



Consolidated Financial Statements of

**IROC SYSTEMS CORP.**

Years ended December 31, 2005 and 2004



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## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the consolidated balance sheets of IROC Systems Corp. as at December 31, 2005 and 2004 and the statements of earnings and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our 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 the years then ended in accordance with Canadian generally accepted accounting principles.

*KPMG LLP*

Chartered Accountants

Calgary, Canada  
April 28, 2006

# IROC SYSTEMS CORP.

Consolidated Balance Sheets

December 31, 2005 and 2004

	2005	2004
<b>Assets</b>		
Current assets:		
Cash	\$ 187,624	\$ 50,571
Accounts receivable	14,113,971	3,433,071
Inventory	1,774,917	46,522
Prepaid expenses and deposits	752,739	156,537
Income taxes recoverable	177,743	—
	<u>17,006,994</u>	<u>3,686,701</u>
Prepaid lease costs	—	17,503
Deferred financing costs	22,108	—
Property and equipment (note 4)	35,603,936	13,318,971
Intangible assets (note 1)	6,261,663	—
Goodwill	7,050,484	1,339,571
Future income taxes (note 10)	—	1,304,000
	<u>\$ 65,945,185</u>	<u>\$ 19,666,746</u>

## Liabilities and Shareholders' Equity

Current liabilities:		
Operating loan (note 5)	\$ 1,452,646	\$ —
Accounts payable and accrued liabilities	5,770,933	2,920,168
Callable term debt (note 6)	6,945,608	2,955,819
Current portion of obligations under capital lease (note 7)	1,012,394	83,472
	<u>15,181,581</u>	<u>5,959,459</u>
Obligations under capital lease (note 7)	3,146,583	33,906
Deferred revenue	216,276	—
Convertible debentures (note 8)	—	279,852
Non-convertible debentures (note 8)	5,977,780	—
Future income taxes payable (note 10)	1,076,134	—
	<u>25,598,354</u>	<u>6,273,217</u>
Shareholders' equity:		
Convertible debentures (note 8)	—	40,000
Share capital (note 9)	36,118,511	13,246,030
Warrants (note 8)	1,150,000	—
Contributed surplus (note 9 (j))	827,973	10,623
Retained earnings	2,250,347	96,876
	<u>40,346,831</u>	<u>13,393,529</u>
Commitments and contingencies (notes 12 and 16)		
	<u>\$ 65,945,185</u>	<u>\$ 19,666,746</u>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

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(Signed) "Tom Alford" Director

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(Signed) "Brian Neeland" Director

# IROC SYSTEMS CORP.

Consolidated Statements of Earnings and Retained Earnings (Deficit)

Years ended December 31, 2005 and 2004

	2005	2004
Revenue	\$ 33,905,452	\$ 10,295,209
Expenses:		
Operating	22,418,865	6,260,273
General and administrative	4,673,794	2,336,857
Depreciation and amortization	3,238,642	1,381,387
Interest on callable term debt	340,372	41,852
Interest and accretion on debentures	333,327	40,652
Interest on obligations under capital lease	25,740	24,293
	31,030,740	10,085,314
	2,874,712	209,895
Other items:		
Gain on disposal of property and equipment	257,800	322,231
Other income(loss)	(19,631)	7,443
	238,169	329,674
Earnings before income taxes	3,112,881	539,569
Income taxes (note 10):		
Current	199,526	–
Future	759,884	333,436
	959,410	333,436
Net earnings	2,153,471	206,134
Retained earnings (deficit), at beginning of year	96,876	(106,058)
Interest on convertible debentures	–	(3,200)
Retained earnings, at end of year	\$ 2,250,347	\$ 96,876
Earnings per share:		
Basic	\$ 0.07	\$ 0.01
Diluted	\$ 0.07	\$ 0.01

See accompanying notes to consolidated financial statements.

# IROC SYSTEMS CORP.

## Consolidated Statements of Cash Flow

Years ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Net earnings	\$ 2,153,471	\$ 206,134
Deferred revenue received	216,277	-
Items not affecting cash:		
Depreciation and amortization	3,238,642	1,381,387
Stock-based compensation	824,274	58,428
Non-cash accretion on debentures	130,875	19,852
Future income taxes	759,884	333,435
Gain on disposal of property and equipment	(257,800)	(322,231)
Deferred financing costs	4,444	-
	7,070,067	1,677,005
Changes in non-cash working capital balances (note 13)	(9,274,840)	356,641
	(2,204,773)	2,033,646
Cash flows from investing activities:		
Purchase of property and equipment	(15,027,918)	(7,685,287)
Collection of note receivable	-	100,000
Business acquisitions	(4,529,682)	(245,125)
Proceeds on sale of property, plant and equipment	424,793	752,781
	(19,132,807)	(7,077,631)
Cash flows from financing activities:		
Issue of callable term debt	5,487,833	3,012,167
Issue of obligations under capital lease	-	58,226
Operating loan advances (repayments)	1,452,646	(350,325)
Issue of non-convertible debentures (net of issue costs)	6,960,000	-
Repayment of callable term debt	(1,498,043)	(842,546)
Repayment of obligations under capital lease	(281,878)	(134,423)
Issue of common shares	10,011,934	3,391,250
Share issue costs	(657,859)	(43,584)
Interest on convertible debentures	-	(3,200)
	21,474,633	5,087,565
Increase in cash during the year	137,053	43,580
Cash, beginning of year	50,571	6,991
Cash, end of year	\$ 187,624	\$ 50,571
Supplementary Information:		
Income taxes paid	\$ 15,884	\$ -
Interest paid	568,564	90,145
	\$ 584,448	\$ 90,145

See accompanying notes to consolidated financial statements.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements

Years ended December 31, 2005 and 2004

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## General:

IROC Systems Corp. (the "Corporation") is a Canadian corporation supplying equipment and personnel in the areas of safety, air quality monitoring, well servicing and reclamation and abandonment services to the oil and gas industry. The Corporation's common stock is traded on the TSX Venture Exchange.

## 1. Significant accounting policies:

### (a) Basis of presentation:

These financial statements are expressed in Canadian dollars and have been prepared in accordance with accounting principles generally accepted in Canada.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. Actual results may differ materially from these estimates.

### (b) Principles of consolidation:

These consolidated financial statements include the accounts of the Corporation and its subsidiaries all of which are wholly owned.

### (c) Inventory:

Inventory consisting of operating supplies, parts and finished goods are carried at the lower of cost, determined on a weighted average basis, and net realizable value.

### (d) Prepaid lease costs:

Prepaid lease costs represent the value of shares issued in exchange for a reduction in lease payments required on the first five years of a property lease held by the Corporation. The lease costs are amortized on a straight-line basis over five years.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 2

Years ended December 31, 2005 and 2004

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## 1. Significant accounting policies (continued):

(e) Depreciation:

Property and equipment are depreciated over their estimated useful lives using the following annual rates and methods:

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Rig equipment	Straight-line with 20% residual	10%
Trailers	Declining balance with 25% residual	15%
Heavy equipment	Declining balance	15%
Field equipment	Declining balance	20% - 50%
Other equipment	Declining balance	20% - 100%
Data acquisition centre	Declining balance	20%
Leasehold improvements	Straight-line	20%
Buildings	Straight-line	4%

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(f) Deferred financing costs:

Costs associated with the issuance of long-term debt are deferred and amortized over the term of the debt. The amortization is included in interest expense.

(g) Goodwill:

Goodwill represents the excess of the purchase price over the fair market value of the net assets acquired in a business combination. Goodwill is not amortized and is tested for impairment, at least annually. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using the Corporation's weighted average cost of capital.

(h) Long-lived assets:

On a periodic basis, management assesses the carrying value of long lived assets for indications of impairment. Indications of impairment include items such as an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, the Corporation tests for impairment by comparing the carrying value of the asset to its net recoverable amount. If the carrying amount is greater than the net recoverable amount, the asset is written down to its estimated fair value.

(i) Revenue recognition:

The Corporation's services are generally sold based upon purchase orders or contracts with customers that include fixed or determinable prices based upon daily, hourly, or job rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services and equipment rentals are rendered and only when collectability is reasonably assured.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 3

Years ended December 31, 2005 and 2004

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## 1. Significant accounting policies (continued):

(j) Intangible assets:

Intangible assets are comprised primarily of customer lists, patents, trademarks, non-competition agreements and are recorded at cost and amortized by the straight-line method over their useful lives ranging from 3 to 10 years. The amortization over the next five years is estimated to be \$ 927,922 per year.

(k) Income taxes:

The Corporation follows the asset and liability method of accounting for income taxes. Temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment or substantive enactment date.

(l) Stock based compensation:

The Corporation has equity incentive plans, which are described in note 10. The fair value of common share purchase options is calculated at the date of grant using the Black-Scholes option pricing model and that value is recorded as compensation expense over the grant's vesting period with an offsetting credit to contributed surplus. Upon exercise of the share purchase option, the associated amount is reclassified from contributed surplus to share capital. Consideration paid by employees upon exercise of share purchase options is credited to share capital.

(m) Per share amounts:

Per share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated following the treasury stock method assuming that proceeds obtained upon exercise of the options, warrants and the conversion of convertible debentures would be used to purchase common shares at the average market price during the period.

(n) Comparative figures:

Certain comparative figures have been reclassified to conform with the presentation adopted for the current year.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 4

Years ended December 31, 2005 and 2004

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## 2. Change in accounting policy and estimates:

### (a) Stock based compensation plans:

Effective January 1, 2004, the Corporation adopted the revised Canadian accounting standards with respect to its accounting policy for stock-based compensation. Under the new standard, the fair value of common share purchase options is calculated at the date of the grant and that value is recorded as compensation expense over the vesting period of those grants. Under the previous standard, no compensation expense was recorded when stock options were issued with any consideration received upon exercise credits to share capital.

The Corporation has retroactively applied this standards, however there has been no affect on the prior years' consolidated financial statements.

### (b) Depreciation:

Effective October 1, 2005, the Company changed the estimates of the useful lives of certain equipment. The change of rate of 30% down to 15% on the declining balance basis better reflected the useful lives of these assets. This change in accounting estimates has been applied prospectively and resulted in a \$52,500 reduction in depreciation expense, or \$0.00 per diluted share, for the year ended December 31, 2005.

## 3. Business combinations:

### (a) On March 22, 2005, the Corporation acquired all of the issued and outstanding shares of Global Atmospheric Sensing Inc. ("Global") for \$1,198,460 consideration consisting of \$75,000 in cash and 607,473 common shares of the Company with an ascribed value of \$1.81 per share.

In accordance with the purchase method, the allocation of the purchase price is based on the financial position of Global at March 22, 2005 and reflects the fair value, at that date, of the assets acquired and liabilities assumed based upon an evaluation of such assets and liabilities by management. Earnings of Global are included from March 23, 2005.

The purchase price of \$1,198,460 including transaction costs of \$23,934 has been allocated to Global's net assets and liabilities as follows:

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 5

Years ended December 31, 2005 and 2004

## 3. Business combinations (continued):

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Assets acquired:	
Cash	\$ 259,455
Accounts receivable	201,557
Other assets	450
Future income taxes	6,279
Property and equipment	247,248
Intangible – customer list	100,000
Intangible – proprietary software development	250,000
Goodwill	431,924
	<hr/> 1,496,913
Liabilities assumed:	
Accounts payable	176,235
Obligation under capital lease	43,689
Income taxes payable	78,529
	<hr/> 298,453
Net assets acquired	<hr/> \$ 1,198,460
Consideration given:	
Cash	\$ 75,000
607,473 common shares	1,099,526
Transaction costs	23,934
	<hr/> Total consideration \$ 1,198,460

- (b) On October 31, 2005 the Corporation acquired all of the issued and outstanding shares of Canada Tech Corp. ("Canada Tech") for \$5,417,487 in cash and 2,328,452 common shares of IROC at an ascribed value of \$2.827 per share.

The purchase price of \$12,117,781 including transaction costs of \$117,760 is expected to be allocated to the fair value of Canada Tech's net assets and liabilities. Additional contingent consideration of up to \$8,000,000 is based on Canada Tech meeting certain revenue and earnings targets for a 24 month period. Earnings of Canada Tech are included from November 1, 2005.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 6

Years ended December 31, 2005 and 2004

## 3. Business combinations (continued):

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Assets acquired:	
Cash	\$ 904,686
Accounts receivable	1,886,031
Inventory	675,583
Other assets	533,903
Property and equipment	1,512,778
Intangible assets - proprietary tool development, trademarks & patents	6,050,000
Goodwill	5,278,989
	<hr/> 16,841,970
Liabilities assumed:	
Accounts payable	1,882,850
Corporate taxes payable	119,774
Capital leases	877,538
Future income taxes	1,844,027
	<hr/> 4,724,189
Net assets acquired	<hr/> \$ 12,117,781
Consideration given:	
Cash	\$ 5,417,487
2,328,452 common shares	6,582,534
Transaction costs	117,760
Total consideration	<hr/> \$ 12,117,781

- (c) On April 30, 2004 the Corporation acquired all of the issued and outstanding shares of Canstar Environmental Corp. ("Canstar"). Pursuant to the agreement the shareholders of Canstar received \$200,000 in cash and 1,600,000 common shares of IROC at an ascribed price of \$0.80 per share. In addition, shareholders' loans owing to Deercorp Financial Inc. were paid by issuance of 357,732 additional common shares of IROC with an aggregate market value totaling \$290,264, the amount of the shareholders' loans. The terms of the acquisition also called for "earn-out payments" based on future operating results of Canstar. See Note 16.

In accordance with the purchase method, the allocation of the purchase price is based on the financial position of Canstar at April 29, 2004 and reflects the fair value, at that date, of the assets acquired and liabilities assumed based upon an evaluation of such assets and liabilities by management.

The purchase price of \$1,833,605, including transaction costs of \$63,341, has been allocated to Canstar's net assets and liabilities as follows:

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 7

Years ended December 31, 2005 and 2004

### 3. Business combinations (continued):

Assets acquired:		
Cash		\$ 18,216
Accounts receivable		373,291
Other assets		76,939
Future income taxes		33,475
Property and equipment		147,832
Goodwill		1,339,571
		<u>1,989,324</u>
Liabilities assumed:		
Accounts payable		155,719
Net assets acquired		<u>\$ 1,833,605</u>
Consideration given:		
Cash		\$ 200,000
1,957,732 common shares		1,570,264
Transaction costs		63,341
Total consideration		<u>\$ 1,833,605</u>

### 4. Property and equipment:

2005	Cost	Accumulated depreciation and amortization	Net book value
Rig equipment	\$ 27,348,456	\$ 2,076,019	\$ 25,272,437
Field equipment	5,229,277	2,140,967	3,088,310
Other equipment	1,190,877	663,723	527,154
Trailers	1,807,572	933,856	873,716
Heavy equipment	556,713	18,058	538,655
Data acquisition centre	353,500	172,508	180,992
Leasehold improvements	301,578	95,649	205,929
Building	3,520	231	3,289
	<u>36,791,493</u>	<u>6,101,011</u>	<u>30,690,482</u>
Under capital lease:			
Heavy equipment	4,108,228	166,329	3,941,899
Other equipment	1,164,064	192,509	971,554
	<u>5,272,292</u>	<u>358,838</u>	<u>4,913,454</u>
	<u>\$ 42,063,785</u>	<u>\$ 6,459,849</u>	<u>\$ 35,603,936</u>

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 8

Years ended December 31, 2005 and 2004

## 4. Property and equipment (continued):

2004	Cost	Accumulated depreciation and amortization	Net book value
Rig equipment	\$ 10,548,247	\$ 445,446	\$ 10,102,801
Trailers	2,468,404	978,660	1,489,744
Field equipment	2,193,887	988,063	1,205,824
Other equipment	395,172	255,449	139,723
Data acquisition centre	353,500	127,260	226,240
Leasehold improvements	47,894	9,102	38,792
Building	3,520	94	3,426
	16,010,624	2,804,074	13,206,550
Under capital lease:			
Trailers	253,577	188,238	65,339
Vehicles	54,418	16,325	38,093
Other equipment	26,216	17,227	8,989
	334,211	221,790	112,421
	\$ 16,344,835	\$ 3,025,864	\$ 13,318,971

## 5. Operating loan:

The Corporation has available a \$7,500,000 operating credit facility - with the Canadian Western Bank which bears interest at the bank prime rate plus 0.75%. This operating loan is payable upon demand and is secured by a general security agreement which provides a specific first charge against certain property and equipment and a floating first charge against all of the Corporation's assets.

## 6. Callable term debt:

	2005	2004
Term demand loans, Canadian Western Bank, repayable in monthly installments of \$114,054 including interest at prime plus 1.0%	\$ 5,122,807	\$ 2,147,736
Term demand loans, Canadian Western Bank, repayable in monthly installments of \$75,165 including interest at prime plus 1.0%	1,822,801	808,083
	\$ 6,945,608	\$ 2,955,819

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 9

Years ended December 31, 2005 and 2004

## 6. Callable term debt (continued):

Security for the callable term debt is the same as for the operating loan as outlined in Note 5.

The total term demand loan facility at Canadian Western Bank at December 31, 2005 is \$8,500,000 which will be completely drawn down to fund the acquisition of service rig support equipment and the construction of other operating equipment.

Assuming that existing obligations are not called, minimum principal repayments on callable term debt for the next five fiscal years, are as follows:

2006	\$ 1,950,711
2007	1,980,560
2008	1,454,768
2009	1,266,100
2010	293,469
	<hr/>
	\$ 6,945,608

## 7. Obligations under capital lease:

	2005	2004
Capital leases, repayable in monthly installments of \$5,151 including interest at 9.24%, maturing in September 2005 and secured by trailers under capital lease	\$ —	\$ 61,725
Capital lease, repayable in monthly installments of \$1,394 including interest at 2.80%, maturing in February 2008 and secured by vehicles under capital lease	35,126	50,634
Capital lease, repayable in monthly installments of \$832 including interest at 12.25%, maturing in April 2005 and secured by other equipment under capital lease	—	5,019
Capital leases, repayable in monthly installments of \$4,183 including interest from 7.79% to 9.05% maturing between June and September 2008 and are secured by other equipment under capital lease	117,449	—
Capital lease, repayable in monthly installments of \$853 including interest at 3.8%, maturing in November 2009 and secured by other equipment under capital lease	37,180	—
Capital leases, repayable in monthly installments of \$13,832 including interest at 7.4%, maturing January and February 2008 and secured by heavy equipment under capital lease	279,897	—
Capital leases, repayable in monthly installments of \$9,048 including interest between 6.5% and 7.0%, maturing between December 2008 and March 2009 and are secured by other heavy equipment under capital lease.	306,716	—

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 10

Years ended December 31, 2005 and 2004

## 7. Obligations under capital lease (continued):

Capital lease, repayable in monthly installments of \$1,054 Including interest at 9.75%, maturing in June, 2008 And secured by heavy equipment under capital lease	27,967	—
Capital leases, repayable in monthly installments of \$57,472 Including interest at 6.7% to 6.8%, maturing in December 2009 and 2010 and are secured by heavy equipment under capital lease.	2,498,710	—
HSBC obligations under capital lease, due in monthly installments aggregating \$13,442 including interest at rates ranging from 5.0% to 5.6% and maturing on dates ranging from May, 2010 to August, 2010 and are secured by certain manufacturing equipment.	710,818	—
National Leasing obligation under capital lease, due in monthly installments of \$918 including interest at 12.6% and maturing in March, 2010, secured by certain computer equipment	38,371	—
Lift Capital obligation under capital lease, due in monthly installments of \$659 including interest at 6.2% and maturing in May 2010 and secured by certain automotive equipment	35,619	—
HSBC obligation under capital lease, due in monthly installments of \$2,317 including interest at 5.2% and maturing October 2008 and secured by certain manufacturing equipment	71,124	—
	4,158,977	117,378
Less current portion	1,012,394	83,472
	<u>\$ 3,146,583</u>	<u>\$ 33,906</u>

Minimum principal repayments on obligations under capital lease for the next five fiscal years are as follows:

2006	\$ 1,012,394
2007	\$ 1,041,216
2008	\$ 976,957
2009	\$ 851,685
2010	\$ 276,725

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 11

Years ended December 31, 2005 and 2004

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## 8. Debentures

### (a) Convertible debentures:

During the year ended December 31, 2003 the Corporation issued \$300,000 of unsecured convertible debentures bearing interest at 8.0% payable quarterly and maturing on June 23, 2006. These debentures are convertible at the option of the holders into common shares of the Corporation prior to maturity at conversion prices of \$0.50 per share on or before June 23, 2005 and \$0.55 per share thereafter. The convertible debenture is presented in the financial statements in its components parts, measured at their respective fair values at the time of issue. The debt component has been calculated as the present value of the required interest and principle payments discounted at a rate approximating the interest rate that would have been applicable to non-convertible debt at the time the debenture was issued. Interest expense is determined on the debt component. The difference between the debt component and the face value of the debenture is classified as equity, net of issue costs adjusted for income taxes.

During the year, the Company paid \$6,000 (2004 - \$24,000) of interest related to the convertible debenture. These debentures were converted to shares in June, 2005.

### (b) Debentures – non-convertible:

On September 12, 2005 the Corporation completed the private placement of \$7.0 million of three year 8% unsecured debentures, which include 1,050,000 warrants to purchase common shares of IROC. Each warrant is exercisable into one common share of the Corporation at a price of \$2.50 for the first two (2) years and at a price of \$2.70 for the third year of the warrant. The debentures and warrants are non transferable. Any common shares issued upon the exercise of the warrant within the first four (4) months and one (1) day after the date that warrants were issued will be subject to a hold period which would expire on the date which is four (4) months and one (1) day after the date the warrants were issued. A commission in the amount of \$40,000 was paid in connection with the offering. No warrants were exercised prior to December 31, 2005.

### (c) Warrants:

The fair value of the warrants was \$1,150,000 and has been included in shareholders' equity. The fair value of \$5,850,000 that has been allocated to the non-convertible debenture and is being accreted using the straight line method over the term of the debentures. In the event that the debentures are retired prior to maturity, the difference between the carrying amount of the debenture and the face value of the debentures will be charged to earnings. Accordingly, \$127,780 of accretion expense has been recorded during the period.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 12

Years ended December 31, 2005 and 2004

## 9. Share capital:

### (a) Authorized:

Unlimited number of voting common shares without nominal or par value

### (b) Issued:

	Number	Amount
Balance at December 31, 2003	12,580,604	\$ 3,312,808
Issued for cash on private placement	6,600,000	3,300,000
Issued on acquisition of service rig equipment	4,421,006	4,951,527
Issued on acquisition of Canstar Environmental Corp.	1,957,732	1,570,264
Issued for cash on exercise of options	175,000	139,055
Share issue costs net of income tax benefits	-	(27,624)
Balance at December 31, 2004	25,734,342	13,246,030
Issued on acquisition of service rig equipment	4,313,463	5,362,067
Issued on acquisition of Global Atmospheric Sensing Inc.	607,473	1,099,526
Issued on acquisition of Canada Tech Corp.	2,328,452	6,582,534
Issued on private placement	3,600,000	9,900,000
Issued for cash on exercise of options	206,000	118,858
Issued on conversion of debenture	600,000	322,947
Share issue costs, net of income tax benefit	-	(513,451)
Balance at December 31, 2005	37,389,730	\$ 36,118,511

### (c) Stock options :

The Corporation has a stock option plan for its directors, officers and key employees whereby options to a maximum of ten percent of the issued and outstanding common shares may be granted subject to certain terms and conditions. Stock option vesting privileges are at the discretion of the Corporation's Board of Directors ranging from two to five years. Changes in the number of common shares under option during the years ended December 31, 2005 and 2004 are summarized as follows:

	2005		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance at beginning of year	630,000	\$ 0.67	555,000	\$ 0.49
Granted	1,180,000	2.32	650,000	0.78
Forfeited	(88,334)	1.04	(400,000)	0.35
Exercised	(206,000)	0.54	(175,000)	0.52
Balance at end of year	1,515,666	1.95	630,000	\$ 0.67
Options exercisable	695,668		447,000	

# IROC SYSTEMS CORP.

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Years ended December 31, 2005 and 2004

## 9. Share capital (continued):

### (c) Stock options (continued):

The following table summarizes information about the stock options outstanding at December 31, 2005:

Exercise price	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable	
				Number exercisable at December 31, 2005	Weighted average exercise price
\$ 0.35	84,000	2.26	\$ 0.35	84,000	\$ 0.35
0.65	155,000	0.04	0.65	155,000	0.65
0.80	5,000	0.06	0.80	5,000	0.80
0.89 – 0.95	100,000	3.44	0.92	66,668	0.92
1.10 – 1.30	266,666	4.04	1.12	83,333	1.12
2.09 – 2.25	450,000	4.50	2.13	150,000	2.13
2.85 – 3.40	455,000	4.79	3.24	151,667	3.24
	1,515,666	3.84	\$ 1.95	695,668	\$ 1.58

The fair value of common share options is estimated as at the grant date using the Black-Scholes option pricing model, with the following weighted average assumptions:

Risk free interest rate (%)	\$ 3.8
Expected lives (years)	5.0
Expected volatility (%)	68.0
Dividend per share	—

The weighted average fair value of the options issued is \$1.95

For the year ended December 31, 2005, stock based compensation costs included in net earnings totaled \$824,274 (2004 - \$58,428).

- (d) On September 8, 2005 the Company closed a private placement, which resulted in the issue of 3,600,000 common shares at a price of \$2.75 per common share for gross proceeds of \$9,900,000.
- (e) On March 11, 2004 the Company closed a private placement, which resulted in the issue of 6,600,000 common shares at a price of \$0.50 per common share for gross proceeds of \$3,300,000.

# IROC SYSTEMS CORP.

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Years ended December 31, 2005 and 2004

## 9. Share capital (continued):

- (f) Per share amounts - The weighted average number of shares outstanding during the year was 31,467,865 (2004 - 19,816,619). In computing diluted earnings per share for 2005, 500,992 shares (1,075,058 - shares for 2004) were added to the average number of common shares outstanding to give effect to stock options and warrants (convertible debentures in 2004).
- (g) Escrowed shares - At December 31, 2005 the Corporation held 458,333 shares in escrow (2004 - 491,666). These shares are releasable at various dates between February 28, 2005 and February 28, 2009.
- (h) On June 2, 2005 the Corporation entered into an agreement to purchase 6 service rig equipment packages consisting of drawworks, right angle drives and transmissions from Key Energy Services Inc. ("Key"), a U.S. public company. The purchase price for the equipment is \$917,400 US, or approximately \$1,144,090 CDN. The purchase price was paid by way of issuance of 547,411 common shares of the Corporation at a price of \$2.09 per share.
- (i) On July 20, 2004 the Corporation entered into an agreement to purchase ten service rigs, supporting equipment and inventory from Key Energy Services Inc. ("Key"), a U.S. public company. The purchase price for the equipment is \$7,000,000 US, approximately \$9,170,000 CDN. The purchase price will be paid by way of issuance of 8,178,058 common shares of the Corporation at a price of \$1.12 per share. As at December 31, 2004 3,757,052 common shares remained to be issued pending future delivery of the remaining service rigs. At December 31, 2005 all shares had been issued.
- (j) Contributed surplus:

Contributed surplus represents the cost of the stock-based compensation payments relating to the compensation expense for stock options granted to employees, directors and consultants.

The following tables summarize information regarding contributed surplus:

	2005	2004
Opening balance	\$ 10,623	\$ -
Stock - based compensation	824,274	58,428
Options exercised	(6,924)	(47,805)
Closing balance	\$ 827,973	\$ 10,623

# IROC SYSTEMS CORP.

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Years ended December 31, 2005 and 2004

## 10. Income taxes:

The future income tax (liability) asset is comprised of:

	2005	2004
Future tax assets:		
Income tax losses	\$ 893,300	\$ 1,084,300
Property and equipment	–	405,200
Share issue costs	275,300	141,200
Investments	28,400	28,400
	1,197,000	1,659,100
Capital assets	(452,227)	–
Intangible assets	(1,820,907)	–
Valuation allowance	–	(355,100)
Future income tax (liability) asset	\$ (1,076,134)	\$ 1,304,000

The following table reconciles income taxes calculated at the Canadian statutory rates as indicated with actual income taxes:

	2005	2004
Earnings before income taxes	\$ 3,112,881	\$ 539,569
Combined federal and provincial income tax rate	33.62%	33.62%
Expected income taxes	1,046,550	181,403
Increase (decrease) resulting from:		
Non-deductible items	52,380	31,326
Income tax effect of income tax rate change	--	140,536
Non-taxable portion of capital gains	(9,090)	(19,830)
Reversal of valuation allowance	(355,137)	–
Stock based compensation	277,121	–
Other	(52,414)	–
	\$ 959,410	\$ 333,435

The Corporation has a loss carry-forwards for income tax purposes totaling \$2,657,197 which are available for application against future taxable income until:

2008	\$ 975
2009	\$ 55,839
2010	\$ 1,500
2014	\$ 309,554
2015	\$ 2,289,329

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 16

Years ended December 31, 2005 and 2004

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## 11. Commitments:

The Corporation has entered into agreements to lease equipment and premises requiring future minimum payments of \$3,235,523. Minimum annual payments during the next five fiscal years are as follows:

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2006	\$ 1,181,252
2007	\$ 1,083,207
2008	\$ 505,229
2009	\$ 285,324
2010	\$ 180,511

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## 12. Financial instruments:

### (a) Fair value of financial instruments:

The Company's financial instruments recognized in the balance sheet consists of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, operating and callable term debt. The fair value of these financial instruments approximate their carrying amounts due to their short terms to maturity. The fair value of capital leases and other liabilities included in the consolidated balance sheet does not materially differ from their carrying values. The fair value of the callable debt and operating loan facility approximates their carrying value as it bears interest at floating rates.

### (b) Interest rate risk:

The Companies exposed to interest rate risk to the extent that changes in market interest rate will impact the Company's debts that have a floating interest rate. The Companies had no interest rate swaps or hedges at December 31, 2005.

### (c) Credit risk:

Accounts receivable includes balances from a large number of customers primarily operating in the oil and gas industry. The Corporation assesses the credit worthiness of its customers on an ongoing basis as well as monitoring the amount and age of balances outstanding. Accordingly, the Corporation views the credit risk on these amounts as normal for the industry.

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 17

Years ended December 31, 2005 and 2004

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## 13. Supplemental information:

Components of change in non-cash working capital balances:

	2005	2004
Accounts receivable	\$ (8,686,882)	\$ (1,822,625)
Inventory	(1,052,810)	58,605
Prepaid expenses and deposits	(515,299)	(54,705)
Income taxes receivable	173,433	—
Accounts payable and accrued liabilities	806,720	2,155,366
	<hr/>	<hr/>
	\$ (9,274,838)	\$ 336,641

## 14. Related party transactions:

- (a) During the year ended December 31, 2005 the Corporation paid \$80,000 (2004 - \$80,000) in management fees to a corporation owned by the spouse of an officer of the Corporation. Included in accounts payable and accrued liabilities at December 31, 2005 is \$7,133 (2004 - \$7,133) owing by the Corporation to an officer and a corporation controlled by the spouse of an officer of the Corporation.
- (b) During the year ended December 31, 2005, the Corporation purchased six service rig packages from Key Energy Services Inc. ("Key"), a U.S. public company that currently holds 23.37 percent of the Corporation's issued and outstanding shares. The purchase price for the equipment was \$917,400 US, (\$1,144,089 CDN dollars). The purchase price was paid by way of issuance of 547,411 common shares of the Corporation at an issuance price of \$2.09 per share. Key has its CFO as a member of IROC's board of directors.
- (c) On July 3, 2003 the Corporation issued two convertible debentures (as outlined in Note 8) to an officer and the spouse of an officer of the Corporation. Interest paid in 2005 was nil (2004 - \$24,000).

# IROC SYSTEMS CORP.

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Years ended December 31, 2005 and 2004

## 15. Segmented information:

As at December 31, 2005 the Corporation operates in four main operating segments, which are substantially in one geographic segment. The Safety, Monitoring, and Communication Services segment includes the provision of on-site safety and communication personnel and equipment and remote data monitoring using IROC's S.M.A.R.T. system and downwind monitoring technology. The Well Servicing segment comprises the operations of Eagle Well Servicing Corp. which includes the contracting of well servicing equipment and the provision of personnel required to operate the equipment. The Environmental Services segment comprises the operations of Envirocore Ltd. (formerly Canstar Environmental Corp.), which includes the provision of personnel and equipment in connection with lease construction, remediation, reclamation and abandonment of oil industry related sites. The Canada Tech Corp. segment develops, manufactures and markets a wide line of tools and systems that measure pressures and temperatures in the downhole and surface environment of oil and gas wells.

Year ended December 31, 2005	Safety Monitoring Communications	Well Servicing	Environmental Services	Downhole Tools	Total
Revenue	\$ 8,905,549	\$ 16,410,585	\$ 6,575,814	\$ 2,013,504	\$33,905,452
Earnings before interest, taxes, depreciation and amortization	786,030	5,126,982	423,687	714,263	7,050,962
Net earnings (loss)	(1,414,125)	3,270,525	17,121	279,950	2,153,471
Depreciation and amortization	1,126,333	1,642,551	212,567	257,191	3,238,642
Purchase of property and equipment	2,464,543	16,850,029	4,696,881	1,512,779	25,524,232
Goodwill	431,924	–	1,339,571	5,278,989	7,050,484
<b>Total assets</b>	<b>\$31,158,188</b>	<b>\$24,114,445</b>	<b>\$3,455,604</b>	<b>\$7,216,948</b>	<b>\$65,945,185</b>

Year ended December 31, 2004	Safety Monitoring Communications	Well Servicing	Environmental Services	Total
Revenue	\$ 6,885,263	\$ 2,249,328	\$ 1,160,618	\$ 10,295,209
Earnings before interest, taxes, depreciation and amortization	1,617,212	467,725	(57,184)	2,027,753
Earnings (loss) from operations	284,391	6,983	(85,240)	206,134
Depreciation and amortization	902,449	450,883	28,055	1,381,387
Purchase of property and equipment	1,995,592	10,580,490	6,231	12,582,313
Goodwill	–	–	1,339,571	1,339,571
<b>Total assets</b>	<b>\$6,158,651</b>	<b>\$11,194,406</b>	<b>\$2,313,689</b>	<b>\$19,666,746</b>

# IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 19

Years ended December 31, 2005 and 2004

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## 16. Contingencies:

- (a) On April 30, 2004 the Corporation acquired all of the issued and outstanding shares of Canstar Environmental Corp. ("Canstar"). See Note 3. The terms of the acquisition called for "earn-out payments" based on future operating results of Canstar. These earn-out payments are subject to certain limitations concerning the timing (calculation based on EBITDA for each of fiscal years 2004 through 2006 and for that three year period in total) and amount (maximum payments of \$83,333 per year and \$250,000 in total) of any such payments. For 2004 and 2005, no amounts had been earned or paid under this agreement.
- (b) A legal action seeking damages and compensation of \$821,000 plus \$50,000 for punitive damages has been filed against the Corporation. Four parties have been named. The claim seeks damages and compensation for non-performance in regard to a 1996 agreement. The claim has been responded to by the Corporation and a counterclaim has been filed in the amount of \$220,241 for failure to perform pursuant to the 1996 agreement, plus all amounts currently outstanding. No liability in respect of these actions has been included in these consolidated financial statements as management intends to vigorously defend the matter and believes the outcome will be in its favor. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.
- (c) A legal action seeking compensation of \$90,000 for wrongful dismissal damages has been filed against the Corporation. Management has indicated that it intends to vigorously defend the matter and believes the outcome will be in its favor. Any amounts awarded as a result of this action will be reflected in the year the amounts become reasonably estimable.
- (d) A legal action seeking \$5.0 million plus general, special and punitive damages has been filed against IROC Systems Corp. Management believes that the suit is completely unfounded and without merit, and management intends to vigorously defend the matter and believes that the outcome will be in its favor. Any amounts awarded as a result of this action will be reflected in the year the amounts become reasonably estimable.