

CANADIAN GAAP

Consolidated Financial Statements of

WORKBRAIN CORPORATION

Years ended December 31, 2005, 2004 and 2003



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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, 2005 and 2004 and the consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2005. 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, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

CHARTERED ACCOUNTANTS

Toronto, Canada
February 15, 2006

WORKBRAIN CORPORATION

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	<u>2005</u>	<u>2004</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 16,566	\$ 30,165
Short-term investments	32,497	20,912
Accounts receivable, net of allowance for doubtful accounts of \$505 (2004 - \$362)	19,129	12,410
Accrued revenue	3,245	-
Other	<u>3,609</u>	<u>3,780</u>
Total current assets	75,046	67,267
Property and equipment (note 3)	4,999	2,879
Other	492	-
Intangibles (note 4)	45	235
Goodwill (note 4)	<u>2,545</u>	<u>2,545</u>
Total assets	<u>\$ 83,127</u>	<u>\$ 72,926</u>
Liabilities and shareholders' equity:		
Current liabilities:		
Accounts payable	\$ 1,697	\$ 1,302
Accrued payroll	5,455	5,125
Accrued liabilities	2,427	1,213
Deferred revenue	12,166	12,852
Current portion of capital lease and other obligations (note 5)	2,381	778
Current portion of leasehold inducements	<u>56</u>	<u>54</u>
Total current liabilities	<u>24,182</u>	<u>21,324</u>
Long-term liabilities:		
Capital lease and other obligations, net of current portion (note 5)	3,277	1,064
Leasehold inducements, net of current portion	<u>56</u>	<u>24</u>
Total long-term liabilities	<u>3,333</u>	<u>1,088</u>
Total liabilities	<u>27,515</u>	<u>22,412</u>
Shareholders' equity:		
Common shares (note 6):		
Authorized - unlimited		
Issued and outstanding - 17,730,825 (2004 - 17,416,290)	67,414	63,802
Contributed surplus	2,069	3,619
Cumulative translation adjustment	(127)	(127)
Deficit	<u>(13,744)</u>	<u>(16,780)</u>
Total shareholders' equity	<u>55,612</u>	<u>50,514</u>
Total liabilities and shareholders' equity	<u>\$ 83,127</u>	<u>\$ 72,926</u>
Commitments (note 7)		
Guarantees (note 8)		
Contingencies (note 9)		
On behalf of the Board of Directors:		

Gerald Throop
Director

Roger Martin
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)

	Years ended December 31,		
	2005	2004	2003
Revenue:			
Licence	\$ 23,063	\$ 16,340	\$ 10,361
Service, maintenance and other	65,679	40,663	23,456
Net revenue	<u>88,742</u>	<u>57,003</u>	<u>33,817</u>
Cost of revenue:			
Licence	683	294	318
Service, maintenance and other	47,648	28,202	17,061
Cost of revenue accruals (recoveries), net	—	(168)	(561)
Total cost of revenue	<u>48,331</u>	<u>28,328</u>	<u>16,818</u>
Gross profit	<u>40,411</u>	<u>28,675</u>	<u>16,999</u>
Operating expenses:			
Sales and marketing	17,033	13,847	8,804
Research and development (note 10)	13,254	9,650	5,153
General and administrative	7,076	5,039	1,614
Amortization of acquisition-related intangibles	190	367	336
Amortization of stock-based compensation*	1,007	1,237	84
Total operating expenses	<u>38,560</u>	<u>30,140</u>	<u>15,991</u>
Income (loss) from operations	1,851	(1,465)	1,008
Interest income, net	1,260	910	232
Income (loss) before provision for income taxes	3,111	(555)	1,240
Provision for income taxes	75	—	—
Net income (loss)	<u>\$ 3,036</u>	<u>\$ (555)</u>	<u>\$ 1,240</u>
Net income (loss) per share (note 11):			
Basic	<u>\$ 0.17</u>	<u>\$ (0.03)</u>	<u>\$ 0.09</u>
Basic weighted average number of common shares outstanding	<u>17,619</u>	<u>16,871</u>	<u>13,249</u>
Diluted	<u>\$ 0.17</u>	<u>\$ (0.03)</u>	<u>\$ 0.09</u>
Diluted weighted average number of common shares outstanding	<u>17,945</u>	<u>16,871</u>	<u>13,949</u>

*Note:

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

	Years ended December 31,		
	2005	2004	2003
Amortization of stock-based compensation:			
Cost of revenue - service, maintenance and other	\$ 361	\$ 468	\$ —
Sales and marketing	355	418	2
Research and development	54	88	—
General and administrative	237	263	82
	<u>\$ 1,007</u>	<u>\$ 1,237</u>	<u>\$ 84</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	Cumulative Translation Adjustment	Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balances at December 31, 2002	6,362,845	\$ 1,007	1,297,686	\$ 4,680	4,932,009	\$ 19,963	\$ 1,628	\$ (127)	\$ (16,967)	\$ 10,184
Issuance of common shares for services rendered	5,517	—	—	—	—	—	—	—	—	—
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
Amortization of stock-based compensation	—	—	—	—	—	—	203	—	—	203
Net income	—	—	—	—	—	—	—	—	1,240	1,240
Balances at December 31, 2003	16,632,104	60,905	—	—	—	—	1,878	(127)	(15,727)	46,929
Issuance of common shares on stock options exercised.....	561,755	2,046	—	—	—	—	—	—	—	2,046
Issuance of common shares on warrants exercised	222,431	851	—	—	—	—	—	—	—	851
Cumulative impact of change in accounting policy (note 1(o))..	—	—	—	—	—	—	498	—	(498)	—
Amortization of stock-based compensation	—	—	—	—	—	—	1,243	—	—	1,243
Net loss.....	—	—	—	—	—	—	—	—	(555)	(555)
Balances at December 31, 2004	17,416,290	63,802	—	—	—	—	3,619	(127)	(16,780)	50,514
Issuance of common shares on stock options exercised.....	310,585	1,043	—	—	—	—	—	—	—	1,043
Issuance of common shares on warrants exercised	3,950	12	—	—	—	—	—	—	—	12
Amortization of stock-based compensation	—	—	—	—	—	—	1,007	—	—	1,007
Transfer of stock-based compensation to common shares related to stock options and warrants exercised	—	2,557	—	—	—	—	(2,557)	—	—	—
Net income	—	—	—	—	—	—	—	—	3,036	3,036
Balances at December 31, 2005	<u>17,730,825</u>	<u>\$ 67,414</u>	<u>—</u>	<u>\$ —</u>	<u>—</u>	<u>\$ —</u>	<u>\$ 2,069</u>	<u>\$ (127)</u>	<u>\$ (13,744)</u>	<u>\$ 55,612</u>

See accompanying Notes to Consolidated Financial Statements

WORKBRAIN CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Years ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net income (loss)	\$ 3,036	\$ (555)	\$ 1,240
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	3,095	2,211	1,389
Amortization of acquisition-related intangibles	190	367	336
Amortization of stock-based compensation	1,007	1,243	203
Amortization of leasehold inducements	(46)	(43)	(19)
Unrealized foreign exchange gain	(640)	(1,342)	(1,038)
Change in operating assets and liabilities, net of acquired balances:			
Accounts receivable	(6,719)	(5,481)	(1,904)
Accrued revenue	(3,245)	(368)	363
Other assets	369	(780)	(173)
Accounts payable	475	(202)	948
Accrued payroll	330	2,665	906
Accrued liabilities	1,214	(301)	168
Deferred revenue	(686)	3,620	(1,256)
Net cash provided by (used for) operating activities	<u>(1,620)</u>	<u>1,034</u>	<u>1,163</u>
Cash flows from investing activities:			
Purchase of short-term investments	(32,497)	(32,282)	(8,666)
Maturity of short-term investments	20,912	20,036	8,931
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	(4,289)	(2,626)	(2,310)
Net cash used for investing activities	<u>(15,874)</u>	<u>(14,872)</u>	<u>(3,435)</u>
Cash flows from financing activities:			
Proceeds on issuance of common shares upon exercise of stock options	1,043	2,046	520
Proceeds on issuance of common shares upon exercise of warrants	12	851	—
Proceeds on issuance of common shares in public offering	—	—	32,426
Proceeds on sale and leaseback of property and equipment	3,201	1,873	—
Repayment of obligations under capital lease	(1,001)	(136)	(55)
Net cash provided by financing activities	<u>3,255</u>	<u>4,634</u>	<u>32,891</u>
Foreign exchange gain on cash held in foreign currency	<u>640</u>	<u>1,342</u>	<u>1,038</u>
Change in cash and cash equivalents	<u>(13,599)</u>	<u>(7,862)</u>	<u>31,657</u>
Cash and cash equivalents, beginning of year	<u>30,165</u>	<u>38,027</u>	<u>6,370</u>
Cash and cash equivalents, end of year	<u>\$ 16,566</u>	<u>\$ 30,165</u>	<u>\$ 38,027</u>
Supplemental cash flow information:			
Cash paid for:			
Interest	<u>\$ 119</u>	<u>\$ 33</u>	<u>\$ 8</u>
Income taxes	<u>\$ 11</u>	<u>\$ 10</u>	<u>\$ —</u>
Non-cash investing and financing activities:			
Property and equipment and other assets financed by capital lease obligations	<u>\$ 1,616</u>	<u>\$ —</u>	<u>\$ 160</u>
Lease inducements provided by landlord	<u>\$ 80</u>	<u>\$ —</u>	<u>\$ —</u>
Acquisition of Workforce Logistics Inc. partially financed by common shares	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,309</u>
Acquisition of Workforce Logistics Inc. partially financed by warrants	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 47</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 Per Share Data)

Years ended December 31, 2005, 2004 and 2003

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, Europe and Australia.

1. Significant accounting policies:

a) Basis of presentation:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted 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 licences 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).

Following the requirements of SOP 97-2, the Company recognizes licence revenue when all of the following have occurred:

- persuasive evidence of an arrangement exists;
- delivery of the software product to the customer has occurred;
- the amount of the fees to be paid by the customer is fixed or determinable; and
- collection of these fees is probable.

Persuasive evidence of an arrangement: The Company requires a written contract signed by both the customer and the Company or a purchase order from those customers who have previously negotiated a standard licence arrangement with the Company.

Delivery has occurred: Typically, the Company delivers its software electronically. If undelivered products or services exist in an arrangement that are essential to the functionality of a delivered product, delivery is not considered to have occurred until these products or services are delivered. In instances where delivery is electronic and all other criteria for revenue recognition have been achieved, the product is considered delivered when the software is sent to the customer electronically or the access code to download the software from the internet has been provided to the customer.

Fee is fixed and determinable: Customers generally pay in the following manner: for perpetual licences, customers pay according to terms consistent with the Company's standard business practice; for maintenance and support, customers pay annually at the beginning of the maintenance year; and for services, customers pay either monthly, as services are performed or based on specific deliverables.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

(Amounts in U.S. Dollars, Tabular Amounts in Thousands, Except Per Share Data)
Years ended December 31, 2005, 2004 and 2003

Collectibility is probable: The Company assesses collectibility on a customer-by-customer basis. The Company performs a credit review on certain new customers, based on established criteria, which evaluates the customer's financial position and ability to pay. If it is determined from the outset of an arrangement that collectibility is not probable based upon the credit review process, revenue is recognized on a cash-collected basis.

SOP 97-2, as modified, generally requires revenue earned on software arrangements involving multiple elements, such as software products, PCS and services (including implementation, hosting and training) to be allocated to each element based on the relative fair values of the elements. The fair value of an element must be based on evidence that is specific to the vendor. The Company limits its assessment of vendor-specific objective evidence of fair value ("VSOE") for each element to the price charged when the same element is sold separately. If VSOE of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred, and the remaining portion of the arrangement fee is recognized as revenue related to the delivered elements.

The Company analyzes all of the elements included in its multiple-element arrangements to determine whether there is sufficient VSOE to allocate revenue to the PCS component. The Company establishes VSOE for PCS based on a contract-specified renewal price provided to the customer where the rate is substantive. Accordingly, if all other revenue recognition criteria are met, revenue from licences is recognized upon delivery using the residual method in accordance with SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition With Respect to Certain Transactions*, and PCS revenue is recognized ratably over the PCS term.

When perpetual licences and professional services are elements of the same arrangement, the Company determines if there is sufficient VSOE to allocate revenue to the services components. Accordingly, if all other revenue recognition criteria are met and the services are not essential to the functionality of the software, revenue from perpetual licences is recognized upon delivery using the residual method and services revenue is recognized as the services are provided.

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.

In accordance with SOP 97-2, when the Company is unable to establish fair value for an undelivered element, and the only undelivered element is PCS, the entire arrangement fee is deferred and recognized ratably over the PCS period. If revenue from an arrangement is deferred due to the inability to establish fair value, the Company defers the direct and incremental costs associated with the arrangement. As such, the Company defers the commissions paid on contracts that are deferred to match those costs ratably against the revenue.

To date, many 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 the loss is determinable.

Under certain of the Company's arrangements, entered into in 2001 and 2000, 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.

Accounts receivable reflected on the consolidated balance sheets represent amounts due from customers from fees 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 sheets. Fees that have been recognized as revenue but have not yet been billed are reflected as accrued revenue on the consolidated balance sheets.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

d) Research and development costs:

Research and development costs, net of investment tax credits, are charged to the consolidated statements 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 statements 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 earned 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 statements of operations and a reduction of the related asset cost for items capitalized on the consolidated balance sheets.

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. 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 business and economic conditions in the future period over which the receivables are collectible. Management has estimated the useful life of its intangibles taking into account the risk of 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 and 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 three months or less 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 Per Share Data)

Years ended December 31, 2005, 2004 and 2003

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, but historically has not experienced any significant losses in excess of its reserves related to individual customers or groups of customers in any particular industry or geographic area.

At December 31, 2005, no customers represented 10% of the balance of accounts receivable. At December 31, 2004, two customers represented 13.9% and 11.4% of the balance of accounts receivable, respectively.

g) Financial instruments:

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

Fair values:

The Company determines the fair values 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 statements 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 consolidated balance sheets, monetary items have been translated into U.S. dollars at exchange rates prevailing at the balance sheet dates and non-monetary items have been translated at historical exchange rates. Amounts included in the Company's consolidated statements 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 statements 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, 2005, 2004 and 2003 were as follows:

	Years ended December 31,		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cost of revenue - service, maintenance and other	\$ 440	\$ 53	\$ 183
Sales and marketing	133	(18)	51
Research and development	140	26	92
General and administrative	<u>334</u>	<u>339</u>	<u>1,700</u>
	<u>\$ 1,047</u>	<u>\$ 400</u>	<u>\$ 2,026</u>

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

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. During the first quarter of fiscal 2004 and 2005, the Company performed its annual impairment test and determined that there was no goodwill impairment in fiscal 2004 or 2005.

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 statements 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 Per Share Data)

Years ended December 31, 2005, 2004 and 2003

n) Net income (loss) per share:

Basic net 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 net 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 net income (loss) per share. A reconciliation of the numerator and denominator used in the calculation of the Company's diluted net income (loss) per share is disclosed in note 11.

o) Stock-based compensation:

The Company has one stock-based compensation plan, which is described in note 6.

Effective January 1, 2004, Canadian GAAP requires the Company to estimate the fair value of stock-based compensation to employees and to expense the fair value over the estimated vesting period of the stock options. In accordance with the transition rules, the fair value of stock options granted to employees since January 1, 2002 was determined using the Black-Scholes option pricing model, and the Company recorded an adjustment to opening deficit at January 1, 2004 in the amount of \$498,000, representing the expense for the 2002 and 2003 fiscal years. The offset to deficit is an increase in contributed surplus. The financial statements for periods prior to January 1, 2004 have not been restated.

The fair value of option grants prior to the date of the Company's initial public offering was 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 five years. Subsequent to the date of the Company's initial public offering, the fair value of option grants was estimated using the Black-Scholes option pricing model, with the following assumptions: expected volatility ranging from 27% to 44%, risk-free interest rates of 3% to 5%, dividend yield of 0% and expected lives of options of three to five and a half years.

The following table reports pro forma amounts for net income (loss) and basic and diluted net income (loss) per share, including stock-based compensation expense, based on stock options issued subsequent to January 1, 2002 for the year ended December 31, 2003:

Net income (loss):	
As reported.....	\$ 1,240
Pro forma	\$ (661)
Basic net income (loss) per share:	
As reported.....	\$ 0.09
Pro forma	\$ (0.05)
Diluted net income (loss) per share:	
As reported.....	\$ 0.09
Pro forma	\$ (0.05)

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

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

Years ended December 31, 2005, 2004 and 2003

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 statements 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 were 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 was exercisable into one common share, at an exercise price of \$5.18.

In 2004 and 2005, all warrants issued to the shareholders of Workforce were either exercised or forfeited according to their terms. Accordingly, during 2004, 12,764 shares were issued to warrant holders for proceeds of \$66,000 and during 2005, 3,950 shares were issued to warrant holders for proceeds of \$12,000.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

3. Property and equipment:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Computer equipment.....	\$ 3,799	\$ 2,988
Office furniture and equipment	2,924	1,764
Computer software	979	854
Leasehold improvements.....	<u>513</u>	<u>239</u>
	8,215	5,845
Less: Accumulated depreciation.....	<u>(3,216)</u>	<u>(2,966)</u>
Total property and equipment	<u>\$ 4,999</u>	<u>\$ 2,879</u>

At December 31, 2005, the cost and accumulated depreciation of assets under capital lease included above were \$5,740,000 and \$2,036,000, respectively (2004 - \$2,220,000 and \$540,000).

4. Intangibles and goodwill:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Customer relationships.....	\$ 325	\$ 325
Developed technology	408	408
Purchased in-process research and development.....	<u>205</u>	<u>205</u>
	938	938
Less: Accumulated amortization	<u>(893)</u>	<u>(703)</u>
Total intangibles.....	45	235
Goodwill	<u>2,545</u>	<u>2,545</u>
Total intangibles and goodwill	<u>\$ 2,590</u>	<u>\$ 2,780</u>

5. Capital lease and other obligations:

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

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
2005	\$ -	\$ 862
2006	2,637	783
2007	2,037	341
2008	1,152	-
2009	151	-
2010	<u>151</u>	<u>-</u>
	6,128	1,986
Less: Amounts representing interest (at an effective rate of approximately 6%).....	<u>(470)</u>	<u>(144)</u>
Balance of capital lease and other obligations.....	5,658	1,842
Less: Current portion.....	<u>(2,381)</u>	<u>(778)</u>
Capital lease and other obligations, net of current portion	<u>\$ 3,277</u>	<u>\$ 1,064</u>

The Company has an agreement in place for a non-committed lease line of credit for up to \$4,341,000 (Cdn. \$5,070,000) with an equipment finance lender to finance selected property and equipment purchases. To December 31, 2005, a total of \$4,089,000 (Cdn. \$4,776,000) had been drawn by the Company under the line at a fixed interest rate of approximately 6% for terms of 24 to 36 months. Under the agreement, advances bear interest at fixed or floating benchmark rates plus 2%. Capital lease obligations are secured by the equipment that has been financed.

The Company has also entered into lending agreements to finance the acquisition of assets. Repayment terms with respect to these financings have been reflected in the above table.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

6. Common shares:

a) Authorized:

Unlimited number of common shares without par value.

b) Transactions:

2005:

The Company issued 310,585 and 3,950 common shares to stock option and warrant holders for consideration of \$1,043,000 and \$12,000, respectively, under stock option and warrant exercises.

2004:

The Company issued 561,755 and 222,431 common shares to stock option and warrant holders for consideration of \$2,046,000 and \$851,000, respectively, under stock option and warrant exercises.

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. 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.

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 cancelled 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 then outstanding stock options granted to employees from four years to seven years.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

d) Continuity of options issued under the Plan:

A summary of the status of the Plan as of December 31, 2005, 2004 and 2003, and the changes during the years ended December 31, 2005, 2004 and 2003 is presented below:

	2005		2004		2003	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	1,296,753	\$ 7.13	1,641,402	\$ 4.74	1,492,340	\$ 3.05
Granted	304,500	13.05	391,183	10.91	611,704	7.35
Exercised	(310,585)	3.38	(561,755)	3.65	(288,864)	1.80
Forfeited	<u>(143,140)</u>	11.32	<u>(174,077)</u>	6.87	<u>(173,778)</u>	4.34
Outstanding, end of year	<u>1,147,528</u>	9.89	<u>1,296,753</u>	7.13	<u>1,641,402</u>	4.74
Options exercisable, end of year	<u>503,061</u>	\$ 7.68	<u>538,354</u>	\$ 3.95	<u>826,210</u>	\$ 3.08
Weighted average fair value of options granted during the year		\$ 3.27		\$ 4.84		\$ 3.09

All options granted during the years ended December 31, 2005, 2004 and 2003 were granted with exercise prices equal to the underlying fair value of the common shares at the grant date.

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

Range of exercise prices	Options Outstanding			Options Exercisable		
	Number Outstanding at December 31, 2005	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at December 31, 2005	Weighted Average Exercise Price	
\$ 0.94	2,208	1.0	\$ 0.94	2,208	\$ 0.94	
3.13 - 4.03	259,823	2.6	3.74	229,453	3.70	
5.18 - 7.75	189,098	4.6	6.23	84,609	6.08	
9.65 - 14.32	522,874	4.4	12.61	138,578	12.75	
14.58 - 15.65	<u>173,525</u>	4.8	15.00	<u>48,213</u>	15.00	
\$ 0.94 - 15.65	<u>1,147,528</u>	4.1	\$ 9.89	<u>503,061</u>	\$ 7.68	

f) Warrants outstanding:

As at December 31, 2005, there were warrants outstanding exercisable into 37,596 common shares (2004 - 37,596) upon the payment of \$4.03 per share by the holder of the warrants. The warrants have expiry dates ranging from June 30, 2007 to December 31, 2008. The Company may be required to issue additional warrants that are exercisable for up to 21,226 common shares.

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

g) Employee stock ownership plan:

During 2005, the Company implemented an Employee Stock Ownership Plan (the ESOP) to encourage full-time permanent employees to invest in shares of the Company, and to allow the Company to provide shares as an incentive to employees. Participants in the ESOP contribute a specified percentage of their base salary through payroll deductions. The ESOP administrator uses these deductions to purchase shares on the open market. Semi-annually, the Company makes a contribution of 30% of the employee's contributions (net of all withdrawals) during the prior six-month period, with which funds the administrator purchases additional shares on the open market on behalf of the participants. The Company accrues its contribution as compensation expense during the period earned by participants. The total contributions expense related to the ESOP for the year ended December 31, 2005 amounted to \$71,000.

7. Commitments:

Future minimum lease payments under non-cancelable operating leases, as of December 31, 2005, are as follows:

2006	\$ 1,195
2007	996
2008	733
2009	727
2010	<u>643</u>
Total minimum lease payments.....	<u>\$ 4,294</u>

Rent expense for the year ended December 31, 2005 was \$1,756,000 (2004 - \$1,363,000; 2003 - \$1,285,000). The Company is also responsible for certain common area costs at its various leased premises.

8. 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.

9. Contingencies:

The Company is subject to legal proceedings and claims that arise in the ordinary course of its business. While management currently believes the amount of ultimate liability, if any, with respect to these actions will not materially affect the financial position, results of operations, or liquidity of the Company, the ultimate outcome of any litigation is uncertain. Were an unfavourable outcome to occur, the impact could be material to the Company.

The Company does not believe that it is probable that a liability has been incurred nor does it believe that the amount of any loss can be reasonably estimated. Accordingly, no liability has been accrued for these matters.

10. Research and development expenses:

	<u>Years ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Gross research and development expenses.....	\$ 13,709	\$ 9,799	\$ 5,693
Less: Investment tax credits	<u>(455)</u>	<u>(149)</u>	<u>(540)</u>
Net research and development expenses	<u>\$ 13,254</u>	<u>\$ 9,650</u>	<u>\$ 5,153</u>

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

11. 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>Years ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income (loss):			
Basic and diluted net income (loss).....	\$ 3,036	\$ (555)	\$ 1,240
Weighted average number of common shares outstanding:			
Common shares.....	17,619	16,871	13,249
Effect of stock options issued	300	-	584
Effect of warrants outstanding	26	-	116
Diluted	<u>17,945</u>	<u>16,871</u>	<u>13,949</u>
Net income (loss) per share:			
Basic	<u>\$ 0.17</u>	<u>\$ (0.03)</u>	<u>\$ 0.09</u>
Diluted	<u>\$ 0.17</u>	<u>\$ (0.03)</u>	<u>\$ 0.09</u>

At December 31, 2004, stock options and warrants outstanding were not included in the calculation of diluted loss per share because the Company reported a loss that year and to do so would have been anti-dilutive. In 2005, options totalling 379,882 (2003 - nil) that were anti-dilutive have been excluded from the calculation.

12. 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>Years ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Combined Canadian basic federal and provincial income tax rate.....	36.1%	36.1%	36.6%
Increase (decrease) in income tax rate resulting from:			
Permanent differences.....	(6.9)	144.6	(73.8)
Change in valuation allowance	(26.3)	(186.7)	101.3
Change in enacted rates	<u>(0.4)</u>	<u>6.0</u>	<u>(64.1)</u>
Effective income tax rate.....	<u>2.5%</u>	<u>0.0%</u>	<u>0.0%</u>

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

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>2005</u>	<u>2004</u>
Future income tax assets:		
Deferred revenue recognized for tax purposes.....	\$ 4,162	\$ 4,753
Non-capital income tax loss carryforwards.....	474	1,243
Share issue costs	188	321
Net capital loss carryforwards.....	-	71
Research and development expenditure carryforwards.....	588	65
Long-term assets	690	330
Other	<u>31</u>	<u>28</u>
	6,133	6,811
Less: Valuation allowance	<u>(6,092)</u>	<u>(6,735)</u>
Net future income tax assets.....	41	76
Future income tax liabilities:		
Net book value of intangible assets in excess of tax bases.....	<u>(41)</u>	<u>(76)</u>
Future income taxes	<u>\$ -</u>	<u>\$ -</u>

c) Tax losses:

As of December 31, 2005, the Company had non-capital income tax loss carryforwards of approximately \$726,000 available to reduce future years' income for Canadian tax purposes. These losses will expire in 2014. In addition, the Company has research and development expenses amounting to \$1,627,000 that can be carried forward indefinitely and applied against future taxable income.

The Company also had non-capital income tax loss carryforwards of approximately \$509,000 available to reduce future years' income for United Kingdom tax purposes. These losses can be carried forward indefinitely.

13. Related party transactions:

The Company has entered into certain transactions in the normal course of business with a law firm, a partner of which is a director of the Company. During the year ended December 31, 2005, the total expense incurred by the Company from such law firm for legal services and other services aggregated to \$124,000 (2004 - \$177,000).

14. 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>Years ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Revenue by geographic location:			
United States.....	\$ 73,422	\$ 49,859	\$ 29,685
United Kingdom	7,673	3,673	2,180
Canada	3,153	1,935	1,952
Asia-Pacific.....	<u>4,494</u>	<u>1,536</u>	<u>-</u>
	<u>\$ 88,742</u>	<u>\$ 57,003</u>	<u>\$ 33,817</u>

WORKBRAIN CORPORATION

Notes to Consolidated Financial Statements

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

Years ended December 31, 2005, 2004 and 2003

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

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Property and equipment by geographic location:		
Canada	\$ 4,390	\$ 2,731
United States	496	148
United Kingdom	<u>113</u>	<u>—</u>
	<u>\$ 4,999</u>	<u>\$ 2,879</u>

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

During the years ended December 31, 2005, 2004 and 2003, no customers of the Company accounted for over 10% of net revenue.

15. Reclassification:

The Company has reclassified certain prior years information to conform to the current year presentation.