

Financial Statements of

WORKBRAIN CORPORATION

Years ended December 31, 2003, 2002 and 2001



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CANADIAN GAAP

AUDITORS' REPORT

To the Shareholders of
WORKBRAIN CORPORATION:

We have audited the consolidated balance sheets of Workbrain Corporation as at December 31, 2003 and 2002 and the consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2003. 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2003 in accordance with Canadian generally accepted accounting principles.

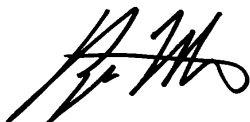
A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, stylized font and is underlined with a single horizontal stroke.

CHARTERED ACCOUNTANTS

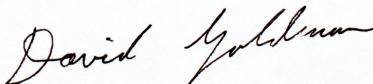
Toronto, Canada
February 13, 2004

WORKBRAIN CORPORATION
CONSOLIDATED BALANCE SHEETS
(Amounts in U.S. Dollars, In Thousands, Except Share Data)

	December 31,	
	2003	2002
Assets:		
Current assets:		
Cash and cash equivalents	\$ 38,027	\$ 6,370
Short-term investments (note 3)	8,666	8,931
Accounts receivable, net of allowance for doubtful accounts of \$300 (2002 - \$266)	6,929	5,027
Other	2,632	2,380
Total current assets	56,254	22,708
Property and equipment (note 4)	2,464	1,315
Intangibles (note 5)	602	-
Goodwill (note 5)	2,545	-
Total assets	\$ 61,865	\$ 24,023
Liabilities and shareholders' equity:		
Current liabilities:		
Accounts payable	\$ 1,504	\$ 777
Accrued payroll	2,460	1,549
Accrued liabilities	1,514	983
Deferred revenue	9,232	10,390
Current portion of capital lease obligation (note 6)	51	-
Current portion of leasehold inducements	50	41
Total current liabilities	14,811	13,740
Long-term liabilities:		
Capital lease obligation, net of current portion (note 6)	54	-
Leasehold inducements, net of current portion	71	99
Total long-term liabilities	125	99
Total liabilities	14,936	13,839
Shareholders' equity:		
Common shares (note 7):		
Authorized - unlimited		
Issued and outstanding - 16,632,104 (2002 - 6,362,845)	60,905	1,007
Class A preferred shares (note 8):		
Authorized - Nil (2002 - unlimited, issuable in series)		
Issued and outstanding - Nil (2002 - 1,297,686)	-	4,680
Class B preferred shares (note 8):		
Authorized - Nil (2002 - unlimited, issuable in series)		
Issued and outstanding - Nil (2002 - 4,932,009)	-	19,963
Contributed surplus	2,058	1,756
Deferred stock-based compensation	(180)	(128)
Cumulative translation adjustment	(127)	(127)
Deficit	(15,727)	(16,967)
Total shareholders' equity	46,929	10,184
Total liabilities and shareholders' equity	\$ 61,865	\$ 24,023
Commitments (note 9)		
Guarantees (note 10)		
On behalf of the Board of Directors:		



Roger Martin
Director



David Goldman
Director

See accompanying Notes to Consolidated Financial Statements

WORKBRAIN CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in U.S. Dollars, In Thousands, Except Per Share Data)

	Year ended December 31,		
	2003	2002	2001
Revenue:			
Licence (note 11)	\$ 10,361	\$ 4,320	\$ 1,181
Service, maintenance and other.....	23,456	12,529	2,557
Net revenue	<u>33,817</u>	<u>16,849</u>	<u>3,738</u>
Cost of revenue:			
Licence.....	318	83	-
Service, maintenance and other.....	17,061	8,623	1,170
Cost of revenue accruals (recoveries), net.....	(561)	(359)	972
Total cost of revenue	<u>16,818</u>	<u>8,347</u>	<u>2,142</u>
Gross profit	<u>16,999</u>	<u>8,502</u>	<u>1,596</u>
Operating expenses:			
Sales and marketing	8,804	5,905	4,989
Research and development (note 12)	5,153	3,456	3,366
General and administrative	1,614	2,215	1,783
Amortization of acquisition-related intangibles	336	-	-
Amortization of stock-based compensation*	84	268	711
Total operating expenses	<u>15,991</u>	<u>11,844</u>	<u>10,849</u>
Income (loss) from operations.....	1,008	(3,342)	(9,253)
Interest income, net.....	232	260	476
Accretion on preferred shares	-	-	(529)
Net income (loss)	<u>\$ 1,240</u>	<u>\$ (3,082)</u>	<u>\$ (9,306)</u>
Net income (loss) per share (note 13):			
Basic	<u>\$ 0.09</u>	<u>\$ (0.24)</u>	<u>\$ (0.76)</u>
Basic weighted average number of common shares outstanding	<u>13,249</u>	<u>12,589</u>	<u>11,618</u>
Diluted	<u>\$ 0.09</u>	<u>\$ (0.24)</u>	<u>\$ (0.76)</u>
Diluted weighted average number of common shares outstanding	<u>13,949</u>	<u>12,589</u>	<u>11,618</u>

*Note:

The amortization of stock-based compensation relates to operating expenses as follows:

	Year ended December 31,		
	2003	2002	2001
Amortization of stock-based compensation:			
Sales and marketing	\$ 2	\$ 8	\$ 307
Research and development.....	-	13	41
General and administrative	82	247	363
	<u>\$ 84</u>	<u>\$ 268</u>	<u>\$ 711</u>

See accompanying Notes to Consolidated Financial Statements

WORKBRAIN CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Amounts in U.S. Dollars, In Thousands, Except Share Data)

	Common Shares		Class A Preferred Shares		Class B Preferred Shares		Contributed Surplus	Share Purchase Loans Receivable	Deferred Stock-based Compensation	Cumulative Translation Adjustment	Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount						
Balances at December 31, 2000	6,464,000	\$ 1,000	1,297,686	\$ 2,963	1,488,406	\$ 5,737	\$ 805	\$ (78)	\$ (333)	\$ (127)	\$ (4,579)	\$ 5,388
Issuance of common shares for services rendered	19,876	-	-	-	-	-	80	-	(80)	-	-	-
Cancellation of common shares	(128,000)	-	-	-	-	-	-	-	-	-	-	-
Payments of share purchase loans receivable	-	-	-	-	-	-	30	78	-	-	-	108
Issuance of Class B preferred shares	-	-	-	-	2,981,366	11,750	-	-	-	-	-	11,750
Issuance of additional Class B preferred shares	-	-	-	-	462,237	-	-	-	-	-	-	-
Transfer of debt component of preferred shares to equity	-	-	-	1,717	-	2,476	-	-	-	-	-	4,193
Deferred stock-based compensation	-	-	-	-	-	-	608	-	(608)	-	-	-
Amortization of stock-based compensation	-	-	-	-	-	-	-	-	751	-	-	751
Net loss	-	-	-	-	-	-	-	-	-	-	(9,306)	(9,306)
Balances at December 31, 2001	6,355,876	1,000	1,297,686	4,680	4,932,009	19,963	1,523	-	(270)	(127)	(13,885)	12,884
Issuance of common shares for services rendered	4,969	-	-	-	-	-	20	-	(20)	-	-	-
Issuance of common shares on stock options exercised	2,000	7	-	-	-	-	-	-	-	-	-	7
Deferred stock-based compensation	-	-	-	-	-	-	213	-	(213)	-	-	-
Amortization of stock-based compensation	-	-	-	-	-	-	-	-	375	-	-	375
Net loss	-	-	-	-	-	-	-	-	-	-	(3,082)	(3,082)
Balances at December 31, 2002	6,362,845	1,007	1,297,686	4,680	4,932,009	19,963	1,756	-	(128)	(127)	(16,967)	10,184
Issuance of common shares for services rendered	5,517	-	-	-	-	-	40	-	(40)	-	-	-
Issuance of common shares on stock options exercised	288,864	520	-	-	-	-	-	-	-	-	-	520
Issuance of common shares and warrants on the acquisition of the net operating assets of Workforce Logistics Inc.	446,183	2,309	-	-	-	-	47	-	-	-	-	2,356
Conversion of Class A and Class B preferred shares into common shares	6,229,695	24,643	(1,297,686)	(4,680)	(4,932,009)	(19,963)	-	-	-	-	-	-
Issuance of common shares on public offering	3,299,000	32,426	-	-	-	-	-	-	-	-	-	32,426
Deferred stock-based compensation	-	-	-	-	-	-	215	-	(215)	-	-	-
Amortization of stock-based compensation	-	-	-	-	-	-	-	-	203	-	-	203
Net income	-	-	-	-	-	-	-	-	-	-	1,240	1,240
Balances at December 31, 2003	<u>16,632,104</u>	<u>\$ 60,905</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>	<u>\$ 2,058</u>	<u>\$ -</u>	<u>\$ (180)</u>	<u>\$ (127)</u>	<u>\$ (15,727)</u>	<u>\$ 46,929</u>

See accompanying Notes to Consolidated Financial Statements

WORKBRAIN CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in U.S. Dollars, In Thousands)

	Year ended December 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net income (loss).....	\$ 1,240	\$ (3,082)	\$ (9,306)
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:			
Depreciation.....	1,389	606	386
Amortization of acquisition-related intangibles.....	336	—	—
Amortization of stock-based compensation.....	203	375	751
Amortization of leasehold inducements.....	(19)	(40)	(36)
Accretion on preferred shares.....	—	—	529
Loss on disposal of property and equipment.....	—	—	32
Change in operating assets and liabilities, net of acquired balances:			
Accounts receivable.....	(1,541)	(3,465)	(1,141)
Other assets.....	(173)	(1,487)	(570)
Accounts payable.....	948	444	(135)
Accrued payroll.....	906	879	556
Accrued liabilities.....	168	946	(115)
Deferred revenue.....	(1,256)	7,741	2,160
Net cash provided by (used for) operating activities.....	<u>2,201</u>	<u>2,917</u>	<u>(6,889)</u>
Cash flows from investing activities:			
Purchase of short-term investments.....	(8,666)	(8,931)	(8,870)
Sale of short-term investments.....	8,931	8,376	494
Payments made on the acquisition of the net operating assets of Workforce Logistics Inc., net of cash acquired.....	(1,390)	—	—
Purchase of property and equipment.....	(2,310)	(1,113)	(433)
Net cash used for investing activities.....	<u>(3,435)</u>	<u>(1,668)</u>	<u>(8,809)</u>
Cash flows from financing activities:			
Repayment of obligations under capital lease.....	(55)	—	—
Proceeds on issuance of common shares upon exercise of stock options.....	520	7	—
Proceeds on issuance of common shares in public offering.....	32,426	—	—
Proceeds on issuance of Class B preferred shares.....	—	—	11,750
Receipt of payment from share purchase loans receivable.....	—	—	108
Net cash provided by financing activities.....	<u>32,891</u>	<u>7</u>	<u>11,858</u>
Change in cash and cash equivalents.....	31,657	1,256	(3,840)
Cash and cash equivalents, beginning of year.....	6,370	5,114	8,954
Cash and cash equivalents, end of year.....	<u>\$ 38,027</u>	<u>\$ 6,370</u>	<u>\$ 5,114</u>
Supplemental cash flow information:			
Cash paid for:			
Interest.....	<u>\$ 8</u>	<u>\$ —</u>	<u>\$ —</u>
Income taxes.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Non-cash investing and financing activities:			
Deferred stock-based compensation.....	<u>\$ 255</u>	<u>\$ 233</u>	<u>\$ 688</u>
Leasehold improvements financed by landlord.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 216</u>
Property and equipment financed by capital lease.....	<u>\$ 160</u>	<u>\$ —</u>	<u>\$ —</u>
Acquisition of Workforce Logistics Inc. partially financed by common shares.....	<u>\$ 2,309</u>	<u>\$ —</u>	<u>\$ —</u>
Acquisition of Workforce Logistics Inc. partially financed by warrants.....	<u>\$ 47</u>	<u>\$ —</u>	<u>\$ —</u>

See accompanying Notes to Consolidated Financial Statements

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)
Years ended December 31, 2003, 2002 and 2001

Workbrain Corporation (the Company) develops, markets, implements, and supports software that helps large organizations optimally deploy and manage their workforces. The Company's solutions automate workforce management processes such as labour forecasting, employee schedule optimization, time and attendance, workforce analytics and employee self-service. The Company markets and sells its products through both direct and indirect channels, primarily in North America and Europe.

1. Significant accounting policies:

a) Basis of presentation:

These consolidated financial statements have been prepared in accordance with Canadian generally accounting principles (Canadian GAAP) and are presented in U.S. dollars.

b) Principles of consolidation:

These consolidated financial statements include the accounts of Workbrain Corporation and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

c) Revenue recognition:

The Company's revenue is derived primarily from licence fees and service fees. The Company licenses software under non-cancelable licence agreements and provides services, including implementation, consulting, training, hosting and post-contract customer support (PCS) to its customers. In certain cases, the Company also provides customers with hardware related to its software offerings. The Company recognizes revenue in accordance with Canadian GAAP, which, in the Company's circumstances, is consistent with the provisions of the American Institute of Certified Public Accountants' Statement of Position No. 97-2 *Software Revenue Recognition* and related provisions (SOP 97-2).

To date, most of the Company's arrangements with customers have involved services that have been determined to be essential to the functionality of the software. Accordingly, the revenue from such arrangements has been recognized under contract accounting using the percentage of completion method to measure progress toward completion. The Company uses either the completion of contractual milestones or the ratio of incurred costs to estimated total costs, as appropriate, as the measure of its progress on each contract. If a loss on a contract is considered probable, all of that loss will be recognized at the date determinable.

Under certain of the Company's arrangements, entered into in 2000 and 2001, where estimating the final outcome of a contract was impractical, except to assure that no loss would be incurred, the Company used a zero estimate of profit until results could be estimated more precisely. Under this method, the portion of total contract revenue earned to-date was determined by measuring progress toward completion. The Company then recorded an equal amount of costs against the revenue. Cost of revenue was adjusted to recognize the profit element from the arrangement once the Company was able to estimate total revenue and total costs, which, in the Company's circumstances, was at the time of substantial contract completion.

Implementation, consulting and training fees, when not essential to the functionality of the software, are recognized as delivered to the customer, based on the prices charged when these services are sold separately to customers.

Hosting fees are recognized monthly as hosting services are provided to the customer, based upon contractually-stated renewal prices provided to customers.

PCS fees are recognized ratably over the term of the support contract, which is generally one year in length, based on the contractually-stated renewal prices provided to customers.

Hardware fees are recognized as hardware is delivered to the customer, once the risks and rewards of ownership have passed to the customer, based on the prices charged when hardware is sold separately to customers.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Years ended December 31, 2003, 2002 and 2001

Accounts receivable reflected on the consolidated balance sheet represent amounts from fees that are due from customers for which revenue has previously been recognized. Fees that have been prepaid but do not yet qualify for recognition as revenue under the Company's revenue recognition policy are reflected as deferred revenue on the consolidated balance sheet.

d) Research and development costs:

Research and development costs, net of investment tax credits, are charged to the consolidated statement of operations in the year in which they are incurred unless the criteria for deferral are met, including the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established once a working model has been produced and tested. To date, development costs incurred between the completion of a working model and the point where a product is released have been insignificant. Accordingly, all research and development costs have been charged to the consolidated statement of operations in the year in which they were incurred, net of related investment tax credits.

The Company is entitled to certain Canadian investment tax credits for qualifying research and development activities performed in Canada. As a Canadian Controlled Private Corporation (CCPC), certain investment tax credits were refundable to the Company. As a public company, investment tax credits are non-refundable, but can be applied against the Company's future income tax liabilities and are subject to a 10-year carryforward period. Investment tax credits are recognized once the Company has reasonable assurance that the amounts will be realized.

Investment tax credits have been accounted for as a reduction of the related expenditures for items expensed in the consolidated statement of operations and a reduction of the related asset cost for items capitalized on the consolidated balance sheet.

e) Use of estimates:

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses to prepare these consolidated financial statements in conformity with Canadian GAAP. Actual results could differ from these estimates.

Significant estimates in these consolidated financial statements include the valuation of accounts receivable, intangibles and goodwill, and the determination of the amount and timing of revenue to be recognized. In its determination of the valuation of accounts receivable, including the allowance for doubtful accounts, management relies on current customer information and its planned course of action as well as assumptions about future business and economic conditions. Management has estimated the useful life of its intangibles based upon rapidly changing industry trends and changes in its customers' businesses. In its determination of the amount and timing of revenue to be recognized, management relies on assumptions supporting its revenue recognition policy. Estimates of the percentage of completion for customer projects are based upon current actual and forecasted information and contractual terms. Vendor-specific objective evidence (VSOE) established by management on the Company's licence and service elements is based upon the prices charged when the Company sells specific elements to customers separately or contractually-stated renewal prices. Changes in the Company's business practices or sales arrangements may impact its ability to establish VSOE on current or newly offered elements, thereby changing the amount and timing of revenue recognized.

f) Concentrations of credit risk:

Financial instruments potentially exposing the Company to a concentration of credit risk principally consist of cash equivalents, short-term investments and accounts receivable.

Cash equivalents consist of highly liquid instruments, such as deposits with major commercial banks, the maturities of which are less than three months from the date of purchase.

Short-term investments consist of commercial paper, the maturities of which are more than three months but less than one year from the date of purchase. Short-term investments are measured at the lower of amortized cost and market.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)
Years ended December 31, 2003, 2002 and 2001

The Company sells its products directly to end users and indirectly via resellers who remarket the product to end users. The Company maintains reserves for potential credit losses and returns, but historically has not experienced any significant losses related to individual customers or groups of customers in any particular industry or geographic area.

At December 31, 2003, one customer represented 18.2% of the balance of accounts receivable. At December 31, 2002, four customers represented 13.2%, 12.9%, 12.5% and 10.6% of the balance of accounts receivable, respectively.

g) Financial instruments:

The Company's financial instruments consist of cash equivalents, short-term investments, accounts receivable, accounts payable, accrued payroll, accrued liabilities and capital lease obligations.

Fair value:

The Company determines the fair value of its financial instruments based on quoted market values or discounted cash flow analyses. Financial instruments are recorded at their cost in these consolidated financial statements, which approximates their fair values.

Foreign exchange risk:

The Company enters into transactions in multiple currencies (primarily U.S. and Canadian dollars) and is, therefore, subject to gains and losses due to fluctuations between those two currencies. The Company has, from time to time, entered into forward contracts intended to manage portions of this risk and does not hold or use any derivative instruments for speculative purposes.

The Company does not account for these forward contracts using hedge accounting and therefore, any variations in these instruments' fair value are marked-to-market on a current basis in the Company's consolidated statement of operations.

h) Foreign currency translation:

The U.S. dollar is the Company's functional currency. Balances of the Company denominated in currencies other than the U.S. dollar have been translated into U.S. dollars. On the balance sheet, monetary items have been translated into U.S. dollars at exchange rates prevailing at the balance sheet date and non-monetary items have been translated at historical exchange rates. Amounts included in the Company's consolidated statement of operations have been translated at the average exchange rates for the year, except for depreciation and amortization which have been translated at historical rates. Exchange gains and losses resulting from the translation of amounts into U.S. dollars are reflected in the consolidated statement of operations in the year in which they occurred.

Foreign exchange gains (losses) included in the net income (loss) for the years ended December 31, 2003, 2002 and 2001 were \$2,026,000, (\$48,000) and (\$7,000), respectively.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Years ended December 31, 2003, 2002 and 2001

i) Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation and are depreciated over their estimated useful lives. Leasehold improvements are recorded at cost and depreciated over the lesser of their estimated useful lives or the term of the related lease. Property and equipment under capital lease is initially recorded at the present value of the minimum lease payments at the inception of the lease. The depreciation policies for property and equipment, by category, are as follows:

<u>Asset</u>	<u>Basis</u>	<u>Rate</u>
Computer equipment.....	Straight-line	2 years
Office furniture and equipment.....	Straight-line	5 years or term of lease
Computer software.....	Straight-line	2 years
Leasehold improvements.....	Straight-line	Term of lease

j) Intangibles:

Intangibles are recorded at cost and are amortized over their estimated useful lives, as follows:

<u>Asset</u>	<u>Basis</u>	<u>Rate</u>
Customer relationships	Straight-line	2 years
Developed technology.....	Straight-line	3 years
Purchased in-process research and development.....	Straight-line	1 year

k) Goodwill:

The Company evaluates goodwill annually or whenever events or circumstances indicate that the carrying amount may not be recoverable. Impairment is tested at the reporting unit level by comparing the reporting unit's carrying value to its fair value. The fair values of reporting units are estimated using a discounted cash flow approach. To the extent a reporting unit's carrying amount exceeds its fair value, an impairment of goodwill exists. Impairment is measured by comparing the fair value of goodwill, determined in a manner similar to a purchase price allocation, to its carrying amount.

l) Impairment of long-lived assets:

The Company reviews the carrying values of its property and equipment and intangibles for impairment on a regular basis or whenever events or circumstances indicate that the carrying amount may not be recoverable. If their carrying value exceeds the amount recoverable, based on undiscounted estimated future cash flows, a write-down to their fair value is charged to the consolidated statement of operations.

m) Income taxes:

The Company uses the liability method of tax allocation in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial accounting and tax bases of assets and liabilities and are measured using enacted or substantively enacted tax rates that are expected to be in effect when the differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized. Income tax expense is the sum of the Company's provision for current income taxes and the difference between opening and ending balances of future income tax assets and liabilities.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Share and Per Share Data)

Years ended December 31, 2003, 2002 and 2001

n) Income (loss) per share:

Basic income (loss) per share has been computed by dividing net income (loss) by the weighted average number of common shares outstanding for the year. Diluted income (loss) per share includes the effect, if any, of securities with dilutive potential on the Company's common shares.

Potentially dilutive items to the Company's common shares include stock options and warrants issued by the Company. All Class A and Class B preferred shares were converted into common shares immediately prior to December 11, 2003 and have been retroactively reflected as common shares in the calculation of basic income (loss) per share. A reconciliation of the numerator and denominator used in the calculation of the Company's diluted income (loss) per share is disclosed in note 13.

o) Stock-based compensation:

The Company has one stock-based compensation plan, which is described in note 7. No compensation expense is recognized for this plan when stock options are issued to employees. Any consideration paid by employees on the exercise of stock options or the purchase of shares is credited to shareholders' equity. If stock options are repurchased from employees, the excess of the consideration paid over the carrying amount of the stock option cancelled is charged to contributed surplus.

A fair value-based method of accounting is applied to all stock-based payments to non-employees and to employee awards that are direct awards of shares, that call for settlement in cash or other assets or are stock appreciation rights that call for settlement by the issuance of equity instruments. A fair value-based method of accounting is also applied to stock-based compensation to a reseller of the Company's software (note 11).

The following table reports pro forma amounts for net income (loss) and basic and diluted income (loss) per share including stock-based compensation expense for options issued to employees and directors under the Company's stock-based compensation plan, determined based on the fair value-based method. The fair value of option grants made to employees, prior to the Company's public offering, were estimated using the minimum value method, with the following assumptions: risk free interest rates ranging from 3% to 6%, dividend yield of 0% and expected lives of options of four years. The fair value of option grants made to employees after the Company's public offering and to non-employees were estimated using a Black Scholes model, with the following assumptions: expected volatility ranging from 31% to 99%, risk-free interest rates ranging from 3% to 6%, dividend yield of 0% and expected lives of options of four years.

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net income (loss):			
As reported	\$ 1,240	\$ (3,082)	\$ (9,306)
Pro forma	\$ (661)	\$ (3,538)	\$ (9,596)
Basic income (loss) per share:			
As reported	\$ 0.09	\$ (0.24)	\$ (0.76)
Pro forma	\$ (0.05)	\$ (0.28)	\$ (0.78)
Diluted income (loss) per share:			
As reported	\$ 0.09	\$ (0.24)	\$ (0.76)
Pro forma	\$ (0.05)	\$ (0.28)	\$ (0.78)

p) Guarantees:

Obligations under guarantees are not recognized in the financial statements but are disclosed in accordance with The Canadian Institute of Chartered Accountants' Accounting Guideline AcG-14. The guideline does not apply to product warranties.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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2. Acquisition of Workforce Logistics Inc.:

Effective April 1, 2003, the Company acquired the net operating assets of Workforce Logistics Inc. (Workforce) for total consideration of \$3,800,000. Workforce is a provider of software solutions that automate employee scheduling processes in large organizations. The acquisition was accounted for using the purchase method, whereby the results of operations of Workforce have been included in the consolidated statement of operations, shareholders' equity and cash flows from the date of acquisition.

The fair values of the net assets acquired were as follows:

Working capital	\$ 249
Property and equipment	68
Customer relationships	325
Developed technology.....	408
Purchased in-process research and development	205
Goodwill	<u>2,545</u>
Net assets.....	<u>\$ 3,800</u>

Intangible assets, consisting of customer relationships, developed technology and purchased in-process research and development, are being amortized over two years, three years, and one year, respectively.

At the date of acquisition, the total consideration consisted of \$2,900,000 in promissory notes issued to the shareholders of Workforce, \$400,000 in promissory notes held in escrow for the shareholders of Workforce, and \$500,000 in acquisition-related costs. Subsequently, the Company entered into subscription agreements with the shareholders of Workforce, whereby the promissory notes issued and held in escrow were exchanged for cash, common shares and warrants, resulting in the following total consideration:

Cash.....	\$ 917
Cash held in escrow	27
373,053 common shares	1,931
73,130 common shares held in escrow	378
Warrants exercisable into 94,612 common shares.....	47
Acquisition-related costs	<u>500</u>
Total consideration	<u>\$ 3,800</u>

The cash and common shares held in escrow will be released after one year, based on satisfaction of indemnification requirements, as defined in the acquisition agreement.

The fair values of common shares, at \$5.18, and warrants, at \$0.50, are based on the stated values in the subscription agreements, which were entered into subsequent to the issuance of promissory notes and provided the shareholders of Workforce with an option to receive cash consideration for amounts equal to the assigned values.

Each warrant is exercisable into one common share, at an exercise price of \$5.18. Warrants expire at the earlier of three years from the date of issue, or 20 days after a liquidation event, as defined in the warrant agreement.

3. Short-term investments:

At December 31, 2003, the Company had \$800,000 of restricted short-term investments related to security posted against foreign exchange forward contracts (2002 - \$75,000).

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WORKBRAIN CORPORATION

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4. Property and equipment:

	December 31,	
	2003	2002
Computer equipment	\$ 2,399	\$ 1,067
Office furniture and equipment.....	1,200	722
Computer software.....	1,127	399
Leasehold improvements	<u>231</u>	<u>231</u>
	4,957	2,419
Less: Accumulated depreciation	<u>(2,493)</u>	<u>(1,104)</u>
Total property and equipment	<u>\$ 2,464</u>	<u>\$ 1,315</u>

At December 31, 2003, the cost and accumulated depreciation of assets under capital lease included above were \$160,000 and \$57,000, respectively (2002 - nil and nil).

5. Intangibles and goodwill:

	December 31,	
	2003	2002
Customer relationships	\$ 325	\$ -
Developed technology.....	408	-
Purchased in-process research and development	<u>205</u>	<u>-</u>
	938	-
Less: Accumulated amortization.....	<u>(336)</u>	<u>-</u>
Total intangibles	602	-
Goodwill	<u>2,545</u>	<u>-</u>
Total intangibles and goodwill	<u>\$ 3,147</u>	<u>\$ -</u>

6. Capital lease obligation:

The following are the Company's minimum lease payments under non-cancelable capital leases:

	December 31,	
	2003	2002
2004	\$ 56	\$ -
2005.....	56	-
Thereafter	<u>-</u>	<u>-</u>
	112	-
Less: Amounts representing interest (at an effective interest rate of 6%).....	<u>(7)</u>	<u>-</u>
Balance of capital lease obligation	105	-
Less: Current portion.....	<u>(51)</u>	<u>-</u>
Capital lease obligation, net of current portion.....	<u>\$ 54</u>	<u>\$ -</u>

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7. Common shares:

a) Authorized:

Unlimited number of common shares without par value.

b) Transactions:

2003:

The Company issued 3,299,000 common shares for cash consideration of \$32,426,000 (net of offering costs of \$3,311,000) in a public offering on December 11, 2003.

The Company issued 446,183 common shares valued at \$2,309,000 in partial consideration for the acquisition of Workforce Logistics Inc. The Company issued 5,517 common shares to directors for no cash consideration as a portion of fees for directorship services rendered. In addition, the Company issued 288,864 common shares to a director and employees for total consideration of \$520,000 under stock option exercises.

2002:

The Company issued 4,969 common shares to a director for no cash consideration as a portion of fees for directorship services rendered. In addition, the Company issued 2,000 common shares to an employee for consideration of \$7,000 under a stock option exercise.

2001:

The Company issued 19,876 common shares to directors for no cash consideration as a portion of their fees for directorship services rendered. In addition, the forgiveness feature was canceled related to 256,000 common shares under a forgivable share purchase loan arrangement made to a founding employee in 1999. A total of 128,000 common shares originally issued under that arrangement were purchased for cancellation by the Company and \$30,000 in cash consideration was received from the employee related to the remaining 128,000 common shares.

c) Stock option plan:

The Company's stock option plan (the Plan) was implemented to encourage ownership of the Company by directors, officers, employees and consultants of the Company and its subsidiaries. The maximum number of common shares which may be set aside for issuance under the Plan is 2,740,000 shares, provided that the Board of Directors of the Company has the right, from time to time, to increase such number subject to the approval of the shareholders of the Company when required by law or regulatory authority. Generally, options issued under the Plan vest over a three to five year period. Any option granted which, for any reason, is canceled or terminated prior to its exercise will become available for grant under the Plan. In accordance with the Plan, the exercise price of options is based on the quoted market price of the Company's common shares on the date of grant.

Options may be granted under the Plan to be exercised during a period of up to ten years from the date of grant, subject to earlier termination upon the optionee ceasing to be a director, officer, employee or consultant of the Company or one of its subsidiaries, as applicable. Options issued under the Plan are non-transferable. During 2003, the Company extended the term of all outstanding stock options granted to employees from four years to seven years.

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d) Continuity of options issued under the Plan:

A summary of the status of the Plan as of December 31, 2003, 2002 and 2001, and the changes during the years ended December 31, 2003, 2002 and 2001 is presented below:

	2003		2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding,						
beginning of year	1,492,340	\$ 3.05	1,102,960	\$ 2.73	942,047	\$ 2.93
Granted	611,704	7.35	432,940	3.95	345,340	3.18
Exercised	(288,864)	1.80	(2,000)	3.25	—	—
Forfeited.....	<u>(173,778)</u>	4.34	<u>(41,560)</u>	3.80	<u>(184,427)</u>	4.43
Outstanding, end of year	<u>1,641,402</u>	4.74	<u>1,492,340</u>	3.05	<u>1,102,960</u>	2.73
Options exercisable,						
end of year	<u>826,210</u>	\$ 3.08	<u>806,558</u>	\$ 2.48	<u>402,996</u>	\$ 2.45

e) Summary of the balances of options issued under the Plan:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2003	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at December 31, 2003	Weighted Average Exercise Price
\$ 0.63 to 0.94	163,759	3.1	\$ 0.87	163,759	\$ 0.87
3.13 to 3.60	432,182	2.7	3.25	413,682	3.25
4.03 to 4.38	487,107	5.1	4.04	219,045	4.04
5.18 to 7.25	394,378	6.3	6.27	28,850	5.73
10.77 to 11.86	<u>163,976</u>	6.1	10.91	<u>874</u>	10.84
\$ 0.63 to 11.86	<u>1,641,402</u>	4.6	\$ 4.74	<u>826,210</u>	\$ 3.08

f) Warrants issued:

As part of the acquisition of the net operating assets of Workforce Logistics Inc., effective April 1, 2003, the Company issued warrants that are exercisable into 94,612 common shares upon the payment of \$5.18 per share by the holder of the warrants which expire in June 2006.

As at December 31, 2003, there are warrants outstanding exercisable into 247,263 common shares (2002 - 229,636) upon the payment of \$4.03 per share by the holder of the warrants. The warrants have expiry dates ranging from April 20, 2006 to December 31, 2008. The Company may be required to issue additional warrants that are exercisable for up to 21,226 common shares.

All of these warrants are unexercised at December 31, 2003.

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8. Preferred shares:

The Class A and Class B preferred shares were converted, on a one-for-one basis, into common shares of the Company immediately prior to the completion of the public offering of the Company's common shares on December 11, 2003.

After the above conversion, the Class A and Class B preferred shares were deleted from the Company's authorized share capital.

9. Commitments:

Future minimum lease payments under non-cancelable operating leases, as of December 31, 2003, are as follows:

2004.....	\$ 931
2005.....	674
2006.....	215
Thereafter	<u>—</u>
Total minimum lease payments	<u>\$ 1,820</u>

Rent expense for the year ended December 31, 2003 was \$1,285,000 (2002 - \$843,000; 2001 - \$456,000). The Company is also responsible for certain common area costs at its various leased premises.

10. Guarantees:

The Company has provided routine indemnifications to its customers against liability if the Company's products infringe on a third party's intellectual property rights. The maximum exposure from these indemnifications cannot be reasonably estimated. In some cases, the Company has recourse against other parties to mitigate its risk of loss from these guarantees. Historically, the Company has made no payments relating to these indemnifications, and the Company is not subject to any pending litigation on this matter.

11. Stock-based compensation related to licence revenue:

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Gross licence revenue	\$ 10,480	\$ 4,427	\$ 1,221
Less: Stock-based compensation related to licence revenue	<u>(119)</u>	<u>(107)</u>	<u>(40)</u>
Net licence revenue.....	<u>\$ 10,361</u>	<u>\$ 4,320</u>	<u>\$ 1,181</u>

The stock-based compensation related to licence revenue results from warrants that have been issued to a reseller of the Company's software based on customer referrals from that reseller.

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12. Research and development expenses:

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Gross research and development expenses	\$ 5,693	\$ 3,600	\$ 3,366
Less: Investment tax credits realized	(540)	(144)	—
Net research and development expenses	<u>\$ 5,153</u>	<u>\$ 3,456</u>	<u>\$ 3,366</u>

13. Net income (loss) per share:

The following table presents a reconciliation of the numerators and denominators used in the calculations of the basic and diluted net income (loss) per share. The table retroactively reflects the conversion of the Class A and Class B preferred shares into common shares that took place immediately prior to December 11, 2003.

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net income (loss):			
Net income (loss)	\$ 1,240	\$ (3,082)	\$ (9,306)
Preferred share accretion	—	—	529
Basic and diluted income (loss)	<u>\$ 1,240</u>	<u>\$ (3,082)</u>	<u>\$ (8,777)</u>
Weighted average number of common shares outstanding:			
Common shares	13,249	12,589	11,618
Effect of stock options issued	584	—	—
Effect of warrants outstanding	116	—	—
Diluted	<u>13,949</u>	<u>12,589</u>	<u>11,618</u>
Net income (loss) per share:			
Basic	<u>\$ 0.09</u>	<u>\$ (0.24)</u>	<u>\$ (0.76)</u>
Diluted	<u>\$ 0.09</u>	<u>\$ (0.24)</u>	<u>\$ (0.76)</u>

At December 31, 2002 and 2001 stock options and warrants outstanding were not included in the calculation of diluted loss per share because the Company had losses for those years and to do so would have been anti-dilutive.

14. Income taxes:

a) Income tax rate reconciliation:

The effective income tax rate differs from the statutory rate that would be obtained by applying the combined Canadian basic federal and provincial income tax rate to net income (loss) before income taxes. These differences result from the following items:

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Combined Canadian basic federal and provincial income tax rate	36.6%	38.6%	42.1%
Increase (decrease) in income tax rate resulting from:			
Permanent differences	(73.8)	(4.7)	(9.2)
Change in valuation allowance	101.3	(26.5)	(22.7)
Change in enacted rates	<u>(64.1)</u>	<u>(7.4)</u>	<u>(10.2)</u>
Effective income tax rate	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>

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b) Components of future income taxes:

The components of the temporary differences which have created future income tax assets and liabilities are as follows:

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Future income tax assets:		
Deferred revenue recognized for tax purposes.....	\$ 2,998	\$ 2,504
Non-capital income tax loss carryforwards	1,007	850
Share issue costs.....	450	-
Net capital loss carryforwards.....	444	-
Research and development expenditure carryforwards.....	358	577
Other.....	<u>134</u>	<u>42</u>
	5,391	3,973
Less: Valuation allowance.....	<u>(5,270)</u>	<u>(3,973)</u>
Net future income tax assets	121	-
Future income tax liabilities:		
Net book value of intangible assets in excess of tax bases	<u>(121)</u>	<u>-</u>
Future income taxes	<u>\$ -</u>	<u>\$ -</u>

c) Tax losses:

As of December 31, 2003, the Company had non-capital income tax loss carryforwards of approximately \$846,000 available to reduce future years' income for Canadian tax purposes. These losses will expire at various dates between 2007 and 2010.

The Company also had non-capital income tax loss carryforwards of approximately \$1,871,000 available to reduce future years' income for U.S. tax purposes. These losses will expire in 2021 and 2023.

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15. Segmented information:

The Company reviewed its operations and determined that it operates in a single reportable operating segment, the workforce management software market. The single reportable operating segment derives its revenue from the sale of software solutions including related services, training and hardware. The following information provides the required enterprise-wide disclosures:

	<u>December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Revenue by geographic location:			
United States	\$ 29,685	\$ 11,671	\$ 2,659
United Kingdom	2,180	3,975	1,067
Canada.....	<u>1,952</u>	<u>1,203</u>	<u>12</u>
	<u>\$ 33,817</u>	<u>\$ 16,849</u>	<u>\$ 3,738</u>

Revenue is attributed to geographic locations based on the location of the external customer.

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Property and equipment by geographic location:		
Canada.....	\$ 2,299	\$ 1,208
United States	<u>165</u>	<u>107</u>
	<u>\$ 2,464</u>	<u>\$ 1,315</u>

Substantially all intangibles and goodwill recognized in the consolidated financial statements are held by one of the Company's Canadian subsidiaries.

During the year ended December 31, 2003, no customers of the Company accounted for over 10% of net revenue. During the year ended December 31, 2002, one customer of the Company account for 23.6% of net revenue. During the year ended December 31, 2001, three customers of the Company accounted for 28.5%, 19.2% and 17.8% of net revenue, respectively.