

Consolidated Financial Statements of

# **AUDIOTECH HEALTHCARE CORPORATION**

Year ended September 30, 2006

**CHARTERED  
ACCOUNTANTS**

MacKay LLP

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## **AUDITORS' REPORT**

### **To the Shareholders of Audiotech Healthcare Corporation**

We have audited the consolidated balance sheet of Audiotech Healthcare Corporation as at September 30, 2006 and 2005 and the consolidated statements of operations, deficit, 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 audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2006 and 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

**Vancouver, Canada  
January 11, 2007**

**“MacKay LLP”  
Chartered Accountants**

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Balance Sheets

September 30, 2006, with comparative figures for 2005

	2006	2005
<b>Assets</b>		
Current assets:		
Cash	\$ 393,756	\$ 402,751
Term deposit	-	16,169
Accounts receivable	369,062	311,813
Inventory	88,172	46,458
Prepaid expenses	11,844	4,035
	<u>862,834</u>	<u>781,226</u>
Property, plant and equipment (note 2)	827,294	827,196
Goodwill	942,775	942,775
Future income taxes (note 6)	50,172	35,929
	<u>\$ 2,683,075</u>	<u>\$ 2,587,126</u>

## Liabilities and Shareholders' Equity

Current liabilities:		
Accounts payable and accrued liabilities	\$ 367,437	\$ 330,154
Unearned revenue	14,852	13,799
Income taxes payable	79,488	-
Current portion of long-term debt (note 3)	467,033	163,052
Current portion of capital lease (note 4)	18,555	22,515
	<u>947,365</u>	<u>529,520</u>
Long-term debt (note 3)	729,768	1,125,949
Obligation under capital lease (note 4)	12,474	32,278
	<u>1,689,607</u>	<u>1,687,747</u>
Shareholders' equity:		
Share capital (note 5)	1,750,340	1,750,340
Other paid in capital (note 5)	193,489	193,489
Cumulative translation account	(45,657)	(37,942)
Deficit	(904,704)	(1,006,508)
	<u>993,468</u>	<u>899,379</u>
Commitments (note 10)		
	<u>\$ 2,683,075</u>	<u>\$ 2,587,126</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Statements of Operations and Deficit

Year ended September 30, 2006, with comparative figures for 2005

	2006	2005
Sales	\$ 3,552,008	\$ 3,811,600
Direct clinic costs:		
Materials and freight	1,104,919	1,318,842
Selling expenses	226,923	287,831
Rent, utilities and clinic overheads	336,108	383,898
Amortization	103,618	88,868
Salaries and benefits	1,070,294	1,149,752
	2,841,862	3,229,191
	710,146	582,409
Expenses:		
General and administrative	99,190	98,071
Amortization	3,911	3,349
Professional fees	68,801	65,357
Foreign exchange	1,273	3,265
Interest on long-term debt	98,484	110,349
Salaries and benefits	238,476	211,886
	510,135	492,277
Income before other expenses	200,011	90,132
Other expenses:		
Loss on disposal of equipment	7,362	1,477
Amortization of debenture discount	25,500	46,025
	32,862	47,502
Income before income taxes	167,149	42,630
Income taxes (recovery):		
Income taxes (note 6)	79,588	-
Future (note 6)	(14,243)	(35,929)
	65,345	(35,929)
Net income for the year	\$ 101,804	\$ 78,559
Weighted average number of shares outstanding	13,364,893	13,520,989
Earnings per share (basic and diluted)	\$ 0.008	\$ 0.006

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Statements of Retained Earnings

Year ended September 30, 2006, with comparative figures for 2005

	2006	2005
Deficit, beginning of year	\$ (1,006,508)	\$ (958,067)
Cumulative effect of stock based compensation	-	(127,000)
Deficit as restated	(1,006,508)	(1,085,067)
Net income for the year	101,804	78,559
Deficit, end of year	\$ (904,704)	\$ (1,006,508)

See accompanying notes to consolidated financial statements.

# AUDIOTECH HEALTHCARE CORPORATION

Consolidated Statements of Cash Flows

Year ended September 30, 2006, with comparative figures for 2005

	2006	2005
Cash flows from operating activities:		
Net income for the year	\$ 101,804	\$ 78,559
Items not involving cash:		
Amortization of plant and equipment	107,529	92,217
Loss on disposal of equipment	10,318	1,477
Amortization of debenture discount	25,500	46,025
Future income taxes	(14,243)	(35,929)
	230,908	182,349
Change in non-cash operating working capital:		
Accounts receivable	(61,544)	40,339
Inventory	(42,751)	25,069
Prepaid expenses	(7,809)	1,828
Accounts payable	41,529	(173,234)
Income taxes payable	79,588	-
Unearned revenue	1,053	(22,628)
	240,974	53,723
Financing:		
Proceeds from long-term debt	65,000	611,917
Principal payments on long-term debt	(166,282)	(495,368)
Repayment of obligation under capital lease	(22,129)	(20,719)
Issue of Share Capital	-	49,500
	(123,411)	145,330
Investing:		
Purchases of property, plant and equipment	(141,173)	(400,782)
Proceeds on disposal of equipment	-	200
Reduction of term deposit	16,169	(207)
	(125,004)	(400,789)
Effect of changes in exchange rates on foreign denominated cash	(1,554)	(3,808)
Increase (decrease) in cash	(8,995)	(205,544)
Cash, beginning of year	402,751	608,295
Cash, end of year	\$ 393,756	\$ 402,751
Supplemental cash flow information:		
Interest paid	\$ 98,484	\$ 110,349
Non-cash transactions:		
Investing: Purchase of property, plant and equipment	\$ -	\$ (41,554)
Financing: Capital lease obligation	\$ -	\$ 41,554
Discount on repaid or converted debentures	\$ -	\$ 64,511

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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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
Building	Declining balance	2%
Audiology equipment	Declining balance	20%
Computer equipment	Declining balance	30% & 45%
Computer software	Declining balance	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.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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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.

### (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.

### (g) Stock based compensation:

The Company has a stock-based compensation plan as described in note 5(b). Effective October 1, 2004, the Company adopted, on a retroactive basis as a current year charge to retained earnings, the recommendations of the CICA with respect to the recognition, measurement, and disclosure of stock-based compensation and other stock based payments. Under this policy the Company is required to value all stock-based compensation granted using the fair value method, as determined using the Black-Scholes option valuation model. The effect of adopting the fair value based method of accounting for stock-based compensation is to increase deficit and contributed surplus by \$127,000.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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## 1. Significant accounting policies (continued):

### (g) Stock based compensation (continued):

Prior to October 1, 2004, the Company accounted for all stock-based payments to non-employees, and employee awards that are direct awards of stock, or call for settlement in cash or other assets, granted on or after January 1, 2002, using the fair value based method. No compensation cost is recorded for all other stock-based employee compensation awards. Consideration paid by employees on the exercise of stock options was 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.

### (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 is 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

Year ended September 30, 2006

## 2. Property, plant and equipment:

	2006		
	Cost	Accumulated amortization	Net book value
Land	\$ 97,087	\$ -	\$ 97,087
Building	360,764	10,751	350,013
Audiology equipment	928,465	687,381	241,084
Computer equipment	83,987	53,425	30,562
Computer software	19,867	4,494	15,373
Leasehold improvements	105,556	56,243	49,313
	1,595,726	812,294	783,432
Audiology equipment under capital lease	75,779	31,917	43,862
	\$ 1,671,505	\$ 844,211	\$ 827,294

	2005		
	Cost	Accumulated amortization	Net book value
Land	\$ 100,996	\$ -	\$ 100,996
Building	375,289	3,753	371,536
Audiology equipment	956,824	712,893	243,931
Computer equipment	82,351	41,112	41,239
Leasehold improvements	55,856	47,755	8,101
	1,571,316	805,513	765,803
Audiology equipment under capital lease	78,829	17,436	61,393
	\$ 1,650,145	\$ 822,949	\$ 827,196

Amortization expense of \$107,529 (2005 - \$92,217) has been charged to earnings in the current year.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 3. Long-term debt:

	2006	2005
Convertible debenture, 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 \$261,000 (2005 \$261,000) and is recorded net of unamortized debenture discount of \$10,630 (2005 - \$36,130).	\$ 250,370	\$ 224,870
Equipment loans repaid during the year based on thirteen installments per annum of \$3,935 each including interest at 5%. Unsecured.	-	39,439
Term loan, repayable in monthly installments of \$6,887, plus an annual payment of interest at a rate of 5.5% per annum. Secured by all assets of the Company. Due June 2011.	392,535	475,174
Term loan (US\$59,852), repayable in quarterly installments of US\$5,000 plus interest at prime plus 2%. Secured by promissory note of the Company subordinated to the security agreement on the previous term loan noted above, and a continuing guarantee. Due 2009.	66,897	92,845
Building loan (US\$290,800), bearing interest at 8.5% per annum, repayable in monthly installments of US\$3,232 including interest and property taxes. Secured by a first position Deed of Trust on real property and guarantees of the Company. Due April 2010.	325,028	352,207
Promissory notes repayable in monthly installments of \$1,450 including interest at 10% per annum. Due June 2007.	96,971	104,466
Promissory notes, monthly interest payments at 8% per annum. Due August 2011. Unsecured.	65,000	-
	1,196,801	1,289,001
Current portion of long-term debt	467,033	163,052
	\$ 729,768	\$ 1,125,949

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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

The estimated principal repayments required in the next five years, assuming renewals on same or similar terms are as follows:

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2007	\$	467,033
2008		120,941
2009		122,132
2010		101,414
2011		147,350
Thereafter		237,931
	\$	1,196,801

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### 4. Obligation under capital lease:

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

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	2006	2005
2007	\$ 20,275	\$ 25,766
2008	11,286	21,091
2009	1,881	11,740
2010	-	1,957
	33,442	60,554
Less: amount representing interest at 4.5% per annum-	2,413	5,761
	31,029	54,793
Less: current portion	18,555	22,515
	\$ 12,474	\$ 32,278

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# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 5. Share capital:

(a) Authorized and issued share capital:

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 of 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:

Voting common shares:

	2006		2005	
	Shares	Amount	Shares	Amount
Balance, beginning of year	13,654,825	\$ 1,750,340	13,329,825	\$ 1,635,840
Stock options exercised	-	-	225,000	94,500
Cancellation of escrow shares (425,000)	(425,000)	-	-	-
Debentures converted to shares	-	-	100,000	20,000
Balance, end of year	13,229,825	\$ 1,750,340	13,654,825	\$ 1,750,340

As at September 30, 2006 there were NIL (2005: 425,000) shares held in escrow.

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 5. Share capital (continued):

### (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 shall 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 \$0.50 per share; 20% for share prices between \$0.51 and \$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.

As at September 30, 2006, the Company under the terms of its stock option plan has 650,000 options outstanding with authority to issue a further 672,982 options based on the presently issued and outstanding share capital.

	2006 Number of options	Weighted average exercise price	2005 Number of options	Weighted average exercise price
Balance, beginning of year	700,000	\$ 0.21	925,000	\$ 0.21
Expired during the year	(50,000)	0.35	-	-
Exercised during the year	-		(225,000)	0.22
Balance, end of year	650,000	\$ 0.20	700,000	\$ 0.21

Details of the Company's outstanding options at September 30, 2006 are as follows:

Exercise	Expiry	price	Number
Employee	June 9, 2007	\$ 0.28	200,000
Employee	May 18, 2009	\$ 0.16	450,000
Balance, end of year			650,000

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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## 5. Share capital (continued):

### (b) Stock options (continued):

As a result of the retroactive adoption of stock based compensation being recorded at fair value a cumulative adjustment has been made to the 2005 beginning deficit balance of \$127,000, of which \$34,000 relates to fiscal 2004.

### (c) Contributed surplus:

	2006	2005
Balance, beginning of the year	\$ 193,489	\$ 176,000
Cumulative adjustment for stock based compensation	-	127,000
Stock options exercised during the year	-	(45,000)
Debentures converted or repaid during the year	-	(64,511)
Balance, end of year	\$ 193,489	\$ 193,489

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 6. Income taxes:

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory tax rates of 34.12% (2005 – 34.12%) to earnings before income taxes. The reasons for the differences and related tax effects are as follows:

	2006	2005
Income before income taxes	\$ 167,149	\$ 42,630
Tax at applicable tax rate	57,031	14,545
Rate variance on self-sustaining foreign operation	(3,389)	(647)
Non-deductible items	25,946	19,932
Tax benefits of losses previously not recognized	(14,243)	(69,759)
	\$ 63,345	\$ (35,929)

The tax effect of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at September 30, 2006 and 2005 are represented below:

	2006	2005
Future tax assets:		
Non-capital loss carry forwards	\$ 214,933	\$ 204,687
Future tax liabilities:		
Goodwill deductibility	(164,761)	(168,758)
Less: Valuation allowance	-	-
	\$ 50,172	\$ 35,929

The Company has available non-capital losses for Income tax purposes, which may be carried forward to reduce taxable income in future years. If not utilized, the non-capital losses in the amount of \$562,478 expire, as follows:

2007	\$ 48,277
2008	259,336
2009	94,705
2010	159,308
2014	-
2015	416
2026	436
	<u>\$ 562,478</u>

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 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:

	2006	2005
Revenue:		
Canada	\$ 2,549,453	\$ 2,566,952
United States	1,002,555	1,244,648
	\$ 3,552,008	\$ 3,811,600
Interest expense:		
Canada	\$ 61,425	\$ 75,334
United States	37,059	35,015
	\$ 98,484	\$ 110,349
Amortization expense:		
Canada	\$ 65,880	\$ 57,855
United States	41,649	34,362
	\$ 107,529	\$ 92,217
Earnings (loss) before income taxes:		
Canada	\$ 137,730	\$ 57,900
United States	29,419	(15,270)
	\$ 167,149	\$ 42,630
Property, plant and equipment:		
Canada	\$ 263,688	\$ 209,530
United States	563,606	617,666
	\$ 827,294	\$ 827,196
Goodwill:		
Canada	\$ 448,661	\$ 448,661
United States	494,114	494,114
	\$ 942,775	\$ 942,775
Total assets:		
Canada	\$ 1,938,334	\$ 1,804,754
United States	744,741	782,372
	\$ 2,683,075	\$ 2,587,126

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

## 8. Related party transactions:

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

	2006	2005
MediaWave Communications Corp., a company controlled by a Director of the Company		
Commissions paid	\$ 1,853	\$ 1,120
Internet services	2,314	1,789
Sherwood Real Estate Corp., a company controlled by a Director the Company		
Rent paid	\$ 34,005	\$ 32,800

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 deposits, 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 71% 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.

Certain financial instruments of the company include amounts translated from foreign currencies into Canadian dollars. Listed below are the relevant instruments and the amount of foreign currencies included in their balances:

	U.S. Dollars
Cash	\$ 39,674
Accounts receivable	95,716
Accounts payable and accrued liabilities	102,812

U.S. Dollars are translated at 1.1177

# AUDIOTECH HEALTHCARE CORPORATION

Notes to Consolidated Financial Statements

Year ended September 30, 2006

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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 is as follows:

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2007	\$	187,396
2008		140,376
2009		96,987
2010		66,882
2011		56,877
	\$	548,518

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## 11. Comparative figures:

The financial statements have been reclassified, where applicable, to conform to the presentation used in the current year. The changes do not affect prior year earnings.