

JEMTEC INC.

Financial Statements
July 31, 2006 and 2005

AUDITORS' REPORT

To the Shareholders of JEMTEC Inc.

We have audited the balance sheets of JEMTEC Inc. as at July 31, 2006 and 2005, 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, 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.

Vancouver, Canada

October 25, 2006

"Morgan & Company"

Chartered Accountants

JEMTEC INC.

Balance Sheets

	July 31, 2006	July 31, 2005
ASSETS		
Current		
Cash and cash equivalents	\$ 2,109,097	\$ 1,699,756
Accounts receivable	473,150	473,293
Prepaid expenses and deposits	21,525	1,500
Total current assets	2,603,772	2,174,549
Property and equipment (note 4)	281,322	365,122
Future income taxes	34,258	41,947
Total assets	\$ 2,919,352	\$ 2,581,618
LIABILITIES		
Current		
Accounts payable and accrued liabilities (note 7(b))	\$ 367,952	\$ 279,105
Deferred revenue	27,923	23,115
Current portion of capital lease obligation (note 5)	75,788	81,093
Income taxes payable	158,721	409,743
Total current liabilities	630,384	793,056
Capital lease obligation (note 5)	163,815	238,922
Total liabilities	794,199	1,031,978
SHAREHOLDERS' EQUITY		
Share capital (note 7)	1,215,250	1,247,160
Contributed surplus (note 7 (c))	194,830	24,612
Retained earnings (note 7 (b))	715,073	277,868
Total shareholders' equity	2,125,153	1,549,640
Total liabilities and shareholders' equity	\$ 2,919,352	\$ 2,581,618

The accompanying notes are an integral part of these audited financial statements

Approved by the Board of Directors:

"Eric Caton"
Director

"Leslie Markow"
Director

JEMTEC INC.

Statements of Operations and Retained Earnings

	For the year ended July 31,	
	2006	2005
Revenue		
Leasing, monitoring and activation (note 8)	\$ 2,645,686	\$ 2,582,349
Parts, sales and other	-	3,728
Interest income	55,811	14,235
	<u>2,701,497</u>	<u>2,600,312</u>
Expenses		
Salaries and benefits	222,851	252,836
Amortization	92,219	67,063
Repairs and maintenance	26,727	48,568
Monitoring and activation fees	538,272	400,258
Equipment rent and installation	234,591	159,411
Consulting fees	155,041	137,598
Travel	33,571	32,086
Shareholder communications	65,355	26,609
Professional fees	61,316	16,462
Office	117,081	98,215
Interest on capital leases	20,123	22,174
Other interest expenses	5,523	1,784
Stock-based compensation (note 7 (c))	170,218	65,067
Directors' fees	53,500	117,068
Accounting and administrative fees	36,835	20,500
	<u>1,833,223</u>	<u>1,465,699</u>
Income before income taxes	<u>868,274</u>	<u>1,134,613</u>
Income tax expense		
Current	367,387	409,744
Future	7,689	10,344
	<u>375,076</u>	<u>420,088</u>
Net income for the period	<u>493,198</u>	<u>714,525</u>
Retained earnings (deficit) - Beginning of period	<u>277,868</u>	<u>(436,657)</u>
Effect of share consolidation (note 7 (b))	<u>(55,993)</u>	<u>-</u>
Retained earnings - End of period	<u>\$ 715,073</u>	<u>\$ 277,868</u>
Earnings per share:		
Basic	\$ 0.21	\$ 0.33
Diluted	\$ 0.20	\$ 0.32
Weighted average number of shares outstanding:		
Basic	2,340,768	2,187,077
Diluted	2,412,213	2,240,114

The accompanying notes are an integral part of these audited financial statements

JEMTEC INC.

Statements of Cash Flows

For the year ended July 31,
2006 2005

	2006	2005
Cash flows from (used in) operating activities		
Net income for the year	\$ 493,198	\$ 714,525
Adjustments to reconcile net income to net cash used in operating activities:		
- amortization	92,219	67,063
- stock-based compensation	170,218	65,067
- future income taxes	7,689	10,344
Changes in non-cash working capital:		
- accounts receivable	143	(230,899)
- prepaid expenses	(20,025)	2,828
- accounts payable and accrued liabilities	8,067	105,079
- deferred revenue	4,808	12,615
- due to related parties	1,600	(54,250)
- income taxes payable	(251,022)	306,260
Cash flows - operating activities	506,895	998,632
Cash flows from (used in) investing activities		
Payment to shareholders (note 7 (b))	(8,723)	-
Purchase of property and equipment	(8,419)	-
Cash flows - investing activities	(17,142)	-
Cash flows from (used in) financing activities		
Shares issued for cash	-	93,712
Payment on capital lease obligation	(80,412)	(90,586)
Cash flows - financing activities	(80,412)	3,126
Net increase in cash	409,341	1,001,758
Cash and cash equivalents, beginning of year	1,699,756	697,998
Cash and cash equivalents, end of year	\$ 2,109,097	\$ 1,699,756

The accompanying notes are an integral part of these audited financial statements

Supplemental cash disclosures

Cash paid for:

Income taxes	\$ 618,409	\$ 103,483
Interest	\$ 25,646	\$ 23,958

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 in Canada 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

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.

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.

2. Significant Accounting Policies (continued)

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 for 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. 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.

The Company uses the fair value based method of accounting for stock based compensation for all grants of options to employees, non-employees and directors. All option grants are accounted for by using the fair value based method, and stock based compensation expense is computed using 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.

i) Earnings per share

Basic earnings 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.

2. Significant Accounting Policies (continued)

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, 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's principal business activities are located in Canada. 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, 2006.

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, 2006, the Company had cash balances on deposit that exceeded federally insured limits by \$2,007,513. All of these funds are on deposit with a Schedule A bank in Canada.

b) Fair value

Unless otherwise noted, cash, accounts receivable, accounts payable, income tax payable and capital lease obligation are stated at amounts that approximate fair value.

c) Foreign exchange risk

The Company is subject to currency risk due to the fluctuations of exchange rates between the Canadian and U.S. dollars. The Company pays for replacement parts and rental and monitoring services from suppliers in U.S. dollars. All of the Company's sales are received in Canada 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.

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4. Property and Equipment

	July 31, 2006			July 31, 2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Furniture and fixtures	\$ 40,351	\$ 35,170	\$ 5,181	\$ 35,676	\$ 34,074	\$ 1,602
Monitoring equipment	457,178	181,037	276,141	453,434	89,914	363,520
	<u>\$ 497,529</u>	<u>\$ 216,207</u>	<u>\$ 281,322</u>	<u>\$ 489,110</u>	<u>\$ 123,988</u>	<u>\$ 365,122</u>

Included in monitoring equipment are assets under capital lease at a cost of \$373,100 (2005 - \$453,434) and a net book value of \$248,733 (July 31, 2005 -\$363,520).

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

Future minimum lease payments on capital leases are payable as follows:

	Principal	Imputed Interest	Total
Year ending July 31, 2007	75,788	14,857	90,645
2008	81,300	9,344	90,644
2009	82,515	2,955	85,470
2010	-	-	-
	<u>239,603</u>	<u>27,156</u>	<u>\$266,759</u>
Less: amounts representing interest (8%)			<u>(27,156)</u>
Present value of minimum lease payments			239,603
Less: current portion			<u>(75,788)</u>
			<u>\$163,815</u>

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

6. Bank Credit Facility and Loan Agreement

The Company has arranged an unutilized term operating loan which is available to a maximum amount of \$75,000. The loan, if utilized, 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, no par value, redeemable, \$0.60 non-cumulative dividend

b) Issued and allotted

	Number of Common Shares	Amount
Balance July 31, 2004	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	2,355,943	1,247,160
Effect of share consolidation	<u>(60,207)</u>	<u>(31,910)</u>
Balance July 31, 2006	<u><u>2,295,736</u></u>	<u><u>\$ 1,215,250</u></u>

Pursuant to a special resolution passed by shareholders on April 21, 2006, the Company consolidated its common shares on a 100 old shares for 1 new share basis effective April 30, 2006, subsequently followed by a 1 for 100 share split effective May 1, 2006. Shareholders holding less than 100 pre-consolidation shares are entitled to receive a cash payment of \$1.46 per share. Accordingly, at April 30, 2006, 60,207 shares were cancelled, a charge of \$55,993 was made to retained earnings, share capital was reduced by the paid up capital of the common shares on the day of the transaction of \$31,910 and \$87,903 was accrued for shareholders entitled to redeem their shares under this agreement. At July 31, 2006, \$79,180 remains in accounts payable and accrued liabilities for the shareholders who have yet to contact the Company regarding this transaction.

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, was 414,332. In January 2006, the Company amended its stock option plan to increase the number of shares reserved for issuance under the plan to 471,188. 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.

7. Share Capital (continued)

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

	Number of Options	Weighted Average Exercise Price
Outstanding, July 31, 2004	300,000	\$ 0.21
Granted	330,000	\$ 0.86
Exercised	<u>(284,284)</u>	\$ 0.33
Outstanding, July 31, 2005 and 2006	<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. The Company adopted the fair value based method on a prospective basis. Had the Company recorded the effect of unvested options on the date of the adoption of the fair value method, the pro-forma effect of the unvested options granted prior to August 1, 2003, would be as follows:

	Year Ended July 31,	
	2006	2005
Net Profit		
As reported	\$ 493,198	\$ 714,525
Pro-forma	\$ 493,198	\$ 712,219
Basic Profit per Share		
As reported	\$ 0.21	\$ 0.33
Pro-forma	\$ 0.21	\$ 0.33
Diluted Profit per Share		
As reported	\$ 0.20	\$ 0.32
Pro-forma	\$ 0.20	\$ 0.32

During the year ended July 31, 2005, the Company granted 330,000 stock options. Stock-based compensation expense of \$65,067 resulted and, of this amount, \$40,455 was credited to share capital upon the exercise of previously vested stock options and \$24,612 was credited to contributed surplus. The fair value of the options granted is charged to earnings over the vesting period of 18 months. 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%.

During the year ended July 31, 2005, 284,284 options were exercised, for net proceeds of \$93,712.

During the year ended July 31, 2006, stock-based compensation expense related to vesting of the 2005 stock option was credited to contributed surplus in the amount of \$170,218.

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7. Share Capital (continued)

Options outstanding at July 31, 2006 are as follows:

	# of Options Granted	Expiry	Exercise Price	Number Outstanding as at July 31, 2006	Options Outstanding		Options Exercisable	
					Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Vested as at July 31, 2006	Weighted Average Exercise Price
Granted, February 26, 2003	150,000	8-Feb-08	\$ 0.11	50,000	1.53	\$ 0.11	50,000	\$ 0.11
Granted, September 21, 2004	50,000	21-Sep-09	\$ 0.30	50,000	3.15	\$ 0.30	50,000	\$ 0.30
Granted, June 9, 2005	<u>280,000</u>	23-Jun-10	\$ 1.10	<u>245,716</u>	3.90	\$ 1.10	<u>152,385</u>	\$ 1.10
	<u>480,000</u>			<u>345,716</u>	3.44	\$ 1.51	<u>252,385</u>	\$ 0.75

8. Economic Dependence

The Company presently derives substantially all of its revenue from two customers of which one customer contributed approximately 90% of revenue in the year ended July 31, 2006 (2005 - 93%). These contracts are reviewed periodically and have cancellation provisions. The non-renewal or cancellation of one or more of these contracts would have a material adverse impact on the Company.

The Company is a Canadian distributor of Pro-Tech Monitoring, Inc.'s ("Pro-Tech") and the exclusive Canadian distributor of 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 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, 2006, \$1,600 (2005 - \$0) is due to a director. During the year ended July 31, 2006, \$1,600 (2005 - \$47,250) was accrued or paid to a director who is the President of the Company under an incentive bonus plan in addition to salaries and benefits paid to the president as management compensation in the normal course of operations.

During the year ended July 31, 2006, \$19,382 (2005 - \$Nil) was paid to an officer of the Company for accounting fees.

During the year ended July 31, 2006, \$53,500 (2005 - \$117,068) was paid to the directors of the Company as directors fees.

JEMTEC INC.
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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>2006</u>	<u>2005</u>
Net income before taxes	\$ 868,274	\$ 1,134,613
Income taxes at federal and provincial statutory rates of 36% (2005 - 36%)	312,579	408,460
Increase (decrease) by the effect of		
Non-deductible items	70,440	31,993
Other	(7,943)	(20,365)
Income tax expense	<u>\$ 375,076</u>	<u>\$ 420,088</u>

Future tax assets of the Company are as follows:

	<u>2006</u>	<u>2005</u>
Excess of book over tax amortization	\$ 34,258	\$ 41,947
	<u>\$ 34,258</u>	<u>\$ 41,947</u>

As at July 31, 2006 and 2005, the Company believes that it is more likely than not that the excess capital cost allowance pools available of \$95,161 for tax purposes will be utilized in the future. Thus, no valuation allowance has been recorded as at July 31, 2006 and 2005, 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.

	Year Ended July 31,	
	<u>2006</u>	<u>2005</u>
	Number of shares	
Basic weighted average shares outstanding	2,340,768	2,187,077
Effect of dilutive securities:		
Options	<u>71,445</u>	<u>53,037</u>
Diluted weighted average shares outstanding	<u>2,412,213</u>	<u>2,240,114</u>

11. Earnings per Share (continued)

Options to purchase Nil (2005: 245,716) common shares at a price of \$1.10 per share were outstanding at July 31, 2006, 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.