

JEMTEC INC.

**Financial Statements
July 31, 2005 and 2004**

AUDITORS' REPORT

To the Shareholders of
JEMTEC Inc.

We have audited the balance sheets of JEMTEC Inc. as at July 31, 2005 and 2004, and the statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Vancouver, Canada

October 21, 2005

"Morgan & Company"

Chartered Accountants

JEMTEC INC.

Balance Sheets

As at July 31,

	2005	2004
ASSETS		
Current		
Cash and cash equivalents	\$ 1,699,756	\$ 697,998
Accounts receivable	473,293	242,394
Prepaid expenses	1,500	4,328
Total current assets	2,174,549	944,720
Property and equipment (note 4)	365,122	59,085
Future income taxes (note 10)	41,947	52,291
Total assets	\$ 2,581,618	\$ 1,056,096
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 279,105	\$ 174,026
Due to related parties (note 9)	-	54,250
Deferred revenue	23,115	10,500
Current portion of capital lease obligation (note 5)	81,093	27,766
Income taxes payable	409,743	103,483
Total current liabilities	793,056	370,025
Capital lease obligation (note 5)	238,922	9,735
Total liabilities	1,031,978	379,760
SHAREHOLDERS' EQUITY		
Share capital (note 7)	1,247,160	1,112,993
Contributed surplus	24,612	-
Retained earnings	277,868	(436,657)
Total shareholders' equity	1,549,640	676,336
Total liabilities and shareholders' equity	\$ 2,581,618	\$ 1,056,096

The accompanying notes are an integral part of these financial statements

Approved by the Board of Directors:

"Eric Caton"
Director

"Leslie Markow"
Director

JEMTEC INC.

Statements of Operations and Retained Earnings For the years ended July 31,

	2005	2004
Revenue		
Leasing, monitoring and activation (note 8)	\$ 2,582,349	\$ 1,620,949
Parts, sales and other	17,963	3,596
	<u>2,600,312</u>	<u>1,624,545</u>
Expenses		
Salaries and benefits	252,836	184,974
Amortization	67,063	55,501
Repairs and maintenance	48,568	18,912
Monitoring and activation fees	400,258	348,511
Equipment rent and installation	159,411	77,138
Consulting fees	137,598	115,705
Travel	32,086	32,239
Shareholder communications	26,609	19,804
Professional fees	16,462	18,986
Office	98,215	72,511
Interest on capital leases	22,174	3,673
Other interest expenses	1,784	3,383
Stock-based compensation	65,067	-
Directors' fees	117,068	26,250
Accounting and administrative fees	20,500	25,300
	<u>1,465,699</u>	<u>1,002,887</u>
Income before income taxes	<u>1,134,613</u>	<u>621,658</u>
Income tax expense		
Current	409,744	103,483
Future	10,344	104,058
	<u>420,088</u>	<u>207,541</u>
Net income for the year	714,525	414,117
Deficit - Beginning of year	(436,657)	(850,774)
Retained Earnings (deficit) - End of year	\$ 277,868	\$ (436,657)
Earnings per share:		
Basic	\$ 0.33	\$ 0.20
Diluted	\$ 0.32	\$ 0.19
Weighted average number of shares outstanding:		
Basic	2,187,077	2,071,659
Diluted	2,240,114	2,200,826

The accompanying notes are an integral part of these financial statements

JEMTEC INC.

Statements of Cash Flows
For the years ended July 31,

	2005	2004
Cash flows from (used in) operating activities		
Net income for the year	\$ 714,525	\$ 414,117
Adjustments to reconcile net income to net cash used in operating activities:		
- amortization	67,063	55,501
- stock-based compensation	65,067	-
- future income taxes	10,344	104,058
Changes in non-cash working capital:		
- accounts receivable	(230,899)	(149,668)
- prepaid expenses	2,828	(2,712)
- accounts payable and accrued liabilities	105,079	66,926
- deferred revenue	12,615	10,500
- due to related parties	(54,250)	54,250
- income taxes payable	306,260	103,483
- income taxes recoverable	-	22,472
Cash flows - operating activities	998,632	678,927
Cash flows used in investing activities		
Purchase of property and equipment	-	(2,289)
Cash flows - investing activities	-	(2,289)
Cash flows from (used in) financing activities		
Bank loan	-	(5,000)
Proceeds from issuance of common stock	93,712	-
Payment on capital lease obligation	(90,586)	(25,735)
Cash flows - financing activities	3,126	(30,735)
Net increase in cash	1,001,758	645,903
Cash, beginning of year	697,998	52,095
Cash, end of year	\$ 1,699,756	\$ 697,998

The accompanying notes are an integral part of these financial statements

Supplemental cash disclosures

Cash paid for:

Income taxes	\$ 103,483	\$ -
Interest	\$ 23,958	\$ 7,056

Supplemental disclosure on non-cash financing and investing activities

During the year ended July 31, 2005, the Company entered into a capital lease for monitoring equipment in the amount of \$373,100.

JEMTEC INC.

Notes to Financial Statements

July 31, 2005 and 2004

1. Nature of Operations

The Company's core business is the provision of services and technology for offender monitoring in Canadian federal and provincial correctional departments.

2. Significant Accounting Policies

a) General

These financial statements have been prepared in Canadian dollars and in accordance with Canadian generally accepted accounting principles.

b) Use of estimates

The preparation of these financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the revenues and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates.

c) Currency and foreign exchange

The functional currency of the company is the Canadian dollar. Monetary assets and liabilities denominated in another currency are translated at exchange rates in effect at the balance sheet dates. Other non-monetary balance sheet items denominated in another currency are translated at the rates of exchange in effect at the time the items arose. Revenue and expenses are translated at the exchange rates in effect at the time of the transaction. Gains and losses arising from fluctuations in exchange rates are included in operations for the periods in which they occur.

d) Cash and cash equivalents

Cash and cash equivalents are defined as cash on hand and short term, highly liquid money market instruments with original maturities of three months or less.

e) Property and equipment

Property and equipment are stated at cost less accumulated amortization. Amortization is charged to earnings over the estimated useful lives of the respective assets at the following rates:

Furniture & fixtures	20% declining balance
Monitoring equipment	straight-line over 5 years or contract period
Demonstration equipment	20% declining balance

Expenditures for maintenance and repairs that do not improve or extend the life of the assets are expensed as operations, while major repairs are capitalized.

2. Significant Accounting Policies (continued)

f) Asset impairment

On an annual basis, or when impairment arises, the Company evaluates the future recoverability of its property and equipment. Impairment losses or write-downs are recorded in the event the net book value of such assets exceeds the estimated future cash flows attributable to such assets.

g) Revenue recognition

Rental and monitoring income is recognized pursuant to various lease agreements which specify the terms and conditions of rental and the services to be performed and electronic surveillance. Rental income is recognized on a straight-line basis over the terms of the leases. Revenue from the sale of parts which are required to repair and maintain the monitoring equipment is recognized upon delivery to the lessee. Maintenance and monitoring service income is recognized when the services are performed.

The Company recognizes sales and leasing revenue over the term of the applicable operating services agreements. The term of existing service agreements is between three and five years. Generally, the lessees have the option to renew or cancel the lease and service agreements upon the expiration of each lease term or, in certain circumstances, the agreements may be cancelled upon specific notice provided to the Company. In situations where leases are terminated, the leased monitoring equipment would be returned to the Company or the Company's lessors with no further obligation on behalf of the lessee.

h) Stock-based compensation

The Company follows the recommendations of CICA Handbook Section 3870 "*Stock-based Compensation and Other Stock-based Payments*" which establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. Effective for year ends beginning on or after January 1, 2004, these recommendation require that compensation for all awards made, including stock appreciation rights, direct awards of stock and awards that call for settlement in cash or other assets, be measured and recorded in the financial statements at fair value. For the purpose of this Section, employees include directors who receive stock compensation for services provided as director. This Section also sets out fair value based methods of accounting for stock options issued to employees.

For the years ended July 31, 2002 and 2003, no compensation expense was recognized for stock options granted to employees and directors, as the company was using the intrinsic method to account for the stock option grants. During the year ended July 31, 2004, the Company adopted, on a prospective basis, the fair value based method of accounting for stock based compensation for all grants of options to employees, non-employees and directors in accordance with the prospective application provision of Section 3870. All option grants beginning August 1, 2003 are accounted by using the fair value based method, and stock based compensation expense is computed the Black-Scholes option pricing model. Accordingly, the fair value of the stock options at the date of grant is charged to operations on a straight-line basis over the vesting period. Any consideration paid on exercise of stock options together with the related portion previously recognized as stock based compensation is credited to share capital.

2. Significant Accounting Policies (continued)

i) Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing earnings (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share has been calculated using the treasury stock method. This method assumes that common shares are issued for the exercise of warrants and options and that the assumed proceeds from the exercise of warrants and options are used to purchase common shares at the average market price during the period. The difference between the number of shares assumed issued and the number of shares assumed purchased is then added to the basic weighted average number of shares outstanding to determine the fully diluted number of common shares outstanding. No exercise or conversion is assumed during periods in which a net loss is incurred as the effect is anti-dilutive.

j) Income taxes

The Company uses the asset and liability method of accounting for income taxes whereby future income tax assets are recognized for deductible temporary differences and operating loss carry-forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in future income tax assets and liabilities during the period.

3. Financial Instruments

The Company's financial instruments recognized in the balance sheet consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank loan, due to related parties, income taxes payable, and capital lease obligations. The fair values of these instruments approximates their carrying value due to their short-term maturity or, in the case of the capital lease obligation, the rate implicit in the lease arrangements.

a) Credit risk

The Company performs certain credit evaluation procedures and does not require collateral for financial instruments subject to credit risk. The Company believes that credit risk is limited because the company routinely assesses the financial strength of its customers, and based upon factors surrounding the credit risk of its customers, establishes an allowance for uncollectible accounts and, as a consequence, believes that its account receivable credit risk beyond such allowances is limited.

The Company's principal business activities are located in Canada. The Company had net sales to two major customers during the year ended July 31, 2005.

The Company maintains cash deposits with financial institutions, which from time to time may exceed federally insured limits. The Company has not experienced any losses and believes it is not exposed to any significant credit risk from cash. At July 31, 2005, the Company had cash balances on deposit that exceeded federally insured limits.

3. Financial Instruments (continued)

b) Fair value

Unless otherwise noted, cash, accounts, advances and deposits receivable, loans and accounts payable are stated at amounts that approximate fair value.

c) Foreign exchange risk

The Company may be subject to limited currency risk due to the fluctuations of exchange rates amongst the Canadian and U.S. dollars.

d) Liquidity risk

The Company is exposed to liquidity risk as its continued operations are dependent upon the Company realizing its account receivable to satisfy its liabilities as they become due.

4. Property and Equipment

	July 31, 2005			July 31, 2004		
	Cost	Accumulated Amortization	Net Book Value	Costs	Accumulated Amortization	Net Book Value
Furniture and fixtures	\$ 35,676	\$ 34,074	\$ 1,602	\$ 35,676	\$ 33,500	\$ 2,176
Monitoring equipment	453,434	89,914	363,520	383,623	327,390	56,233
Demonstration equipment	8,653	8,653	-	8,653	7,977	676
	<u>\$ 497,763</u>	<u>\$ 132,641</u>	<u>\$ 365,122</u>	<u>\$ 427,952</u>	<u>\$ 368,867</u>	<u>\$ 59,085</u>

Included in monitoring equipment are assets under capital lease at a cost of \$453,434 (2004 - \$80,334) and a net book value of \$363,520 (2004 - \$24,100). During the year ended July 31, 2005, the Company removed \$303,289 (2004 - \$nil) of fully amortized monitoring equipment from its books as the equipment is no longer in use.

The Company amortizes its monitoring equipment over its estimated useful life as described in note 2. Such estimates are based on management's experience and expectations of the continued renewal of the contracts for which equipment is acquired or the use of existing equipment in new contracts. Advances in technology and other considerations could result in significant changes to the estimated lives of these assets or otherwise impact the ability of the Company to realize on existing monitoring equipment. In these circumstances, additional provisions could be required.

5. Capital Lease Obligation

Further minimum lease payments to capital leases are as follows:

		<u>Total</u>
Year ending July 31,	2006	\$ 101,216
	2007	90,645
	2008	90,645
	2009	85,470
	2010	<u>-</u>
		\$ 367,976
Less: amounts representing interest (8%)		<u>(47,961)</u>
Present value of minimum lease payments		320,015
Less: current portion		<u>(81,093)</u>
		<u>\$ 238,922</u>

A general security agreement over all of the assets of the Company has been pledged as security for the capital lease obligations.

6. Bank Credit Facility and Loan Agreement

The Company has arranged an uncommitted term operating loan which is available to a maximum amount of \$75,000. The loan, if committed, would be due on demand, would bear interest at bank prime plus 1.3% per annum and would be secured by a general security agreement over all of the assets of the Company.

7. Share Capital

a) Authorized

Common shares:	Unlimited, no par value
First preference shares:	Unlimited, no par value, issuable in series
Second preference shares:	25,000 Series A, \$0.60 non-cumulative and redeemable

b) Issued and allotted

	<u>Number of Common Shares</u>	<u>Amount</u>
Balance July 31, 2004 and 2003	2,071,659	\$1,112,993
Shares issued for exercise of stock options	<u>284,284</u>	<u>\$134,167</u>
Balance July 31, 2005	<u>2,355,943</u>	<u>\$1,247,160</u>

7. Share Capital (continued)

c) Options

During the year ended July 31, 2003, the Company adopted a fixed stock option plan that permits the directors of the company to grant incentive stock options to employees, directors and consultants to the Company. The maximum number of shares issuable under the plan, which follows the policies of the TSX Venture Exchange ("TSXV") regarding stock option awards, is 414,332. Options granted under the plan vest in 6 equal installments over a period of 18 months, with the first installment vesting immediately, and the remaining options vesting upon 6, 9, 12, 15 and 18 months after the date of grant. The option exercise price is generally set as the market price at the time of grant; however, a discount from the market price is permitted under the plan, subject to the policies of the TSX Venture Exchange.

The table below summarizes the options that have been granted under the Company's stock options plan.

	Number of Options	Weighted Average Exercise Price
Outstanding, July 31, 2004 and 2003	300,000	\$ 0.21
Granted	330,000	\$ 0.86
Exercised	<u>(284,284)</u>	\$ 0.33
Outstanding, July 31, 2005	<u>345,716</u>	\$ 0.84

Prior to August 1, 2003, the Company applied the intrinsic value based method of accounting for stock based compensation granted under the Company's fixed stock option plan to employees and directors.

Had compensation cost been determined based on the fair value at the grant dates for awards under the plan consistent with the fair value based method of accounting for stock based compensation, the Company's net loss and loss per share would have been increased to the pro-forma amounts indicated below. The fair value of the options granted in the fiscal year ended July 31, 2005 was estimated on the date of grant using the Black-Scholes option pricing model, assuming risk-free interest rates of 3.96%; dividend yield of \$nil; expected lives of 5 years and volatility of 122%.

	Year Ended July 31,	
	2005	2004
Net Income		
As reported	\$ 714,525	\$ 414,117
Pro-forma	\$ 712,219	\$ 404,891
Basic Earnings per Share		
As reported	\$ 0.33	\$ 0.20
Pro-forma	\$ 0.33	\$ 0.20
Diluted Earnings per Share		
As reported	\$ 0.32	\$ 0.19
Pro-forma	\$ 0.32	\$ 0.18

7. Share Capital (continued)

During the year ended July 31, 2005, the Company granted 330,000 stock options. The fair value of the options granted is charged to earnings over the vesting period of 18 months. During the year ended July 31, 2005, 284,284 options were exercised, for net proceeds of \$93,712. Stock-based compensation expense was credited to contributed surplus in the amount of \$65,067. Of this amount, \$40,455 was credited to share capital upon the exercise of previously vested stock options.

Options outstanding at July 31, 2005 are as follows:

# of Options Granted	Expiry	Exercise Price	Number Outstanding as at July 31, 2005	Options Outstanding		Options Exercisable	
				Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Vested as at July 31, 2005	Weighted Average Exercise Price
150,000	8-Feb-08	\$ 0.11	50,000	0.37	\$ 0.02	50,000	\$ 0.07
50,000	21-Sep-09	\$ 0.30	50,000	0.60	\$ 0.04	24,999	\$ 0.09
<u>280,000</u>	23-Jun-10	\$ 1.10	<u>245,716</u>	<u>3.48</u>	<u>\$ 0.78</u>	<u>5,714</u>	<u>\$ 0.08</u>
480,000			345,716	4.45 years	\$ 0.84	80,713	\$ 0.24

8. Economic Dependence

The Company presently derives substantially all of its revenue from two customers of which one customer contributed approximately 93% of revenue in 2005 and 88% in 2004. These contracts are reviewed periodically and have cancellation provisions. The non-renewal or cancellation of one or more of these contracts could have a material adverse impact on the Company.

Also, the Company is the exclusive Canadian distributor of Pro-Tech Monitoring, Inc.'s ("Pro-Tech") and BI Inc.'s (both U.S. companies) offender monitoring and tracking devices, the sales and leasing of which account for substantially all of the Company's 2005 and 2004 revenues, capital asset additions and replacement parts purchased. The Company is economically dependent on Pro-Tech and BI Inc. for the continued supply of monitoring equipment, replacement parts, and maintenance services provided by Pro-Tech and BI Inc. for resale or rental by the Company.

9. Related Party Balances and Transactions

At July 31, 2005, there are no amounts due to related parties. At July 31, 2004, due to related parties included \$28,000 as payable to the President of the Company (who is also a director) under an incentive bonus agreement, and also included \$26,250 owed to directors as directors' fees. During the year ended July 31, 2005, \$47,250 (2004 - \$28,000) was paid to a director as an incentive bonus, and \$117,068 (2004 - \$26,250) was paid to the directors of the Company as directors fees.

JEMTEC INC.
Notes to Financial Statements
July 31, 2005 and 2004

10. Income Taxes

A reconciliation of the combined federal and provincial income taxes at statutory rates and the Company's effective income tax expense is as follows:

	<u>2005</u>	<u>2004</u>
Net income before income taxes	<u>\$ 1,134,613</u>	<u>\$ 621,658</u>
Income taxes at Canadian and provincial statutory rates of 36% (2004 - 37%)	408,460	227,402
Increase (decrease) by the effects of		
Non-deductible items	31,993	1,715
Other	<u>(20,365)</u>	<u>(21,576)</u>
Income tax expense	<u>\$ 420,088</u>	<u>\$ 207,541</u>

Future tax assets of the Company are as follows:

	<u>2005</u>	<u>2004</u>
Excess of book over tax amortization	<u>\$ 41,947</u>	<u>\$ 52,291</u>
	<u>\$ 41,947</u>	<u>\$ 52,291</u>

As at July 31, 2005 and 2004, the Company believes that it is more likely than not that the excess capital cost allowance pools available of \$116,519 for tax purposes and \$Nil in operating losses carried forward will be utilized in the future. Thus, no valuation allowance has been recorded as at July 31, 2005 and 2004, and a future tax asset representing the sum of the tax amortization pools over net book values available for application against future taxable income was recorded.

11. Earnings per Share

The following table shows the effect of dilutive securities on the weighted average common share outstanding. No adjustments to earnings were required for the calculation of diluted earnings per share.

	<u>2005</u>	<u>2004</u>
	<u>Number of shares</u>	<u>Number of shares</u>
Basic weighted average shares outstanding	2,187,077	2,071,659
Effect of dilutive securities:		
Options	<u>53,037</u>	<u>129,167</u>
Diluted weighted average shares outstanding	<u>2,240,114</u>	<u>2,200,826</u>

Options to purchase 245,716 (2004: - Nil) common shares at a price of \$1.10 (2004 - \$Nil) per share were outstanding at July 31, 2005, but were not included in the computation of diluted earnings per share because the respective exercise price exceeded the average market price of the common shares.