

# **AUDIOTECH HEALTHCARE CORPORATION**

## **SCHEDULE A: Consolidated Financial Statements**

Period ended December 31, 2004

(Unaudited – prepared by Management)

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Balance Sheets

December 31, 2004, with comparative figures for September 30, 2004

	Dec 31 2004	Sep 30 2004
<b>Assets</b>		
Current assets:		
Cash	\$ 511,866	\$ 608,295
Term deposit	15,962	15,962
Accounts receivable	358,150	361,187
Inventory	37,503	73,343
Prepaid expenses	5,259	5,916
	<u>928,740</u>	<u>1,064,703</u>
Property, plant and equipment (note 2)	670,723	519,455
Goodwill	942,775	942,775
	<u>\$ 2,542,238</u>	<u>\$ 2,526,933</u>

## Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 431,541	\$ 512,313
Unearned revenue	15,617	36,427
Current portion of long-term debt	150,952	151,170
Current portion of obligation under capital lease	22,190	13,630
	<u>620,300</u>	<u>713,540</u>
Long-term debt (note 3)	1,041,325	959,812
Obligation under capital lease (note 4)	50,952	24,337
Shareholders' equity:		
Share capital (note 5)	1,635,840	1,635,840
Other paid in capital (note 3)	210,000	176,000
Cumulative translation account	(27,824)	(24,529)
Deficit	<u>(988,355)</u>	<u>(958,067)</u>
	829,661	829,244
Commitments (note 10)		
	<u>\$ 2,542,238</u>	<u>\$ 2,526,933</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

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"Osvaldo (Ozzie) Iadarola" Director      "Grant Robertson" Director

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Statements of Operations and Deficit

Period ended December 31, 2004, with comparative figures for December 31, 2003

	Dec 31 2004 3 months	Dec 31 2003 3 months
Sales	\$ 1,013,716	\$ 777,069
Direct clinic costs:		
Materials and freight	408,515	351,217
Selling expenses	97,525	17,334
Rent, utilities and clinic overheads	64,430	79,489
Amortization	19,263	17,432
Salaries and benefits	294,587	211,642
	884,320	677,114
	129,397	99,955
Expenses:		
General and administrative	22,323	12,516
Amortization	744	405
Professional fees	6,210	6,297
Foreign exchange	3,632	3,259
Interest on long-term debt	25,636	20,858
Salaries and benefits	53,056	51,206
	113,601	94,541
Income (loss) before other expenses	17,796	5,414
Other expenses:		
Loss on disposal of equipment	-	-
Amortization of debenture discount	14,084	-
	14,084	-
Net earnings (loss) for the period	3,712	5,414
Deficit, beginning of period	(958,067)	(1,111,714)
Prior period adjustment – stock options	(34,000)	-
Deficit, end of period	(988,355)	\$ (1,103,041)
Weighted average number of shares outstanding	13,329,825	13,329,825
Earnings (loss) per share (basic and diluted)	\$ 0.0003	\$ 0.0004

See accompanying notes to consolidated financial statements.

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Statements of Cash Flows

Period ended December 31, 2004, with comparative figures for December 31, 2003

	Dec 31 2004 3 months	Dec 31 2003 3 months
Cash flows from operating activities:		
Net earnings (loss)	\$ 3,712	\$ 8,673
Items not involving cash:		
Amortization of plant and equipment	20,007	17,837
Loss on disposal of equipment	-	-
Amortization of debenture discount	14,084	-
	<u>37,804</u>	<u>26,510</u>
Change in non-cash operating working capital:		
Accounts receivable	(1,994)	10,301
Inventory	34,756	27,662
Prepaid expenses	571	19,874
Accounts payable	(75,272)	(32,635)
Unearned revenue	(20,810)	(7,373)
	<u>(24,945)</u>	<u>44,339</u>
Financing:		
Proceeds from long-term debt	132,295	-
Principal payments on long-term debt	(53,292)	(24,201)
Repayment of obligation under capital lease	(3,921)	-
	<u>74,082</u>	<u>(24,201)</u>
Investing:		
Purchases of property, plant and equipment	(145,598)	(8,686)
Proceeds on disposal of equipment	-	-
Reduction of term deposit	-	10,000
	<u>(145,598)</u>	<u>1,314</u>
Effect of changes in exchange rates on foreign denominated cash	(3,409)	(8,728)
Increase in cash	(96,429)	12,724
Cash, beginning of year	608,295	329,875
Cash, end of year	<u>\$ 511,866</u>	<u>\$ 342,599</u>

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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Audiotech Healthcare Corporation (the "Company") is incorporated under the laws of the Province of Alberta. Its primary activity is the provision of hearing related services and sale of hearing related devices through its clinics in British Columbia, Alberta and Idaho.

## 1. Significant accounting policies:

### (a) Basis of presentation:

The consolidated financial statements include the accounts of the Company's wholly-owned subsidiaries Canadian Hearing Care (BC) Inc., Canadian Hearing Care (Alberta) Inc., HearingDepot Inc., Canadian Hearing Network Canada Inc., American Hearing Care Corporation and Audiology and Hearing Aid Services, Inc.

All significant intercompany balances and transactions have been eliminated on consolidation.

### (b) Inventory:

Inventory is recorded at the lower of cost, as determined on a specific item basis, and net realizable value.

### (c) Property, plant and equipment:

Property, plant and equipment are recorded at cost. Property under capital lease is initially recorded at the present value of minimum lease payments at the inception of the lease. Amortization is provided using the following methods and annual rates:

Asset	Basis	Rate
Audiology equipment	Declining balance	20%
Computer equipment	Declining balance	30% and 45%
Leasehold improvements	Straight-line	20%

### (d) Goodwill:

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

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (d) Goodwill (continued):

Goodwill is not amortized and is tested for impairment annually, or more frequently if events or changes in circumstances indicate the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case the implied fair value of the unit's goodwill is compared with its carrying amount to measure the impairment loss, if any. The implied fair value of the goodwill is determined in the same manner as the value of goodwill is determined in a business combination described in the preceding paragraph, using the fair value of the reporting unit as if it was the purchase price. When the carrying amount of reporting unit goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess and is presented as a separate line item in the statement of operations and deficit.

### (e) Revenue recognition:

Revenue from sales of product is recognized when title passes to the customer, net of an estimated allowance for sales returns. Service revenue is recognized at the time service is provided. Amounts received in advance for products which have not yet transferred title are recorded as unearned revenue.

### (f) Foreign currency:

The Company's investment in its foreign operations is of a self-sustaining nature. Accordingly, assets and liabilities of foreign operations are translated to Canadian dollars at the exchange rates in effect at the balance sheet date and revenues and expenses are translated at average rates for the period. Related foreign currency translation adjustments are recorded as a separate component of shareholders' equity and included in the cumulative translation account.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (g) Stock-based compensation:

Effective October 1, 2004, the Company retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants Handbook Amended Section 3870, Stock Based Compensation and Other Stock-based Payments, ("Amended Section 3870"). Amended Section 3870 requires the Company to account for stock-based compensation awards granted to employees, officers, and directors, on or after January 1, 2002, using the fair value based method.

The Company has a stock-based compensation plan as described in note 5(b). No compensation cost is recorded for all other stock based employee compensation awards. Consideration paid by employees on the exercise of stock options is recorded as share capital and contributed surplus.

Under the fair value based method, stock based payments to non employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued or liabilities incurred whichever is more reliably measurable. The fair value of stock based payments to non employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock based payments to non-employees that are fully vested and non forfeitable at the grant date is measured and recognized at that date.

Under the fair value based method, compensation cost attributable to awards to employees that call for settlement in cash or other assets is measured at the intrinsic value and recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. In accordance with the Amended Section 3870, the Company has estimated the fair value of stock options granted to employees and directors on or after January 1, 2002 using the Black-Scholes Options Pricing Model, and recorded an adjustment to opening retained earnings and share capital in the amount of \$34,000, representing the expense for the period from January 1, 2002 to September 30, 2004.

Under the fair value based method, compensation cost attributable to awards to employees that call for settlement in cash or other assets is measured at the intrinsic value and recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. For awards that vest at the end of the vesting period, compensation cost is recognized on a straight-line basis; for awards that vest on a graded basis, compensation cost is recognized on a pro-rata basis over the vesting period.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 1. Significant accounting policies (continued):

### (h) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the 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 enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

### (i) Earnings per share:

Basic earnings per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings per share are computed similar to basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated assuming that outstanding stock options were exercised and the proceeds from such exercise were used to acquire shares of common stock at the average market price during the reporting period.

### (j) Use of estimates:

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

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 2. Property, plant and equipment:

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	Cost	Accumulated amortization	Dec 31 2004 Net book value	Sep 30 2004 Net book value
Land	\$ 104,410	\$ -	\$ 104,410	\$ 109,587
Construction in progress	191,556	-	191,556	67,295
Audiology equipment	932,968	678,694	254,274	268,360
Computer equipment	69,781	34,733	35,048	23,585
Leasehold improvements	55,856	43,051	12,805	14,045
	1,354,571	756,478	598,093	482,872
Audiology equipment under capital lease	81,494	8,864	72,630	36,583
	\$ 1,436,065	\$ 765,342	\$ 670,723	\$ 519,455

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Amortization expense of \$20,007 (2003 - \$17,837) has been charged to earnings in the current period.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
 Period ended December 31, 2004

## 3. Long-term debt:

	Dec 31 2004	Sep 30 2004
Convertible debentures, bearing interest at 10% per annum, maturing April 2007. Debentures are convertible at the holder's option into common shares at prices of \$0.20 per common share in year 1, \$0.22 per common share in year 2 and \$0.25 per common share in year 3. Face value of debentures is \$629,000 and is recorded net of unamortized debenture discount of \$132,582.	496,418	482,334
Equipment loans repayable based on thirteen instalments per annum of \$3,935 each including interest at 5%. Unsecured. Due 2006.	74,855	90,595
Term loan, repayable in monthly instalments of \$4,167, plus an annual payment of interest at a rate of 5.5% per annum. Secured by all assets of the Company. Due 2009.	220,833	233,333
Term loan, repayable in quarterly instalments of \$6,308 plus interest at prime plus 2%. Secured by promissory note of the Company subordinated to the security agreement on the previous term line noted above, and a continuing guarantee. Due 2009.	114,013	126,160
Construction loan draws available to an approximate maximum of \$389,000, bearing interest at 8.5% per annum, repayable in monthly instalments of \$3,834 including interest beginning no later than April 1, 2005. Secured by a first position Deed of Trust on real property and guarantees of the Company. Due April, 2010.	176,531	67,295
Promissory notes repayable in monthly instalments of \$1,450 including interest at 10% per annum. Due June, 2005.	109,627	111,265
	<u>1,192,277</u>	<u>1,110,982</u>
Current portion of long-term debt	150,952	151,170
	<u>\$ 1,041,325</u>	<u>\$ 959,812</u>

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

### 3. Long-term debt (continued):

During the year ended September 30, 2004, the Company issued new convertible debentures in the amount of \$629,000 and has allocated proceeds between the fair value of the equity and liability components as required for compound financial instruments. The fair value of the equity component was determined using the Black-Scholes option pricing model with residual proceeds assigned to the liability component. As a result, \$176,000 was recorded as other paid in capital and \$453,000 as long-term debt. The discount to face value of the long-term debt is being amortized over the life of the debentures.

The construction loan balance as at December 31, 2004 consists of draws for costs incurred on the construction project to that date. The total loan is expected to be \$389,356 upon completion of construction in 2005.

The estimated principal repayments required in the next five years are as follows:

2005	\$	150,952
2006		140,347
2007		749,936
2008		123,774
2009		94,567
Thereafter		67,299
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		\$ 1,192,277

### 4. Obligation under capital lease:

The Company has financed certain equipment purchases by entering into a capital leases. Capital lease repayments are due as follows:

	Dec 31	Sep 30
	2004	2004
2005	\$ 26,637	\$ 15,216
2006	26,637	15,216
2007	18,179	10,144
2008	11,126	-
	<hr/>	<hr/>
	82,579	40,575
Less: amount representing interest	9,437	2,608
	<hr/>	<hr/>
	73,142	37,967
	<hr/>	<hr/>
Less: current portion	22,190	13,630
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	\$ 50,952	\$ 24,337

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 5. Share capital:

(a) Authorized and issued share capital:

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	Dec 31 2004	Sep 30 2004
Authorized:		
Unlimited number of voting common shares without par value		
Unlimited number of first preferred shares, ranking in priority to all other classes of shares, issuable in one or more series with designation, rights, privileges, restrictions and conditions determined by the Board of Directors upon issuance		
Unlimited number of second preferred shares, ranking in priority to all other classes of shares with exception the holders of first preferred shares, issuable in one or more series with designation, rights, privileges, restrictions and conditions determined by the Board of Directors upon issuance		
Issued:		
13,329,825 common shares (September 30, 2004 - 13,329,825 common shares)	\$ 1,635,840	\$ 1,635,840

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(b) Stock options:

The Company's stock option plan allows the Company to issue incentive share purchase options to a rolling maximum of 10% of the Company's issued and outstanding shares to directors, senior officers, consultants and employees. Upon granting of stock options, the Company will conclude a written Stock Option Agreement with the recipient.

The option price can not be less than the Discounted Market Price provided the option price is not be less than \$0.10 per share. Discounted Market Price is defined in Policy 1.1 of the TSX Venture Exchange to mean the market price (which is typically the last closing price on the day before option is granted) less a discount which is prescribed based on the Company's share price. The applicable discount is 25% for share prices up to \$0.50 per share; 20% for share prices between \$0.51 and \$2.00 per share; and 15% for share prices above \$2.00 per share. The maximum term of any option will be ten years and the Company may terminate an option at any time without notice.

During the year ended September 30, 2004, the Company granted 450,000 options to employees and directors of the Company under the terms of its stock option plan. As at December 31, 2004, the Company has 925,000 options outstanding with authority to issue a further 407,983 options based on the presently issued and outstanding share capital.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

## 5. Share capital (continued):

	Dec 31 2004 Number of options	Weighted average exercise price	Sep 30 2004 Number of options	Weighted average exercise price
Balance, beginning of year	925,000	\$ 0.21	545,000	\$ 0.28
Granted during the period	-		450,000	0.16
Expired during the period	-		(70,000)	(0.45)
Balance, end of period	925,000	\$ 0.21	925,000	\$ 0.21

Details of the Company's outstanding options at December 31, 2004 are as follows:

Exercise	Expiry	Price	Number
Employee	February 24, 2005	0.22	225,000
Employee	February 2, 2006	0.35	50,000
Employee	June 9, 2007	0.28	200,000
Employee	May 18, 2009	0.16	450,000
Balance, end of year			925,000

No compensation costs were recorded in the consolidated statement of earnings for the period for options granted to employees (2004 – nil), as no options were issued during the period.

## 6. Income taxes:

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory tax rates of 35.60% (2003 - 37.60%) to earnings before income taxes, due to use of tax loss carryforwards not previously recognized, and the difference in effective tax rates for the company's self-sustaining U.S. operations. During the 3 months ended December 31, 2004, and the comparative period in fiscal 2004, all income taxed that would have been otherwise payable have been offset by the use of tax loss carryforwards not previously recognized.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Period ended December 31, 2004

## 7. Segmented information:

The Company operates a single operating segment, hearing related services and sale of hearing related devices, in Canada and the United States. Geographic segmented information is as follows:

	Dec 31 2004	Dec 31 2003
Revenue:		
Canada	\$ 651,653	\$ 442,832
United States	362,063	334,237
	<u>\$ 1,013,716</u>	<u>\$ 777,069</u>
Interest expense:		
Canada	\$ 27,084	\$ 25,207
United States	5,496	1,680
	<u>\$ 32,580</u>	<u>\$ 26,887</u>
Amortization expense:		
Canada	\$ 27,850	\$ 14,855
United States	6,241	2,982
	<u>\$ 34,091</u>	<u>\$ 17,837</u>
Earnings (loss) before income taxes:		
Canada	\$ (17,922)	\$ (7,076)
United States	21,634	15,748
	<u>\$ 3,712</u>	<u>\$ 8,673</u>
Equipment and leasehold improvements:		
Canada	\$ 239,784	\$ 242,114
United States	430,939	57,061
	<u>\$ 670,723</u>	<u>\$ 299,175</u>
Goodwill:		
Canada	\$ 448,661	\$ 448,661
United States	494,114	494,114
	<u>\$ 942,775</u>	<u>\$ 942,775</u>
Total assets:		
Canada	\$ 1,938,272	\$ 1,668,470
United States	603,966	227,062
	<u>\$ 2,542,238</u>	<u>\$ 1,895,532</u>

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 8. Related party transactions:

During the year the Company had the following transactions with related parties:

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	Dec 31 2004	Dec 31 2003
MediaWave Communications Corp., a company controlled by a Director of the Company		
Commissions paid	\$ 313	\$ 513
Internet services	925	433
Sherwood Real Estate Corp., a company controlled by a Director of the Company		
Rent paid	\$ 9,286	\$ -

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These transactions were in the normal course of operations and were measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

## 9. Financial instruments:

The carrying values of cash, term deposit, accounts receivable and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these items.

The fair value of the Company's long-term debt approximates its carrying value as there is a market rate of interest attached to the repayment.

Approximately 72% of the Company's accounts receivable are due from customers in Canada with the remainder due from customers in the United States. The maximum credit risk associated with the Company's financial assets is the carrying value of those assets. The Company's exposure to foreign exchange risk associated with self-sustaining foreign operations is limited to its net investment in those operations.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements  
Period ended December 31, 2004

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## 10. Commitments:

The Company leases premises at various locations throughout British Columbia, Alberta and Idaho. The expected annual minimum lease payments under the terms of these agreements over the next five years are as follows:

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2005	\$ 159,068
2006	130,173
2007	83,769
2008	63,682
2009	27,110
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	\$ 463,802

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In addition, the Company has entered into a cost sharing agreement with an unrelated party to acquire land and construct a new hearing and balance facility in Idaho. The total cost of the project is estimated at \$1,030,000 of which the Company's share is approximately \$515,000. The project is expected to be completed and opened in the spring of 2005. At December 31, 2004 the Company has incurred costs of \$295,965 related to the project which have been recorded as land and construction in progress.