

**SPECTRA INC.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**YEAR ENDED DECEMBER 31, 2005**

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## AUDITORS' REPORT

To the Shareholders of  
**Spectra Inc.**

We have audited the consolidated balance sheet of **Spectra Inc.** as at December 31, 2005 and the consolidated statements of deficit, operations and cash flows for the year then ended. The financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and the results of its operations and the changes in its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2004 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated April 27, 2005.

*SF Partnership, LLP*

**Toronto, Canada**  
April 27, 2006

**CHARTERED ACCOUNTANTS**

**SPECTRA INC.**  
 (Incorporated under the Ontario Business Corporations Act)  
 Consolidated Balance Sheet  
 December 31, 2005

	2005	2004
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	\$ 4,443	\$ 7,915
Accounts receivable	75,287	124,604
Inventory (note 4)	122,048	147,419
Prepaid expenses	24,767	25,383
	<u>226,545</u>	<u>305,321</u>
<b>Capital Assets</b> (note 5)	63,363	68,496
<b>Other Assets</b> (note 6)	173,059	282,426
	<u>\$ 462,967</u>	<u>\$ 656,243</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued charges	\$ 1,139,482	\$ 821,349
Current portion of loans payable (note 7)	126,536	129,836
	<u>1,266,018</u>	<u>951,185</u>
<b>Long-Term Debt</b>	<u>1,063,229</u>	<u>1,083,851</u>
	<u>2,329,247</u>	<u>2,035,036</u>
<b>SHAREHOLDERS' DEFICIT</b>		
<b>Capital Stock</b> (note 8)	4,053,098	4,053,098
<b>Stock-Based Compensation</b>	24,435	-
<b>Deficit</b>	<u>(5,943,813)</u>	<u>(5,431,891)</u>
	<u>(1,866,280)</u>	<u>(1,378,793)</u>
	<u>\$ 462,967</u>	<u>\$ 656,243</u>

**APPROVED ON BEHALF OF THE BOARD**

"Michael Faye"

\_\_\_\_\_  
 Director

"Andrew J. Malion"

\_\_\_\_\_  
 Director

(The accompanying notes are an integral part of these financial statements)

**SPECTRA INC.**  
Consolidated Statement of Deficit  
Year Ended December 31, 2005

	2005	2004
<b>Deficit - beginning of year</b>	<b>\$ (5,431,891)</b>	<b>\$ (4,919,610)</b>
Net loss	<u>(511,922)</u>	<u>(512,281)</u>
<b>Deficit - end of year</b>	<b><u>\$ (5,943,813)</u></b>	<b><u>\$ (5,431,891)</u></b>

(The accompanying notes are an integral part of these financial statements)

**SPECTRA INC.**  
 Consolidated Statement of Operations  
 Year Ended December 31, 2005

	2005	2004
<b>Sales</b>	\$ 713,009	\$ 699,640
<b>Cost of Sales</b>	<u>318,076</u>	<u>289,046</u>
<b>Gross Profit</b>	<u>394,933</u>	<u>410,594</u>
<b>Expenses</b>		
Management	200,000	200,000
Royalty debenture	79,559	32,443
Royalty	76,280	44,705
Subcontract labour	69,620	58,890
Amortization	69,483	135,066
Selling expenses	62,152	66,338
Office and general	61,151	56,940
Consulting	58,923	61,115
Premises	57,250	56,109
Professional fees	71,330	80,080
Interest on long-term debt	49,526	85,674
Stock-Based Compensation	24,435	-
Commission	20,341	31,892
Advertising and promotion	4,854	2,704
Bad debts	715	-
Product development	-	10,919
Public relations	1,236	-
	<u>906,855</u>	<u>922,875</u>
<b>Loss Before Income Taxes</b>	(511,922)	(512,281)
Income tax (note 9)	<u>-</u>	<u>-</u>
<b>Net Loss</b>	<u>\$ (511,922)</u>	<u>\$ (512,281)</u>
<b>Net Loss per Share - Basic and Fully Diluted During the Period</b>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
<b>Weighted Average Number of Shares Outstanding - Basic</b>	<u>35,966,837</u>	<u>35,966,837</u>

(The accompanying notes are an integral part of these financial statements)

**SPECTRA INC.**  
 Consolidated Statement of Cash Flows  
 Year Ended December 31, 2005

	2005	2004
<b>Cash Flows from Operating Activities</b>		
Net loss	\$ (511,922)	\$ (512,281)
Adjustments for:		
Amortization	69,483	135,066
Stock-Based Compensation	24,435	-
Royalties	74,377	-
	<u>(343,627)</u>	<u>(377,215)</u>
Changes in non-cash working capital		
Accounts receivable	49,317	(75,165)
Inventories	25,371	(60,768)
Prepaid expenses and sundry assets	616	(244)
Accounts payable and accrued charges	318,133	(20,579)
	<u>49,810</u>	<u>(533,971)</u>
<b>Cash Flows from Investing Activities</b>		
Additions to capital assets	(2,874)	(10,324)
Patent, product rights and other	(26,485)	(247,782)
	<u>(29,359)</u>	<u>(258,106)</u>
<b>Cash Flows from Financing Activities</b>		
Loan repayment	(54,836)	739,946
Increase (decrease) in management loans	30,913	(150,883)
Issuance of shares	-	205,000
	<u>(23,923)</u>	<u>794,063</u>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	(3,472)	1,986
<b>Cash and Cash Equivalents - beginning of year</b>	<u>7,915</u>	<u>5,929</u>
<b>Cash and Cash Equivalents - end of year</b>	<u>\$ 4,443</u>	<u>\$ 7,915</u>
<b>Supplemental Cash and Cash Equivalents Flow Information</b>		
Interest paid	<u>\$ 49,526</u>	<u>\$ 87,485</u>
Income taxes paid	<u>\$ -</u>	<u>\$ -</u>

(The accompanying notes are an integral part of these financial statements)

**SPECTRA INC.**  
Notes to Consolidated Financial Statements  
December 31, 2005

## **1. Nature of Business and Basis of Presentation**

### **Nature of Business**

Spectra Inc. (the "Company") is a manufacturing and marketing company incorporated under the laws of the Province of Ontario on December 18, 1996. The Company operates in one market segment - bus and truck transportation safety equipment. The Company manufactures and markets brake monitoring equipment as an after market product through transportation dealers, distributors and direct sales to fleet operators.

### **Going Concern**

These consolidated financial statements have been prepared on a going concern basis which presumes the realization of assets and the discharge of liabilities in the normal course of business.

The Company has experienced operating losses and as at December 31, 2005 has a working capital deficiency of \$1,039,473 (2004 - \$645,864). The Company's ability to continue operations is dependent upon its ability to achieved profitability, maintain current financing and obtain new sources of financing. The outcome of these matters cannot be predicted at this time. The consolidated financial statements do not include any adjustments to amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue operations.

## **2. Summary of Significant Accounting Policies**

The Company follows Canadian generally accepted accounting principles. The following is a summary of significant accounting policies used in the preparation of these consolidated financial statements.

### a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Spectra Products Inc. All significant inter-company balances and transactions have been eliminated on consolidation.

### b) Use of estimates

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

### c) Inventory

Inventory is valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value. Cost consists of raw material and direct labour.

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**2. Summary of Significant Accounting Policies (cont'd)**

d) Capital Assets

Capital assets are carried at cost. Amortization is provided over the assets estimated useful life as follows:

Dies and molds		Units of production method
Furniture and fixtures	20%	Declining balance
Computer equipment	30%	Declining balance
Plant equipment	20%	Declining balance

e) Impairment of Long Lived Assets

Annually, or more frequently as circumstances require, (such as a decrease in sales prices, an increase in operating costs), reviews are undertaken to evaluate the carrying values of capital assets. Effective January 1, 2004 the Company prospectively adopted the requirements of CICA 3063 "Impairment of Long-lived Assets" to evaluate impairment. If it is determined that the future cash flows from an asset are less than its carrying value, a write-down to the estimated fair value is made with a charge to earnings. Adoption of CICA 3063 had no effect on these financial statements.

The Company's estimates of future cash flows are subject to risks and uncertainties. It is reasonably possible that changes in estimates could occur which may affect the expected recoverability of the Company's investment in capital assets.

f) Other Assets

Other assets are carried at cost. Amortization is provided over the assets estimated useful life as follows:

Patents and products rights	Straight line method over the term of the asset
Prototypes	Straight line, 3 years
Finance fee	Straight-line over term of debenture
Prepaid royalty	Straight line over original term of royalty agreement

**SPECTRA INC.**

Notes to Consolidated Financial Statements  
December 31, 2005

**2. Summary of Significant Accounting Policies (cont'd)**

## g) Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to the customer at the time of delivery of the product to a common carrier. Revenue is recognized upon delivery, provided that fulfillment of acceptance criteria can be demonstrated prior to shipment. The Company considers the receipt of a purchase order in writing or verbally together with a signed packing slip or bill of lading as persuasive evidence that an arrangement exists provided the customer is purchasing C.O.D. or is credit worthy. Based on these circumstances the customer is invoiced and the receivable is booked. The Company permits customer returns subject to a restocking charge and issues a credit to the customer. The returned product is entered into inventory.

## h) Earnings Per Share

Basic earnings per share is calculated based on the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated using the treasury stock method based on the weighted average number of shares that would have been outstanding during the year had all the dilutive options been exercised at the beginning of the year, or date of issuance if later, and assuming that option proceeds would be used to purchase common shares at the average market price during the year. As of each year ended there were no dilutive common equivalent shares.

## i) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

## j) Financial Instruments

The Company's financial instruments consists of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and loans payable. Unless otherwise stated the fair value of the financial instruments approximates their carrying value.

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**3. Changes in Accounting Policies**

Stock-Based Compensation

Executives and certain senior managers of the Company participate in the stock-based compensation plan, as described in note 8. The Company has adopted the recommendations of CICA Section 3870, "Stock-based Compensation and Other Stock-based Payments". These recommendations require that compensation for all equity based awards made to non-employees and employees be measured and recorded in the consolidated financial statements at fair value. The fair value of stock based compensation is determined using the Black-Scholes option pricing model. The resulting value is charged against income over the vesting periods of the option. The Company values options based on the trading price of the Company's common shares on the date of the grant, (CICA Handbook section 3870, Stock-based compensation and other stock-based payments).

**4. Inventory**

	2005	2004
Product for resale	\$ 16,355	\$ 35,712
Raw materials	<u>105,693</u>	<u>111,707</u>
	<u>\$ 122,048</u>	<u>\$ 147,419</u>

**5. Capital Assets**

	2005		2004	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Dies and molds	\$ 96,191	\$ 46,662	\$ 96,191	\$ 42,135
Furniture and fixtures	24,731	19,974	24,731	18,892
Computer equipment	13,069	10,078	10,744	9,023
Plant and equipment	<u>28,573</u>	<u>22,487</u>	<u>28,024</u>	<u>21,144</u>
	<u>\$ 162,564</u>	<u>\$ 99,201</u>	<u>\$ 159,690</u>	<u>\$ 91,194</u>
Net carrying amount		<u>\$ 63,363</u>		<u>\$ 68,496</u>

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**6. Other Assets**

	2005		2004	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents and trademarks	\$ 495,981	\$ 491,361	\$ 495,180	\$ 466,174
Product rights	18,000	14,400	18,000	12,600
Prototypes	115,153	64,312	89,468	29,822
Royalty Debenture Finance Fee	68,388	6,839	68,388	2,280
Prepaid Royalty Brake Safe Inc.	149,862	97,414	149,862	27,596
	<u>\$ 847,384</u>	<u>\$ 674,326</u>	<u>\$ 820,898</u>	<u>\$ 538,472</u>
Net carrying amount		<u>\$ 173,059</u>		<u>\$ 282,426</u>

**7. Loans Payable**

	2005	2004
Business Development Bank of Canada (a)	\$ 16,500	\$ 36,300
Management loans (b)	447,210	416,297
TD Canada Trust (c)	11,109	21,144
Dynamic Venture Opportunities Fund (d)	714,946	739,946
	<u>1,189,765</u>	<u>1,213,687</u>
Current portion	<u>126,536</u>	<u>129,836</u>
Long-term portion	<u>\$ 1,063,229</u>	<u>\$ 1,083,851</u>

- a) A working capital loan has been secured with the Business Development Bank of Canada repayable over a five year period, bearing interest at a floating rate currently at 12%. This loan is secured by a general security agreement and personal guarantees from Management (Andrew Malion and Michael Faye). Repayment to the Business Development Bank of Canada in the following year is \$16,500.

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**7. Loans Payable (cont'd)**

- b) Loans from management total \$447,210 and bear interest at 9.0% per annum. These loans are secured with a general security agreement including a fixed charge on the Schandelmeier patent. The management loans are repayable 366 days after demand.
- c) The Company's operating line of credit with TD Canada Trust Bank for \$50,000 was converted into a demand loan payable over 60 months beginning February 28, 2002 bearing interest at prime plus one percent. This loan is secured with a general security agreement. The balance at December 31, 2005 is \$11,109 (2004 - \$21,144). The amount due in each of the following next two years is as follows:

2006	\$	10,036
2007		<u>1,073</u>
	\$	<u>11,109</u>

- d) On August 6, 2004 the Company closed a debenture financing arrangement with Dynamic Venture Opportunities Fund Ltd. ("DVOF"), an Ontario labour-sponsored venture capital fund, whereby DVOF advanced \$750,000 to the Company's wholly-owned subsidiary, SPI. In consideration of the advance of these funds, DVOF is entitled to receive royalty payments equal to the greater of \$100,000 per annum or 10% of the total annual gross revenue generated by SPI. Twenty-five percent of each royalty payment shall be allocated against the principal amount of the debenture. The royalty payment shall continue at 10% of SPI's gross revenue until the earlier of (i) the date that the Royal Debenture has been fully repaid; and (ii) 15 years from issue date, at which time any remaining principal amount shall be due. As additional consideration, the Company issued 3,000,000 bonus shares to DVOF at a deemed price of \$0.05 per share, representing a deemed value equal to 20% of the \$750,000 financed. The minimum amount due in each of the next five years is as follows:

2006	\$	100,000
2007		100,000
2008		100,000
2009		100,000
2010		100,000
Thereafter		<u>214,946</u>
	\$	<u>714,946</u>

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
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**8. Capital Stock**

Authorized share capital - unlimited number of common voting shares, first, second, third and fourth preferred shares.

	2005	2004
Issued share capital		
35,966,837 (2004 - 35,966,837) common shares	4,026,098	4,026,098
90,000 (2004 - 90,000) Spectra preferred shares	<u>27,000</u>	<u>27,000</u>
	<b><u>\$ 4,053,098</u></b>	<b><u>\$ 4,053,098</u></b>
	<b># of Shares</b>	<b>Share Value</b>
Balance, December 31, 2003	<b>28,916,837</b>	\$ 3,281,098
Issued during 2004	<u>7,050,000</u>	<u>205,000</u>
Balance, December 31, 2004	<b>35,966,837</b>	4,026,098
Issued during 2005	<u>-</u>	<u>-</u>
<b>Balance, December 31, 2005</b>	<b><u>35,966,837</u></b>	<b><u>\$ 4,026,098</u></b>

Stock Options

The Company has a stock option plan that permits the grant of options to directors, officers, employees and consultants. The plan provides for the grant of a maximum number of options equal to ten percent of issued and outstanding common shares issued with maximum term of five years, fully vested at date of grant. The table below lists Options granted for the twelve month period ended December 31, 2005.

Expiry Date	Number of Options	Exercise	Remaining Contractual Life
October 1, 2006	250,000	\$0.25	0.6 years
January 15, 2007	375,000	\$0.20	2.0 years
March 2, 2008	800,000	\$0.10	2.2 years
August 31, 2010	950,000	\$0.10	3.7 years
October 11, 2010	125,000	\$0.10	3.9 years
<b>Total Options</b>	<b>2,500,000</b>	<b>\$0.13*</b>	

\* Weighted average exercise price

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**8. Capital Stock (cont'd)**

The table below presents pro-forma net income using the fair market value method of accounting for stock-based compensation:

	2005	2004
Net loss - as reported	\$ (511,922)	\$ (512,281)
Add: Share-based compensation included in net income	24,435	-
Deduct: Share-based compensation determined under the fair value method	<u>(24,435)</u>	<u>-</u>
Net loss - pro-forma	<u>\$ (511,922)</u>	<u>\$ (512,281)</u>
Weighted average basic and fully diluted loss per share - as reported	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Weighted average basic and fully diluted loss per share - pro-forma	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. There were no options issued in 2004. The following weighted average assumptions were applied:

	2005
Dividend yield	0.0 %
Expected volatility	107.0 %
Risk-free interest rate	4.0 %
Expected lives	5

**SPECTRA INC.**  
 Notes to Consolidated Financial Statements  
 December 31, 2005

**9. Income Taxes**

a) The Company has non-capital tax losses of approximately \$3,174,479 available to offset future taxable income. The tax losses expire as follows:

2006	\$	107,479
2007		373,125
2008		583,363
2009		526,948
2010		643,521
2014		452,556
2015		<u>487,487</u>
	\$	<u>3,174,479</u>

The potential benefit of these losses have not been recognized in the accounts. There are no significant timing differences between accounting and taxable income.

b) The Company's income tax provision (recovery) has been calculated as follows:

	2005	2004
Expected income tax recovery at statutory rates - 36.12%	\$ (184,906)	\$ (185,036)
Stock-Based Compensation	8,825	-
Other	3,833	-
Change in valuation allowance	<u>172,248</u>	<u>185,036</u>
	<u>-</u>	<u>-</u>

The following summarizes the principal temporary differences and related future tax effects:

Capital assets	30,706	67,498
Other assets	48,869	15,909
Non-capital losses	<u>1,146,622</u>	<u>970,542</u>
	1,226,197	1,053,949
Net capital gain	<u>-</u>	<u>-</u>
	1,226,197	1,053,949
Valuation Allowance	<u>(1,226,197)</u>	<u>(1,053,949)</u>
	\$ -	\$ -

**SPECTRA INC.**  
Notes to Consolidated Financial Statements  
December 31, 2005

**10. Related Party Transactions**

The following summarizes the Company's related party transactions for the year. These transactions occur in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the parties. Included in Accounts payable is approximately \$454,028 in amounts owed to directors of the Company. The amounts are unsecured, non-interest bearing and due on demand.

**11. Commitments**

The Company is obligated under an operating lease for premises until February 28, 2007 as follows:

2006	\$ 50,892
2007	<u>8,482</u>
	<u>\$ 59,374</u>