SustainCo Inc.

Consolidated Financial Statements

For the years ended August 31, 2016 and 2015

(Expressed in Canadian Dollars)

Independent Auditors' Report

To the Shareholders of SustainCo Inc.

We have audited the accompanying consolidated financial statements of SustainCo Inc., which comprise the statements of financial position as at August 31, 2016 and 2015, and the statements of loss and comprehensive loss, changes in shareholders' equity (deficiency) and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of SustainCo Inc. as at August 31, 2016 and 2015, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw attention to Note 1 to the consolidated financial statements which highlights the existence of a material uncertainty relating to conditions that cast significant doubt on SustainCo Inc.'s ability to continue as a going concern.

MNP LLP

Chartered Professional Accountants
Licensed Public Accountants

Mississauga, Ontario
December 21, 2016

MNP

SustainCo
Sustainable Infrastructure Solutions

Consolidated Statements of Financial Position
(Expressed in Canadian Dollars)

		August 31, 2016		August 31, 2015
Assets				
Current assets				
Cash	**$**	**20,400**	$	33,042
Accounts receivable, net of $214,367 allowance (Aug 31, 2015 - $215,579)		**3,950,863**		3,483,364
Unbilled receivables		**688,882**		425,338
Inventories *(note 4)*		**295,740**		326,511
Prepaid expenses		**89,790**		66,142
		5,045,675		4,334,397
Property and equipment *(note 5)*		**131,251**		127,942
Intangible assets *(note 7)*		**286,667**		351,667
Goodwill *(note 6)*		**599,802**		599,802
	$	**6,063,395**	$	5,413,808
Liabilities				
Current liabilities				
Trade payables and accrued liabilities	**$**	**2,627,851**	$	2,540,418
Bank indebtedness *(note 12)*		**60,357**		525,104
Acquisition payable		**60,000**		60,000
Deferred revenue		**1,074,798**		447,064
Notes payable *(note 14)*		**100,000**		-
Due to related parties *(note 9)*		**374,602**		260,000
		4,297,608		3,832,586
Notes payable *(note 14)*		**599,451**		-
Debentures *(note 13)*		**-**		4,856,864
		4,897,059		8,689,450
Shareholders' equity (deficiency)				
Share capital *(note 8)*		**20,061,132**		15,442,371
Share-based payment reserve *(note 8)*		**2,142,152**		1,600,869
Deficit		**(21,036,948)**		(20,318,882)
		1,166,336		(3,275,642)
	$	**6,063,395**	$	5,413,808

The accompanying notes are an integral part of these consolidated financial statements.

Nature of operations and going concern *(note 1)*

Subsequent event *(note 20)*

Approved on behalf of the Board

Signed: *"Emlyn J. David"* — Director

Signed: *"Michael Galloro"* — Director

Consolidated Statements of Loss and Comprehensive Loss
(Expressed in Canadian Dollars)

		For the years ended August 31,		
		2016		2015
Sales *(note 16)*	**$**	**14,288,823**	$	12,305,380
Cost of sales *(note 4)*		**10,815,951**		8,958,595
Gross profit		**3,472,872**		3,346,785
General and administrative *(note 11)*		**3,393,356**		3,727,169
Finance expense *(note 9, 12, 13 & 14)*		**644,974**		699,337
Amortization and depreciation *(note 5 & 7)*		**145,610**		110,539
Share-based payments *(note 8)*		**66,283**		117,616
Loss on disposal of equipment *(note 5)*		**8,733**		21,564
Loss on extinguishment of debentures *(note 13)*		**424,332**		-
Gain on settlement of payables *(note 19)*		**(492,350)**		-
Net loss and comprehensive loss	**$**	**(718,066)**	$	(1,329,440)
Net loss per share				
Basic and diluted	**$**	**(0.26)**	$	(0.57)
Weighted average shares outstanding		**2,803,044**		2,337,090

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity (Deficiency)
(Expressed in Canadian Dollars)

		Share Capital		Share-based payment reserve		Deficit		Total
Balance, August 31, 2014	$	15,442,371	$	1,483,253	$	(18,989,442)	$	(2,063,818)
Share-based payments		-		117,616		-		117,616
Net loss for the year		-		-		(1,329,440)		(1,329,440)
Balance, August 31, 2015	$	15,442,371	$	1,600,869	$	(20,318,882)	$	(3,275,642)
Issuance of shares for debt		4,618,761		-		-		4,618,761
Issuance of warrants for debt		-		475,000		-		475,000
Share-based payments		-		66,283		-		66,283
Net loss for the year		-		-		(718,066)		(718,066)
Balance, August 31, 2016	**$**	**20,061,132**	**$**	**2,142,152**	**$**	**(21,036,948)**	**$**	**1,166,336**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

(Expressed in Canadian Dollars)

	For the years ended August 31, **2016**	2015
Cash flow from operating activities		
Net loss	$ **(718,066)**	$ (1,329,440)
Add (deduct) items not involving cash		
Accretion	**137,202**	60,618
Amortization and depreciation	**145,610**	110,539
Share-based payments	**66,283**	117,616
Loss on disposal of equipment	**8,733**	21,564
Loss on extinguishment of debentures *(note 13)*	**424,332**	-
Gain on settlement of payables *(note 19)*	**(492,350)**	-
Change in non-cash working capital		
Accounts receivable	**(467,499)**	(65,484)
Unbilled receivables	**(263,544)**	(24,476)
Inventory	**30,771**	25,316
Prepaid expenses	**(23,648)**	62,594
Deferred revenue	**627,734**	127,289
Accounts payable and accrued liabilities	**579,783**	(135,832)
	55,341	(1,029,696)
Cash flow from financing activities		
Issuance of notes payable	**100,000**	-
Payment of acquisition payable	-	(10,000)
Advance from related party	**389,416**	131,801
Repayment of bank indebtedness, net	**(464,747)**	(570,759)
	24,669	(448,958)
Cash flow from investing activities		
Investment in property and equipment	**(92,652)**	(7,835)
Proceeds from sale of property and equipment	-	4,694
	(92,652)	(3,141)
(Decrease) in cash	**(12,642)**	(1,481,795)
Cash, beginning of period	**33,042**	1,514,837
Cash, ending of period	$ **20,400**	$ 33,042

The accompanying notes are an integral part of these consolidated financial statements.

1. Nature of Operations and Going Concern

SustainCo Inc. (the "Company" or "SustainCo"), was incorporated under the *Canada Business Corporation Act* on August 22, 2008. The address of the Company's corporate office is 1 Royal Gate Blvd., Suite D, Vaughan, Ontario, Canada. The Company is listed on the TSX Venture Exchange Inc. (the "TSX-V" or the "Exchange") under the trading symbol "SMS".

SustainCo conducts its operations through two wholly-owned subsidiaries, Clean Energy Developments Corp. ("CleanEnergy") and VCI CONTROLS Inc. ("VCI" or "VCI CONTROLS").

CleanEnergy is a Canadian industry leading geoexchange company that provides heating and cooling solutions for residential and commercial buildings using energy from the earth. It provides a complete energy solution and is able to provide engineering and design, geo installation, equipment and control systems as well as manage the complete project.

VCI is a leading supplier of building technologies and services that improve comfort, safety, energy efficiency, and occupant productivity. It is an industry leader in the development of intelligent building technology, including the integration of all building systems utilizing the latest in communications technologies and standards. VCI's business focuses on digital controls and mechanical services, performance monitoring, and energy efficiency solutions.

These consolidated financial statements are prepared on the assumption that the Company is a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of operations. Over the past two years the Company has incurred significant losses including operating losses for the years ended August 31, 2016 and 2015 of $718,066 and $1,329,440 respectively. As a result, the Company has an accumulated deficit of $21,036,948 and working capital of $748,067 at August 31, 2016. The Company has taken and continues to take steps to reduce these losses and ultimately become profitable including the restructuring of debt; however, losses may continue for the 2017 fiscal year. As a result, there is substantial doubt surrounding the Company's ability to continue as a going concern. In order to rectify these problems, in addition to increasing revenues and decreasing costs in order to reduce losses, the Company may require additional financing in the form of debt or equity. Failure to obtain such financing could result in delay or indefinite postponement of the Company's strategic goals. These consolidated financial statements do not include any adjustments to the carrying values and classifications of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

2. Basis of Presentation

Statement of compliance

The Company's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations of the IFRS Interpretations Committee ("IFRIC").

These consolidated financial statements were authorized for issue by the Board of Directors on December 21, 2016.

Basis of measurement and functional currency

The consolidated financial statements are prepared on the historical cost basis.

The consolidated financial statements are presented in Canadian dollars, the Company's functional currency.

Principles of consolidation

The Company consolidates its interest in entities which it controls. Control comprises the power to govern an entity's financial and operating policies so as to obtain benefits from its activities. All intercompany balances and transactions have been eliminated.

3. Summary of Significant Accounting Policies

Revenue recognition

Revenue from long-term service contracts, consisting of design and engineering services and installation of mechanical and geoexchange systems, is recognized using the percentage-of-completion method of accounting. The degree of completion is determined by comparing the costs incurred to the total costs anticipated for the contract. Where the contract outcome cannot be measured reliably, revenue is recognized only to the extent that the expenses incurred are eligible to be recovered. Revenues earned in excess of billings issued are recorded as unbilled receivables. Advance payments received from customers, in excess of revenue recognized, are classified as deferred revenue until the service is provided or the product delivered.

Service revenue is recognized on a straight-line basis over the term of the service agreement.

Product revenue is recognized when the significant risks and rewards are transferred to the buyer, the amount of revenue can be measured reliably, it is probable that the economic benefits will be received, and the costs incurred or to be incurred can be measured reliably.

3. Summary of Significant Accounting Policies – continued

Financial instruments

All financial instruments are classified into one of the following categories: fair value through profit and loss ("FVTPL"), held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. Loans and receivables, held-to-maturity investments, and other financial liabilities which are initially measured at fair value and then at amortized cost. FVTPL financial instruments are subsequently re-measured at fair value and all gains and losses are included in net income or loss in the period which they arise. Available-for-sale financial instruments are subsequently measured at fair value with revaluation gains and losses included in other comprehensive income or loss until the instrument is derecognized or impaired.

Cash and accounts receivable are classified as loans and receivables, which are measured at amortized cost less any provision for impairment. Trade payables and accrued liabilities, bank indebtedness, acquisition payable, due to related parties, notes payable and debentures are classified as other financial liabilities which are measured at amortized cost. The Company had neither available-for-sale nor held-to-maturity instruments during the years ended August 31, 2016 and 2015. The Company assesses at each reporting period whether there is any objective evidence that a financial asset is impaired. A financial asset is deemed impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset and that loss has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

Foreign currency translation

Transactions in foreign currencies are initially recorded at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange at the end of the reporting period. All differences are recorded in the statement of loss and comprehensive loss.

Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that they relate to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

3. Summary of Significant Accounting Policies – continued

Income taxes - continued

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when the related asset is realized or liability is settled, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Such cost includes the cost of replacing parts of the property and equipment. Likewise, when a major inspection is performed, its cost is recognized in the carrying value of the equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in the statement of loss and comprehensive loss as incurred. The present value of the expected cost for the decommissioning of the asset after its use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Depreciation is calculated on a declining balance basis over the expected useful life of the asset at the following rates:

Office furniture and equipment	– 10-20%
Computer equipment	– 30-40%
Job equipment	– 20-30%
Vehicles	– 20-30%
Leasehold improvements	– straight-line over the lease term

An item of equipment is derecognized upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in the consolidated statement of loss and comprehensive loss in the period the asset is derecognized.

The assets’ residual values, useful lives and methods of depreciation are reviewed at each financial year end, and adjusted prospectively if appropriate.

3. Summary of Significant Accounting Policies – continued

Intangible assets

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. Amortization expense on the intangible assets with finite lives is recognized in the consolidated statement of loss and comprehensive loss.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statement of loss and comprehensive loss when the asset is derecognized.

Intangible assets consist of customer relationships, exclusivity contracts, and brand names. Customer relationships are amortized over five years, and exclusivity contracts over the expected life of the contract. The brand name is an indefinite life intangible, which is tested for impairment annually.

Inventories

Inventories are valued at the lower of cost and net realizable value.

The costs incurred to bring each product to its present location and condition are accounted for as follows:

- Raw materials – purchased cost on a first in, first out basis.
- Work in progress – cost of direct materials and labour.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

3. Summary of Significant Accounting Policies – continued

Impairment of non-financial assets

At the end of each reporting period, the Company assesses whether there is an indication that an asset or cash-generating unit ("CGU") may be impaired. If any indication exists, or when annual impairment testing for an asset or CGU is required, the Company estimates the recoverable amount. The recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value in use. Where the carrying value of an asset or CGU exceeds its recoverable amount, the asset or CGU is considered to be impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU, using an appropriate valuation model. These calculations are corroborated by calculation multiples or other available fair value indicators.

Impairment losses are recognized in the statement of loss and comprehensive loss in those expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at the end of each reporting period as to whether there is any indication that previously recognized impairment losses no longer exist or may be decreased. If such indication exists, the Company estimates the asset's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of loss and comprehensive loss.

Goodwill is tested for impairment annually and when circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of each CGU to which goodwill relates. Where the recoverable amount of the CGU, including goodwill, is less than its carrying value, an impairment loss is recognized. Impairment losses related to goodwill cannot be reversed in future periods.

Stock-based compensation

The Company has in effect a stock option plan which is described in Note 10(c). All stock-based awards granted are accounted for using the fair value based method. Fair value is calculated using the Black-Scholes valuation model. Any consideration paid by eligible participants on the exercise of stock options is credited to share capital. The contributed surplus associated with options is transferred to share capital upon exercise.

3. Summary of Significant Accounting Policies – continued

Loss per share

Basic loss per share is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding during the year. The Company applies the treasury stock method in the calculation of diluted loss per share. Diluted loss per share excludes all dilutive potential common shares if their effect is anti-dilutive.

Use of estimates

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the end of the reporting period and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The following are the critical assumptions concerning the key sources of estimation uncertainty at August 31, 2016, that have a significant risk of causing adjustments to the carrying values of assets and liabilities.

Assessment of impairments

The Company's impairment tests for goodwill and intangible assets are based on the greater of value in use calculations that use a discounted cash flow model and estimated fair value less cost to sell. The value-in-use calculations employ the following key assumptions: future cash flows, growth projections including economic risk assumptions and estimates of achieving key operating metrics. The cash flows are derived from the Company's budget for the future and do not include restructuring activities that the Company is not yet committed to or significant future investments that will enhance the asset base of the CGU being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. The estimated fair value less cost to sell is based on assessment of comparable company multiples and precedent transactions. Refer to Note 8 for more details on the current year impairment analysis.

Percentage of completion

The Company uses the percentage of completion method in accounting for its contract revenues. Use of the percentage of completion method requires the Company to estimate the contract work performed to date as a proportion of the total contract work to be performed and it is management's judgment that use of the costs to date in proportion to the total estimated costs provides the most appropriate measure of percentage of completion.

3. Summary of Significant Accounting Policies – continued

Changes in accounting standards

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended August 31, 2016, and have not been applied in preparing these consolidated financial statements but may affect the Company.

IFRS 9 - Financial Instruments, effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, introduces new requirements for the classification and measurement of financial instruments.

IFRS 15 - Revenue from Contracts with Customers, effective for annual periods beginning on or after January 1, 2018, with early adoption permitted, specifies how and when to recognize revenue and enhances relevant disclosures to be applied to all contracts with customers.

IFRS 16 - Leases was issued by the IASB in January 2016 and specifies the requirements to recognize, measure, present and disclose leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted.

The Company is currently assessing the effects of these new standards and intends to adopt them on their effective date.

4. Inventories

The Company maintains inventory, which consist of raw materials, equipment and spare parts for sale or for use.

During the year, the Company recognized an impairment charge on inventory of $10,000 (2015 - $nil), which has been included in cost of sales. Total raw materials, equipment and spare parts charged to cost of sales for the year was $3,154,229 (2015 - $3,095,663).

5. Property and Equipment

	Computer equipment	Equipment	Vehicles	Furniture & fixtures	Leasehold improvements	Total
Cost						
At August 31, 2014	$ 280,720	$ 179,531	$ 58,102	$ 407,785	$ 32,591	$ 958,729
Additions	2,309	3,747	-	1,779	-	7,835
Disposals	(106,865)	(76,373)	(22,368)	(160,766)	-	(366,372)
At August 31, 2015	**176,164**	**106,905**	**35,734**	**248,798**	**32,591**	**600,192**
Additions	81,450	11,202	-	-	-	92,652
Disposals	(80,007)	(16,663)	-	(18,246)	(20,250)	(135,166)
At August 31, 2016	**$ 177,607**	**$ 101,444**	**$ 35,734**	**$ 230,552**	**$ 12,341**	**$ 557,678**
Accumulated depreciation						
At August 31, 2014	$ 222,145	$ 144,354	$ 41,531	$ 334,695	$ 24,100	$ 766,825
Expense for the year	17,578	11,870	4,181	9,949	1,961	45,539
Disposals	(104,240)	(72,206)	(18,949)	(144,719)	-	(340,114)
At August 31, 2015	**135,483**	**84,018**	**26,763**	**199,925**	**26,061**	**472,250**
Expense for the year	44,540	7,948	2,826	23,416	1,880	80,610
Disposals	(75,590)	(14,593)	-	(16,000)	(20,250)	(126,433)
At August 31, 2016	**$ 104,433**	**$ 77,373**	**$ 29,589**	**$ 207,341**	**$ 7,691**	**$ 426,427**
Net book value						
At August 31, 2015	$ 40,681	$ 22,887	$ 8,971	$ 48,873	$ 6,530	$ 127,942
At August 31, 2016	$ 73,174	$ 24,071	$ 6,145	$ 23,211	$ 4,650	$ 131,251

The Company disposed of equipment resulting in a loss of $8,733 for the year ended August 31, 2016 (2015 - $21,564).

6. Goodwill

The Company completed the acquisition of VCI in fiscal 2014, resulting in goodwill of $599,802.

For 2016, the Company performed an impairment test, which compared the carrying amount of VCI to the recoverable amount. VCI is regarded as its own CGU, as it is the smallest identifiable group of assets that generates cash inflows, which consists of VCI's trade name, customer relationships and goodwill as listed above and in Note 7.

Using a five year (and related terminal value) discounted future cash flow model, the Company determined the recoverable amount by calculating its value in use. The recoverable amount of the CGU was determined to be above its carrying value as at August 31, 2016.

The key assumptions used in the discounted future cash flow model in fiscal 2016 include projections surrounding pricing, competition, market trends, growth rates and expense cuts. The model used average annual revenue growth rates between 3% and 7% and post-tax discount rates of 20%. A sensitivity analysis was performed using different gross margin rates of 25% and 26% and concluded there was no impairment on the VCI CGU. Management believes that the discount rate reasonably reflects the risks associated with cash flow projections for the business.

7. Intangible Assets

	Customer relationships	Exclusivity contracts	Brand or trade name	Total
Cost				
At Aug 31, 2014, 2015, and August 31, 2016	**$ 395,000**	**$ 180,000**	**$ 203,000**	**$ 778,000**
Accumulated depreciation				
At August 31, 2014	113,333	180,000	68,000	361,333
Expense for the year	65,000	-	-	65,000
At August 31, 2015	**$ 178,333**	**$ 180,000**	**$ 68,000**	**$ 426,333**
Expense for the year	65,000	-	-	65,000
At August 31, 2016	**$ 243,333**	**$ 180,000**	**$ 68,000**	**$ 491,333**
Net book value				
At August 31, 2015	$ 216,667	$ -	$ 135,000	$ 351,667
At August 31, 2016	$ 151,667	$ -	$ 135,000	$ 286,667

8. Share Capital

(a) Authorized

An unlimited number of common shares

(b) Issued

	Number of shares	Amount
Issued as at August 31, 2014 and August 31, 2015	2,337,090	$ 15,442,371
Shares issued for debt	7,105,800	4,618,761
Issued as at August 31, 2016	**9,442,890**	**$ 20,061,132**

In August 2016, the Company issued 6,683,009 common shares valued at $4,343,951 as part of the extinguishment of its debentures (note 13).

In August 2016, the Company issued 422,791 common shares valued at $274,810 as part of the extinguishment of its debt to a related party (note 9(a)(i)).

During the year, the Company consolidated its common shares on a 20 to 1 basis. All figures presented in these consolidated statements have been adjusted on a fully retrospective bases for the effect of this consolidation.

8. Share Capital – continued

(c) Stock options

The Company adopted a stock option plan under which it is authorized to grant options to officers, directors, employees, and consultants enabling them to acquire up to 10% of the issued and outstanding common stock of the Company. The options granted can be exercised for a maximum of 5 years and vest as determined by the Board of Directors. The exercise price of each option may not be less than the discounted fair market value of the common shares on the date of grant.

The option details of the Company are as follows:

Weighted average exercise price	Number of Options	Weighted average remaining life (years)	Vested
$2.00	77,500	3.58	58,125
$10.00	17,500	0.00	17,500
$13.60	35,000	1.59	35,000
Balance at August 31, 2016	**130,000**	**2.56**	**110,625**

30,000 options expired unexercised during the year from accelerated expiration due to consultants and employees leaving the Company (2015 – 2,500) and 17,500 options were forfeited (2015 – nil). On September 1, 2016, 17,500 stock options exercisable at $10.00 expired.

In April 2015, the Company granted 112,500 options with an exercise price of $2.00 per share, for a period of 5 years from the date of grant. The options vest 25% upon grant, with the remainder vesting 25% per six months thereafter. The Company uses the Black-Scholes option pricing model to determine the fair value of options granted. The assumptions used were the following: volatility of 100%; risk-free interest rate of 0.73%; expected life of 5 years; dividend yield of nil; forfeiture rate of nil; share price of $0.11.

In 2016, the Company recognized share-based payment expense of $66,283 (2015 - $117,616).

(d) Warrants

Weighted average exercise price	Number of warrants	Weighted average remaining life (years)
$0.65	1,251,750	4.94
$5.00	25,375	0.78
Balance at August 31, 2016	**1,277,125**	**4.86**

In August 2016, the Company issued 1,251,750 warrants valued at $475,000 as part of the extinguishment of its debentures (note 13). The warrants are exercisable at $0.65 for a period of 5 years and were valued using the Black Scholes option pricing model and the following assumptions: share price - $0.65, exercise price - $0.65, volatility – 93%, risk-free rate – 0.6%, expected life – 3 years. No warrants expired unexercised during the year (2015 – 126,725).

(e) Agent options

	Number of agent options	Weighted average exercise price	Weighted average remaining life
Outstanding, August 31, 2016	1,309	$5.00	0.78

No agent options expired unexercised during the year (2015 – 10,138).

9. Related Party Balances and Transactions

(a) Due to related parties is as follows:

		August 31, 2016		August 31, 2015
Promissory notes payable (i)	**$**	**90,917**	$	135,000
Consideration payable (ii)		**125,000**		125,000
Demand loan payable (iii)		**158,685**		-
	$	**374,602**	$	260,000

(i) Notes payable to a corporation controlled by an officer and director of the Company bearing interest at 12% per annum. During the year, additional notes in the amount of $200,000 were advanced to the Company. In August 2016, the Company signed a settlement agreement under which it extinguished $245,000 of the notes and accrued interest totalling $29,810 in exchange for 422,791 common shares valued at $274,810. There was no gain or loss recognized as a result of this transaction. As at August 31, 2016, the balance payable comprises $90,000 in promissory notes (2015 – $135,000) and accrued interest of $917 (2015 - $nil). Total interest expense on these promissory notes for the year ended August 31, 2016 was $30,731 (2015 – $nil).

(ii) A corporation that holds significant influence over the Company is owed $125,000 (August 31, 2015 - $125,000), which is outstanding consideration payable for the qualifying transaction. These amounts are non-interest bearing and are due on demand.

(iii) In February 2016 the Company received a demand loan in the amount of $152,250 from a corporation controlled by an officer and director of the Company bearing interest at 8% per annum. During the year ended August 31, 2016, interest of $6,435 has accrued on the balance (2015 - $nil).

Additional related party disclosures

(b) During the year, rent of $15,500 (2015 - $37,200) was paid to a company controlled by an officer of the Company, for additional office space used by the Company.

(c) As part of the debenture extinguishment described in note 13, 379,112 common shares valued at $246,423 were issued to a corporation controlled by an officer and director of the Company in settlement of $241,500 debentures and $4,923 accrued interest.

(d) Remuneration of key management personnel of the Company for the year ended August 31, 2016, included $405,000 of short-term compensation (2015 - $456,335). In 2016, no stock options were issued to key management. In 2015, 92,500 stock options were issued to key management generating $54,499 of share-based compensation expense in 2016 (2015 – $96,706). Within accounts payable, there is $327,776 payable to key management personnel (2015 $66,261).

10. Financial Instruments and Risk Management

Capital management

The Company's capital currently consists of debt and equity (deficiency). Its principal sources of cash are from operations, the issuance of common shares and debt. The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence.

The Company intends to maintain a flexible capital structure consistent with the objectives mentioned above and to respond to changes in economic conditions and the risk characteristics of underlying assets. In order to maintain or adjust its capital structure, the Company may issue new shares, raise secured debt or refinance existing debt with different characteristics.

VCI is subject to a financial covenant related to its bank indebtedness which consists of a maximum threshold for its liabilities to tangible net worth ratio (note 12).

Financial instrument risk exposure and management

Liquidity risk

The Company is exposed to liquidity risk or the risk of not meeting its financial obligations as they come due. The Company constantly monitors and manages its cash flows to assess the liquidity necessary to fund operations (see note 1).

The carrying value of accounts receivable, trade payables and accrued liabilities, bank indebtedness, acquisition payable, notes payable, and due to related parties reflected in the consolidated statement of financial position approximates fair value because of the short-term nature of these instruments. The fair value of debentures approximates their carrying value.

10. Financial Instruments and Risk Management – continued

Credit risk

The Company's cash is held at chartered Canadian financial institutions. Management reviews the strength of these institutions on a regular basis.

Accounts receivable subject the Company to credit risk. The Company believes the remaining amounts will be collected. Holdbacks are received upon substantial completion of the projects.

Accounts receivable aging		**August 31, 2016**		August 31, 2015
Within 30	**$**	**1,868,206**	$	1,492,358
31 to 60		**670,473**		1,149,097
61 to 90		**453,736**		345,558
Over 90		**574,648**		235,172
Holdbacks		**383,800**		261,179
Total accounts receivable	**$**	**3,950,863**	$	3,483,364

The maximum exposure is limited to the carrying amount of financial assets on the consolidated statement of financial position that includes cash and accounts receivable.

Interest rate risk

Debentures owed by the Company are fixed rate instruments. The Company is subject to interest rate risk from its bank indebtedness, which is subject to a floating interest rate, which changes based on prevailing market conditions. The Company also has notes payable (note 13) bearing fixed rates of interest.

Concentration risk

The concentration of revenue generated from major customers is not significant, with the three largest customers combined accounting for less than 25% of gross revenue.

Foreign exchange risk

The Company purchases a portion of its inventory in United States dollars ("USD") and does not currently engage in hedging activities. Accordingly, the Company is exposed to foreign exchange risk on a portion of its accounts payable and accrued liabilities and its USD bank account balances. However, the foreign exchange exposure to the Company at this time is not significant.

11. General and Administrative Expense

	For the years ended August 31, 2016	2015
Salaries and wages	**$ 1,895,562**	$ 2,123,819
Office expense	**839,556**	894,698
Professional and consulting fees	**474,097**	489,826
Travel	**82,264**	67,477
Bad debts	**101,877**	151,349
	$ 3,393,356	$ 3,727,169

12. Bank Indebtedness

As at August 31, 2016, bank indebtedness is made up of a $nil demand operating loan and $60,357 bank overdraft (2015 - $315,000 and $210,104 respectively).

The demand operating loan bears interest at the Royal Bank prime rate plus 3.60% (6.30% at August 31, 2016), which was increased from Royal Bank prime rate plus 1.60%. Security for the above indebtedness is comprised of a general security agreement, and postponement and assignment of claim of amounts due to related parties. The Company previously entered into a forbearance agreement with the bank, which reduces the operating loan maximum to $650,000.

During the year ended August 31, 2016, interest of approximately $10,643 (2015 - $27,977) related to the above indebtedness has been charged to interest expense.

VCI is subject to a financial covenant related to its bank indebtedness which consists of a maximum threshold for its liabilities to tangible net worth ratio. At August 31, 2016, VCI is in compliance with this financial covenant.

13. Debentures

The Company had issued $5,075,000 of debentures bearing interest at a rate of 12% per annum with a maturity date of June 2019.

In August 2016, the Company settled all issued and outstanding debentures through the issuance of 6,683,009 of common shares, $834,500 of promissory notes payable (note 14), and 1,251,750 warrants.

	August 31 2016	August 31 2015
Opening balance	**$ 4,856,864**	$ 4,796,246
Accretion expense	**28,294**	60,618
Extinguishment of debentures	**(4,885,158)**	-
Closing balance	**$ -**	$ 4,856,864

The loss on extinguishment on the settlement is determined as follows:

Fair value of 6,683,009 common shares issued (note 8(b))	$ 4,343,951
Fair value of 1,251,750 warrants issued (note 8(d))	475,000
Fair value of $834,500 interest-free promissory note (note 14)	593,981
Total fair value of consideration issued to extinguish debentures	**$ 5,412,932**
Carrying value of debentures prior to extinguishment	$ 4,885,158
Accrued interest on debentures	103,442
Total value of debt extinguished	**$ 4,988,600**
Loss on extinguishment of debentures	**$ 424,332**

14. Notes Payable

The Company was advanced $100,000 as notes payable during the period. The notes are repayable upon demand and are non-interest bearing.

In August 2016, in connection with the extinguishment of debentures described in note 13, the Company issued $834,500 of promissory notes payable. The notes have a three-year term and are non-interest bearing. The Company determined the fair value of the notes on initial recognition to be $593,981 based on a discount rate of 12%. The Company recognized accretion interest of $5,470 during the year (2015 - $nil).

15. Contingent Liabilities and Commitments

The Company is involved in several claims in the capacity of plaintiff as well as defendant. The Company or its insurer, where applicable, has filed defenses where the Company has been named defendant. In the opinion of management, the resolution of claims against the Company for an amount differing from the amount reflected in the records will not result in a material adverse effect on the financial position of the Company.

The Company has a lease commitment for the rental of office space and vehicles. The minimum payments payable over the next five years are as follows:

2017	$	259,000
2018		200,000
2019		92,000
2020		47,000
2021		23,000
Thereafter		4,000
Total	**$**	**625,000**

16. Revenues

		Year ended August 31,		
		2016		2015
Construction and other project revenue	**$**	**10,703,063**	$	8,095,925
Repairs revenue		**1,195,758**		1,452,422
Service revenue		**2,192,416**		2,129,885
Product revenue		**197,586**		627,148
	$	**14,288,823**	$	12,305,380

17. Segmented Information

Year ended August 31, 2016	Corporate	Geoexchange services	Controls and Mechanical contracting	**Total**
Capital expenditures	$ -	$ -	$ 92,652	**$ 92,652**
Total assets	21,001	609,861	5,432,533	**6,063,395**
Statement of operations				
Revenue	-	1,396,970	12,891,853	**14,288,823**
Cost of sales	-	(1,245,433)	(9,570,518)	**(10,815,951)**
General and administrative	(749,216)	(180,160)	(2,463,980)	**(3,393,356)**
Finance expense	(622,513)	(1,778)	(20,683)	**(644,974)**
Share-based payments	(66,283)	-	-	**(66,283)**
Amortization and depreciation	-	(24,265)	(121,345)	**(145,610)**
Loss (gain) on disposal of equipment	-	-	(8,733)	**(8,733)**
Loss on extinguishment of debentures	(424,332)	-	-	**(424,332)**
Gain on settlement of payables	492,350	-	-	**492,350**
Segmented (loss) income	$ (1,369,994)	$ (54,666)	$ 706,594	**$ (718,066)**

Year ended August 31, 2015	Corporate	Geoexchange services	Controls and Mechanical contracting	**Total**
Capital expenditures	$ -	$ -	$ 7,835	**$ 7,835**
Total assets	20,232	356,424	5,037,152	**5,413,808**
Statement of operations				
Revenue	-	1,451,336	10,854,044	**12,305,380**
Cost of sales	-	(972,461)	(7,986,134)	**(8,958,595)**
General and administrative	(921,388)	(400,976)	(2,404,805)	**(3,727,169)**
Finance expense	(669,574)	(1,153)	(28,610)	**(699,337)**
Share-based payments	(117,616)	-	-	**(117,616)**
Amortization and depreciation	-	(5,670)	(104,869)	**(110,539)**
Loss (gain) on disposal of equipment	-	2,774	(24,338)	**(21,564)**
Segmented (loss) income	$ (1,708,578)	$ 73,850	$ 305,288	**$ (1,329,440)**

18. Income Taxes

Current Income Taxes

The reconciliation of the combined Canadian federal and provincial statutory income taxes rate of 26.5% (2015 – 26.5%) to the effective tax rate is as follows:

	2016	2015
Net loss before income taxes	**$ 718,066**	$ 1,329,440
Expected income tax recovery	**$ (190,287)**	$ (352,302)
Tax rate changes and other adjustments	**10,575**	(10,122)
Non-deductible expenses	**(5,036)**	30,173
Change in tax benefits not recognized	**184,748**	332,251
Income tax (recovery) expense	**$ -**	$ -

Deferred Tax

The following table summarizes the components of deferred tax:

	2016	2015
Deferred Tax Assets		
Property and equipment	**$ 12,499**	$ 3,792
Share issuance costs	**1,727**	2,629
SR&ED pool	**-**	32,197
Non-capital losses carried forward	**-**	113,790
Warranty provision	**12,111**	-
Cumulative eligible capital	**483**	491
Investment tax credits	**46,863**	-
	75,483	176,127
Deferred Tax Liabilities		
Completed contract revenue	**-**	(4,654)
Intangible asset	**(75,483)**	(84,130)
Warranty provision	**-**	(10,119)
Debentures	**-**	(77,224)
Net deferred tax liabilities	**$ -**	$ -

18. Income Taxes - continued

Unrecognized Deferred Tax Assets

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities. Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

Net deferred tax assets		**2016**		2015
Property and equipment	$	**50,143**	$	-
Debenture		**233,130**		-
Share issuance costs		**164,901**		352,774
Non-capital losses carried forward		**9,446,644**		8,727,325
Net capital losses carried forward		**5,910,090**		5,910,090
Cumulative eligible capital		**220,143**		220,143

The Canadian non-capital loss carry forwards expire as noted in the table below. The net capital loss carry forward may be carried forward indefinitely, but can only be used to reduce capital gains. Share issue and financing costs will be fully amortized in 2018. The remaining deductible temporary differences may be carried forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the group can utilize the benefits therefrom.

The Company's Canadian non-capital income tax losses expire as follows:

2031	$	1,216,153
2032		227,870
2033		2,776,930
2034		2,465,504
2035		1,572,934
2036		1,187,253
	$	9,446,644

19. Gain on Settlement of Payables

The Company recognized a gain on settlement of payables of $492,350 during the year (2015 - $nil) based on negotiations with various vendors and service providers.

20. Subsequent Events

On September 1, 2016, 17,500 stock options exercisable at $10.00 expired (note 8(c)).
In November the Ontario Labour Relations Board ordered the certification of the United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry of the United States and Canada, Local 787, effective June 1, 2017, as the exclusive bargaining agent for the refrigeration and air-conditioning mechanics and apprentices employed by VCI Controls Inc., a wholly-owned subsidiary of the Company, in Ontario.