at a deemed price of \$0.16 per share (discounted from the trading price of \$0.20 per share due to hold periods associated with the shares issued).

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the date of acquisition.

Fair value of the net assets acquired	
Computer software	\$ 569
Customer relationships and contracts	257
	\$ 826
Consideration:	
Cash	\$ 500
2,000,000 common shares	326
	\$ 826

The computer software will be amortization over 5 years reflecting its estimated economic life, while customer relationships and contracts will be amortized over 15 years which reflects the pattern in which the economic benefit of the contracts will be consumed.

- (e) Effective March 31, 2005, the Corporation acquired all of the issued and outstanding shares of BMP Energy Systems Ltd. ("BMP") for \$7,570, consisting of \$4,000 of cash, 14 million common shares of the Corporation valued at a deemed price of \$0.23 per share (discounted from the trading price of \$0.33 per share due to hold periods and contractual trading restrictions on the shares issued), 2,000,000 warrants to purchase common shares of the Corporation at a price of \$0.40 per share expiring March 31, 2007 valued at \$295 (based on the Black Scholes option valuation model) and, transaction costs of \$75.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the date of acquisition.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

Fair value of net assets acquired:	
Non-cash working capital	\$ 196
Property & equipment	139
Computer software	1,200
Customer relationships and contracts	2,800
Goodwill	3,091
	7,426
Cash	144
Net assets acquired	\$ 7,570
Consideration:	
Cash	\$ 4,000
14,000,000 common shares	3,200
2,000,000 Warrants	295
Transaction costs	75
	\$ 7,570

The computer software related to the acquisition of BMP will be amortized over 5 years reflecting its estimated economic life, while customer relationships and contracts will be amortized over 15 years which reflects the pattern in which the economic benefit of the contracts will be consumed.

5. Property & Equipment:

2006	Cost	Accumulated amortization	Net book value
Computer software	\$6,150	\$4,278	\$1,872
Computer hardware	2,042	1,095	947
Office furniture and equipment	785	394	391
Leasehold improvements	193	98	95
Under capital lease:			
Computer software	519	519	-
Office furniture and equipment	29	18	11
	\$9,718	\$6,402	\$3,316
<hr/>			
2005	Cost	Accumulated amortization	Net book value
Computer software	\$5,654	\$3,630	\$2,024
Computer hardware	1,641	749	892
Office furniture and equipment	731	300	431
Leasehold improvements	94	70	24
Under capital lease:			
Computer software	519	485	34
Office furniture and equipment	29	16	13
	\$8,668	\$5,250	\$3,418

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

6. Customer relationships & contracts:

	Net book value
Balance, December 31, 2004	\$ 336
Acquisition of BMP Energy (note 4 (e))	2,800
Acquisition of Dow West	30
Acquisition of Netflow (note 4 (d))	257
Acquisition of Deines (note 4 (c))	848
Amortization	(525)
Balance, December 31, 2005	\$3,746
Acquisition of RDA (note 4(b))	538
Acquisition of Protrend (note 4(a))	310
Acquisition of Oil & Gas Accounting	29
Amortization	(471)
Balance, December 31, 2006	\$4,152

7. Goodwill:

The changes in the carrying amount of goodwill are as follows:

	Net book value
Balance, December 31, 2004	\$ 2,115
Additional consideration on acquisition of Valcura	500
Acquisition of BMP (note 4(e))	3,091
Write-down	(125)
Balance, December 31, 2005	\$ 5,581
Acquisition of Protrend (note 4(a))	367
Balance, December 31, 2006	\$ 5,948

The goodwill balance at December 31, 2006 is included in the segment assets of Government (\$2,490) and Energy (\$3,458). At December 31, 2005, the goodwill balance is included in the segmented assets of Government (\$2,490) and Energy (\$3,091). In 2005, a charge of \$125 was taken related to the goodwill associated with the Corporation's network infrastructure consulting business contained in the Corporate and Other segment. The write down resulted from the Corporation's strategic plan to reallocate its resources away from this business unit in favor of its more proprietary solutions geared to the Government and Energy sectors, causing the fair value of the reporting unit to be lower than its carrying value. No other impairment charges resulted from the required impairment evaluations on the rest of the reporting units.

8. Provision for contract losses:

In 2005 the Corporation was notified that Novalis Technologies Limited had filed a proposal pursuant to section 50.4 (1) of the Bankruptcy and Insolvency Act of Canada. The Corporation's Real Property Division provided system integration services to municipalities for Novalis' computer assisted mass appraisal software. Accordingly, the Corporation has taken a charge of \$245 against it's accounts receivable for the year ended December 2005.

9. Income taxes:

(a) The provision for income taxes differs from the amount computed by applying the statutory income tax rate to loss before income tax recovery. The sources and tax effects of the differences are as follows:

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

	Year ended December 31, 2006	Year ended December 31, 2005
Loss before income tax recovery	\$ (273)	\$ (1,326)
Statutory income tax rate	32.49%	33.62%
Expected income tax recovery	(89)	(446)
Adjustments resulting from:		
Rate adjustment	508	10
Other	42	52
Increase / (Decrease) in Valuation allowance	(461)	384
Income tax recovery	\$ -	\$ -

(b) Future income tax assets and liabilities are comprised of:

	December 31, 2006	December 31, 2005
Non-capital losses carried forward	\$3,245	\$ 4,033
Property & equipment	2,301	2,283
Share issuance costs	116	189
Future tax asset	5,662	6,505
Less:		
Future tax liability related to customer contracts	(846)	(1,048)
Valuation allowance	(4,816)	(5,457)
Future income taxes	\$ -	\$ -

As at December 31, 2006 the Corporation and its subsidiaries have approximately \$11,190 of non-capital loss carry forwards for income tax purposes available to reduce future taxable income, which expire as follows:

Year ending December 31,	
2008	498
2009	3,641
2010	1,178
2011	1,829
2012	836
2015	1,667
2026	1,541
	\$11,190

The future tax asset with respect to non-capital loss carry forwards has been recognized only to the extent that it reduces the future tax liability from customer contracts.

10. Operating line of Credit:

On August 21, 2006, the corporation entered into a revolving credit agreement which provided a line of credit up to \$1,000. The line bears interest at prime rate plus 2.5% payable monthly in arrears. The total cost of obtaining the line is being amortized over a 1 year term.

As of December 31, 2006, \$550 was drawn on the line.

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2006 and 2005

(In thousands of Canadian dollars, except share data)

11. Long-term debt:

(a) The Corporation has the following long-term debt obligations:

	December 31, 2006	December 31, 2005
(i) Capital lease obligation, \$265, payable in monthly installments of principal and interest of \$12.5 for the third year, bearing interest at 10% per annum	\$ -	\$ 137
(ii) Demand loan, payable in monthly installments of principal and interest of \$5, bearing interest at the bank's prime interest rate plus 3% certain computer hardware, computer software and furniture and fixtures of a subsidiary company have been provided as collateral	-	50
(iii) Debenture, \$1,700, due August 20, 2007, general security agreement placing a charge on the assets of the Corporation and securities pledge agreements, subordinated to the interests of the Corporation's bank, have been provided as collateral (note 11 (b),(e))	1,687	2,588
(iv) Capital lease obligation, \$225, due February 2007, payable in monthly installments of principal and interest of \$10, bearing interest at 9.9% per annum, computer hardware has been provided as collateral	10	127
(v) Debenture, \$4,250, due January 3, 2008, general security agreement placing a charge on the assets of the Corporation and securities pledge agreements, subordinated to the interests of the Corporation's bank, have been provided as collateral (note 11 (c),(e))	4,040	3,867
	5,737	6,769
Less: current portion	1,697	2,890
	\$4,040	\$3,879

(b) On August 20, 2004, the Corporation closed a private placement of a debenture in the principal amount of \$2,700, arranged by an agent (the "Agent"). The terms of the debenture include interest at 12% per annum payable monthly, with principal being due on August 20, 2006 (see note 11(e)). Upon the occurrence of any event of default the interest on the principal amount and any unpaid accrued interest will increase to 20% per annum. A general security agreement and securities pledge agreements have been pledged as security. The Corporation paid a commitment fee to the debenture holder of \$135 and a fee to the Agent of \$75 which have been recorded as deferred financing costs in the consolidated balance sheet.

In addition, the Corporation granted to the debenture holder 11,739,130 special warrants (the "Special Warrants"), each Special Warrant entitling the holder to receive, without payment of any additional consideration, one common share purchase warrant (the "Warrants"), each Warrant entitling the holder to acquire one common share of the Corporation at \$0.115 per share. 2,934,783 Special Warrants are exercisable for Warrants that expire on August 20, 2008 and 8,804,347 Special Warrants are exercisable for Warrants that expire on February 20, 2009. The Corporation also issued 1,173,913 Warrants to the Agent (the "Agent Warrants"), each Agent Warrant entitling the holder to acquire one common share of the Corporation at \$0.115 per share. The Agent Warrants expired on August 20, 2006. An amount of \$350 has been attributed to the Special Warrants and Agent Warrants and has been recorded as

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contributed surplus. This amount was determined by deducting the estimated value of the debenture from the proceeds of the financing.

- (c) On March 31, 2005, the Corporation closed a private placement of a debenture in the principal amount of \$4,250. The terms of the debenture include interest at 12% per annum payable monthly, with the principal amount being due on March 31, 2007 (see note 11(e)). Upon the occurrence of any event of default the interest on the principal amount and any unpaid accrued interest will increase to 20% per annum. A general security agreement and securities pledge agreements have been pledged as security.

In addition, the Corporation granted to the debenture holder 4,250,000 warrants, each warrant entitling the holder to purchase one common share of the Corporation at a price of \$0.35 per share. An amount of \$613 has been attributed to the warrants and has been recorded as contributed surplus. This amount was determined by deducting the estimated value of the debenture from the proceeds of the financing. The proceeds of the debenture were used to fund the acquisition of BMP Energy Systems Ltd. (see note 4(e)).

Pursuant to the terms of the debenture agreement, the Corporation is required to maintain, for the fiscal quarter ended December 31, 2005 and for every fiscal quarter thereafter, (A) a four-quarter trailing earnings before interest, tax depreciation and amortization ("EBITDA") of \$1,500 and (B) a four-quarter trailing EBITDA, less any capitalized software development expenses and less any funds used for capital expenditures (in each case over such trailing four quarters), of not less than \$1,100.

The Corporation met these covenants for the fiscal quarter ended December 31, 2006.

- (d) During 2005, the Corporation agreed to settle a note payable for \$200 due September 2005 and all outstanding claims with respect to the software license and periodic payments of \$10 for each sale of a specific software license to a third party. The Corporation recorded a gain on settlement of debt of \$50 in 2005.
- (e) On June 30, 2006, the corporation extended the term of its financing agreements with its lender. Repayment of the \$2,700 debenture which was due on August 20, 2006 has been amended such that \$1,000 was paid on August 20, 2006 and the remainder is due on August 20, 2007. Repayment of the debentures in the amount of \$4,250 due March 31, 2007 has been extended to January 3, 2008. As consideration the Company has paid its lender a 1% extension fee and replaced warrants previously granted to purchase 4.25 million shares at \$0.35 per share prior to March 31, 2009 with Special Warrants to purchase 4.25 million shares at \$0.22 per share prior to January 3, 2010. An additional amount of \$85 has been attributed to the warrants and has been recorded as contributed surplus.

12. Share capital:

- (a) Authorized:
- Unlimited common shares without nominal or par value.

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(b) Issued and outstanding:

	Number	Amount
Common shares:		
Balance, December 31, 2004	86,143,871	\$ 14,394
Issued on acquisition of BMP (note 4(e))	14,000,000	3,200
Issued on conversion of convertible debenture	2,500,000	300
Issued on exercise of stock options– see (i) below	419,900	71
Issued on exercise of warrants – see (ii) below	3,657,500	567
Decrease in note receivable from Employee Trust	0	6
Issued on cancellation of Performance Rights	1,250,000	500
Issued on Equity Financing – see (iii) below	16,150,000	3,622
Issued on acquisition of Netflow (note 4(d))	2,000,000	326
Balance, December 31, 2005	126,121,271	\$22,986
Issued on exercise of stock options – see (iv) below	215,659	38
Issued on exercise of warrants – see (v) below	1,073,913	158
Issued on acquisition of RDA (note 4(b))	189,655	55
Issued on acquisition of ProTrend (note 4(a))	1,843,318	300
Balance, December 31, 2006	129,443,816	\$23,537

- (i) During the year ended December 31, 2005, options to purchase common shares were exercised for proceeds of \$42. The additional \$29 credited to share capital represents a transfer of the contributed surplus in respect of these options.
- (ii) During the year ended December 31, 2005, warrants to purchase common shares were exercised for proceeds of \$427. The additional \$140 credited to share capital represents a transfer of the contributed surplus in respect of these warrants.
- (iii) On May 19, 2005 the Corporation completed a private placement of 16,150,000 units of the Corporation at a price of \$0.25 per unit, before share issue costs of \$413. Each unit includes one common share of the Corporation and one half of a share purchase warrant. Each full share purchase warrant is exercisable into one common share of the Corporation until May 19, 2007, at an exercise price of \$0.33.
- (iv) During the year ended December 31, 2006, options to purchase common shares were exercised for proceeds of \$22. The additional \$16 credited to share capital represents a transfer of the contributed surplus in respect of these options.
- (v) During the year ended December 31, 2006, warrants to purchase common shares were exercised for proceeds of \$119. The additional \$39 credited to share capital represents a transfer of the contributed surplus in respect of these warrants.

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(c) Contributed surplus:

Balance, December 31, 2004	\$ 718
Stock-based compensation expense (note 12(d))	112
Reclassification to Share Capital for stock options exercised (note 12(b)(i))	(29)
Reclassification to Share Capital for warrants exercised (note 12(b)(ii) & (f))	(140)
Value attributed to warrants (notes 4(e) & 11(c))	908
Balance, December 31, 2005	\$ 1,569
Stock-based compensation expense (note 12(d))	58
Reclassification of deferred annual bonus plan	52
Reclassification to share capital for stock options exercised (note 12(b)(iv))	(16)
Reclassification to share capital for warrants exercised (note 12(b)(v))	(39)
Value attributed to warrants (note 11(e))	85
Balance, December 31, 2006	\$ 1,709

(d) Stock option plan:

The Corporation grants stock options pursuant to an incentive plan (the "Plan"). Under the Plan, stock options may be granted to directors, officers, employees, and consultants of the Corporation. A maximum of 10% of the issued and outstanding common shares of the Corporation have been reserved for issuance under the Plan. If any option expires without having been exercised or an award is terminated or forfeited for any reason, the common shares shall again be available for issuance in connection with future awards under the Plan. The Board of Directors (or Compensation Committee of the Board, if designated by the Board) may set the exercise price of each option, subject to certain pricing restrictions. Generally, stock options vest over a three-year period from the date of grant and are exercisable over a period of not more than five years. The Board of Directors or Compensation Committee, as the case may be, must specify the vesting schedule for each option upon its grant.

As at December 31, 2006, the Corporation had 4,019,600 (2005 – 5,166,433) stock options outstanding with exercise prices ranging from \$0.10 to \$0.50 per share, expiring April 30, 2007 to December 17, 2009. The following table summarizes stock option transactions:

	Number of options	Weighted-average exercise price
Outstanding, December 31, 2004	5,095,200	\$0.14
Granted	867,333	0.16
Exercised	(419,900)	0.10
Cancelled	(376,200)	0.10
Outstanding, December 31, 2005	5,166,433	\$0.15
Exercisable, December 31, 2005	3,192,395	\$0.17
Granted	145,000	0.21
Exercised	215,659	0.10
Cancelled	1,076,174	0.30
Outstanding, December 31, 2006	4,019,600	\$0.12
Exercisable, December 31, 2006	3,306,765	\$0.11

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The Corporation has the following stock options outstanding:

Exercise Price	Number outstanding at December 31, 2006	Weighted-average remaining contractual life (years)	Number exercisable at December 31, 2006
\$0.10	3,129,100	1.47	3,024,100
\$0.11	50,000	2.56	33,333
\$0.12	365,000	3.21	124,999
\$0.17	2,000	1.68	667
\$0.20	225,500	3.01	31,000
\$0.24	40,000	3.20	13,333
\$0.25	193,000	3.33	64,333
\$0.50	15,000	0.33	15,000
	4,019,600	1.83	3,306,765

The Corporation records compensation costs on the granting of stock options using the fair value based method. The following table presents the weighted-average assumptions used to determine stock-based compensation expense using the Black-Scholes option pricing model:

	December 31, 2006	December 31, 2005
Stock-based compensation expense	\$ 58	\$ 112
Dividend yield	0.0%	0.0%
Expected volatility	103% - 147%	170%
Risk-free interest rate	4.0%	3.3%
Expected life	4 years	4 years
Weighted-average grant date fair value	0.15	\$0.11

(e) **Deferred Annual Bonus and Share Purchase Plan**

As an additional performance incentive measure, the Corporation adopted a Deferred Annual Bonus and Share Purchase Plan ("DSP") in 2006. The DSP enables employees to elect to receive up to 10% of their annual base salary and up to 100% of any annual bonus to which they become entitled in the form of Deferred Common Shares ("DCS"). Each DCS may be redeemed by the holder for one common share of the Corporation for no additional payment on the death or termination of the holder's service to the Corporation. Up to 3,000,000 DCS may be issued under the Plan, but in no event shall the total number of DCS, combined with the number of outstanding stock options issued pursuant to the Corporation's stock option plan, exceed 10% of the outstanding shares of the Corporation.

The following table represents all DCS granted:

	Deferred Common Shares	Deemed Value
Outstanding, December 31, 2005	0	\$ 0
Issued in 2006	181,035	\$52
Outstanding, December 31, 2006	181,035	\$52

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(f) Warrants and special warrants:

As at December 31, 2006, the Corporation has 11,111,280 (December 31, 2005 – 13,185,193) warrants and 13,981,630 Special Warrants (December 31, 2005 – 13,981,630) outstanding to acquire common shares with exercise prices ranging from \$0.115 to \$0.40 per share, expiring March 31, 2007 to January 3, 2010, as follows:

Exercise price	Number outstanding at December 31, 2006	Weighted-average remaining contractual life (years)
\$0.115	9,731,630	2.0
\$0.22	4,250,000	3.0
\$0.25	1,111,280	0.4
\$0.33	8,000,000	0.4
\$0.40	2,000,000	0.3
	25,092,910	1.4

The following table summarizes warrant and special warrant transactions:

	Number of warrants	Weighted-average exercise price
Outstanding, December 31, 2004	16,463,043	\$ 0.20
Granted in 2005	15,361,280	0.34
Exercised in 2005	(3,657,500)	0.11
Expired in 2005	(1,000,000)	0.70
Outstanding, December 31, 2005	27,166,823	\$ 0.27
Cancelled (see note 11(e))	(4,250,000)	0.35
Granted (see note 11(e))	4,250,000	0.22
Exercised	(1,073,913)	0.11
Expired	(1,000,000)	0.90
Outstanding, December 31, 2006	25,092,910	\$ 0.23

(g) Loss per share:

The calculation of net loss per share is based on the weighted-average number of common shares outstanding for the year (2006 – 127,890,482; 2005 – 123,801,722). Diluted amounts are calculated taking into consideration the potential conversions and the exercise of options and warrants. Such conversions and exercises of options and warrants are anti-dilutive and have been excluded from the calculation of diluted net loss per share.

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13. Commitments and contingencies:

The Corporation is committed to annual minimum lease payments under operating leases for premises and equipment through 2012. Annual payments required are as follows:

Year ending December 31,	
2007	\$857
2008	766
2009	751
2010	762
2011	763
2012	408
	<u>\$4,307</u>

14. Financial instruments:

As at December 31, 2006, the estimated fair values of cash and cash equivalents, accounts receivable, operating line of credit, and accounts payable approximated their carrying values. The estimated fair value of the long-term debt is not practicably determinable.

15. Subsequent events:

- (a) On March 1, 2007, the Corporation announced that it has completed the acquisition of Idein Technologies Ltd. ("Idein"). Based in Calgary, Alberta, Idein's primary business is providing access to and control of electronic flow measurement and other devices at the wellsite. As consideration, CriticalControl paid \$225 in cash and issued 1,133,333 common shares of CriticalControl to the vendors. The acquisition, which is expected to be immediately accretive to the company, is expected to add more than \$500 in annualized revenue
- (b) On March 1, 2007, the Corporation agreed to settle the deferred payment to Crimtech for \$135 (see note 4(b)). This component of the purchase price will be recognized as an additional cost of the purchase being assigned to customer relationships and contracts.

16. Comparative figures:

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted for the current period.