SustainCo Inc.

Consolidated Financial Statements

For the years ended August 31, 2018 and 2017

(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 consolidated statements of financial position as at August 31, 2018 and 2017, and the consolidated statements of (loss) income and comprehensive (loss) income, changes in shareholders' equity, 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 auditors’ 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 in our audits 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, 2018 and 2017, 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 20, 2018

MNP

Consolidated Statements of Financial Position
As at
(Expressed in Canadian Dollars)

		August 31, 2018		August 31, 2017
Assets				
Current assets				
Cash	**$**	**93,548**	$	472,305
Accounts receivable, net of $131,381 allowance (2017 - $178,344)		**3,980,307**		3,577,796
Unbilled receivables		**702,039**		630,675
Inventories *(note 4)*		**297,026**		310,736
Prepaid expenses		**81,295**		91,270
		5,154,215		5,082,782
Property and equipment *(note 5)*		**101,813**		85,933
Intangible assets *(note 7)*		**156,667**		221,667
Goodwill *(note 6)*		**599,802**		599,802
	$	**6,012,497**	$	5,990,184
Liabilities				
Current liabilities				
Bank indebtedness (*note 12*)	**$**	**352,909**	$	-
Trade payables and accrued liabilities		**1,822,058**		1,920,000
Acquisition payable		**-**		30,000
Deferred revenue (*note 18*)		**885,238**		1,008,259
Notes payable *(note 13)*		**50,000**		74,500
Promissory notes payable *(note 13)*		**618,330**		-
Current income tax payable (*note 19*)		**19,173**		59,581
		3,747,708		3,092,340
Promissory notes payable *(note 13)*		**-**		553,327
Deferred income taxes (*note 19*)		**40,453**		51,675
		3,788,161		3,697,342
Shareholders' equity				
Share capital *(note 8)*		**21,011,132**		21,011,132
Share-based payment reserve *(note 8)*		**2,229,156**		2,173,805
Deficit		**(21,015,952)**		(20,892,095)
		2,224,336		2,292,842
	$	**6,012,497**	$	5,990,184

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

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

Approved on behalf of the Board

Signed: *"Emlyn J. David"* — Director

Signed: *"Michael Galloro"* — Director

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

	For the years ended August 31, 2018	2017
Sales *(note 15)*	**$ 13,687,391**	$ 13,824,215
Cost of sales *(note 4)*	**10,518,926**	10,229,079
Gross profit	**3,168,465**	3,595,136
General and administrative *(note 11)*	**3,081,323**	3,099,168
Amortization and depreciation *(notes 5 & 7)*	**92,824**	121,333
Finance expense *(notes 12 & 13)*	**73,046**	132,542
Share-based payments *(note 8)*	**55,351**	31,653
Gain on disposal of equipment *(note 5)*	**(296)**	(3,887)
Gain on settlement of payables (*note 17*)	**(64,000)**	(95,000)
(Loss) income from operations before income taxes	**(69,783)**	309,327
Current tax expense *(note 19)*	**(65,296)**	(153,159)
Deferred tax recovery (expense) *(note 19)*	**11,222**	(11,315)
Net (loss) income and comprehensive (loss) income after income taxes	**(123,857)**	144,853
Net (loss) income per share		
Basic and diluted	**$ (0.01)**	$ 0.01
Weighted average shares outstanding	**15,776,223**	10,813,666

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

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

		Share Capital		Share-Based Payment Reserve		Deficit		Total
Balance, August 31, 2016	$	20,061,132	$	2,142,152	$	(21,036,948)	$	1,166,336
Issuance of shares for cash *(note 8)*		950,000		-		-		950,000
Share-based payments		-		31,653		-		31,653
Net income for the year		-		-		144,853		144,853
Balance, August 31, 2017	$	21,011,132	$	2,173,805	$	(20,892,095)	$	2,292,842
Share-based payments *(note 8)*		-		55,351		-		55,351
Net loss for the year		-		-		(123,857)		(123,857)
Balance, August 31, 2018	**$**	**21,011,132**	**$**	**2,229,156**	**$**	**(21,015,952)**	**$**	**2,224,336**

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,	
	2018	2017
Cash flow from operating activities		
Net (loss) income	**$ (123,857)**	$ 144,853
Add (deduct) items not involving cash		
Accretion (*note 13*)	**65,003**	111,776
Amortization and depreciation *(notes 5 & 7)*	**92,824**	121,333
Share-based payments *(note 8)*	**55,351**	31,653
Gain on disposal of equipment (*note 5*)	**(296)**	(3,887)
Gain on settlement of payables (*note 17*)	**(64,000)**	(95,000)
Deferred income taxes payable (*note 19*)	**(11,222)**	51,675
Change in non-cash working capital		
Accounts receivable	**(402,511)**	373,067
Unbilled receivables	**(71,364)**	58,207
Inventories	**13,710**	(14,996)
Prepaid expenses	**9,975**	(1,480)
Deferred revenue	**(123,021)**	(66,539)
Accounts payable and accrued liabilities	**(33,942)**	(707,851)
Current income tax payable (*note 19*)	**(40,408)**	59,581
	(633,758)	62,392
Cash flow from financing activities		
Issuance of shares for cash proceeds *(note 8)*	**-**	950,000
Repayment of notes payable (*note 13*)	**(24,500)**	(183,400)
Repayment to related party	**-**	(279,602)
Loans (repayment) (*note 12*)	**352,909**	(60,357)
Acquisition payable	**(30,000)**	(30,000)
	298,409	396,641
Cash flow from investing activities		
Investment in property and equipment *(note 5)*	**(44,584)**	(25,780)
Proceeds from sale of property and equipment *(note 5)*	**1,176**	18,652
	(43,408)	(7,128)
(Decrease) increase in cash	**(378,757)**	451,905
Cash, beginning of year	**472,305**	20,400
Cash, end of year	**$ 93,548**	$ 472,305

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 geoexchange company that provides heating and cooling solutions for residential and commercial buildings using energy from the earth.

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. The Company reported a net loss of $123,857 for the year ended August 31, 2018 compared to net income of $144,853 in the prior year. The Company has working capital of $1,406,507 as at August 31, 2018 (2017 – $1,990,442) and an accumulated deficit of $21,015,952 (2017 – $20,892,095). As a result, there is significant 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, 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 20, 2018.

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 and repairs revenue are recognized when the significant risks and rewards of ownership 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 and promissory notes payable are classified as other which are measured at amortized cost. The Company had no financial liabilities classified as available-for-sale, FVTPL, or held-to-maturity instruments during the years ended August 31, 2018 and 2017. 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 consists of current and deferred tax expense. Current tax and deferred tax are recognized in profit or loss except to the extent that they relate to items recognized directly in equity or in other comprehensive income.

Current tax is recognized and measured at the amount expected to be recovered from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period and includes any adjustment to taxes payable in respect of previous years.

3. Summary of Significant Accounting Policies – continued

Income taxes - continued

Deferred tax is recognized on any temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable earnings. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized and the liability is settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in net earnings and comprehensive income or in equity depending on the item to which the adjustment relates.

Deferred tax assets are recognized only to the extent future recovery is probable. At each reporting period end, deferred tax assets are reduced to the extent that it is no longer probably that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

Provisions for taxes are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

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 annually. 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, equipment, and spare parts – 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 8(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

Net income (loss) per share

Basic income (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 income (loss) per share. Diluted income (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, 2018, 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 6 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 determine the contract work performed to date as a proportion of the estimated 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, 2018 and have not yet 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.

Total raw materials, equipment, and spare parts charged to cost of sales for the year was $2,865,437 (2017 - $2,731,078).

(Expressed in Canadian Dollars)

5. Property and Equipment

	Computer equipment	Equipment	Vehicles	Furniture & fixtures	Leasehold improvements	Total
Cost						
At August 31, 2016	$ 177,607	$ 101,444	$ 35,734	$ 230,552	$ 12,341	$ 557,678
Additions	9,182	13,092	-	3,506	-	25,780
Disposals	(17,712)	(14,493)	(19,693)	-	(3,000)	(54,898)
At August 31, 2017	$ 169,077	$ 100,043	$ 16,041	$ 234,058	$ 9,341	$ 528,560
Additions	18,980	20,629	4,175	800	-	44,584
Disposals	(1,656)	-	(5,205)	(1,779)	-	(8,640)
At August 31, 2018	**$ 186,401**	**$ 120,672**	**$ 15,011**	**$ 233,079**	**$ 9,341**	**$ 564,504**
Accumulated depreciation						
At August 31, 2016	$ 104,433	$ 77,373	$ 29,589	$ 207,341	$ 7,691	$ 426,427
Expense	42,058	10,254	1,578	558	1,885	56,333
Disposals	(7,694)	(12,167)	(17,272)	-	(3,000)	(40,133)
At August 31, 2017	$ 138,797	$ 75,460	$ 13,895	$ 207,899	$ 6,576	$ 442,627
Expense	13,297	8,626	1,131	2,900	1,870	27,824
Disposals	(1,317)	-	(4,664)	(1,779)	-	(7,760)
At August 31, 2018	**$ 150,777**	**$ 84,086**	**$ 10,362**	**$ 209,020**	**$ 8,446**	**$ 462,691**
Net book value						
At August 31, 2017	$ 30,280	$ 24,583	$ 2,146	$ 26,159	$ 2,765	$ 85,933
At August 31, 2018	**$ 35,624**	**$ 36,586**	**$ 4,649**	**$ 24,059**	**$ 895**	**$ 101,813**

The Company disposed of equipment for total proceeds of $1,176 (2017 - $18,652) resulting in a gain of $296 for the year ended August 31, 2018 (2017 - $3,887).

6. Goodwill

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

In 2018, 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; it includes VCI's trade name, customer relationships, and goodwill as listed 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, 2018.

The key assumptions used in the discounted future cash flow model in fiscal 2018 include projections surrounding pricing, competition, market trends, growth rates and expense cuts. The model used average annual revenue growth rates between 2% and 3% 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.

(Expressed in Canadian Dollars)

7. Intangible Assets

		Customer relationships		Brand or trade name		Total
Cost						
At August 31, 2016, 2017 and 2018	**$**	**395,000**	**$**	**203,000**	**$**	**598,000**
Accumulated depreciation						
At August 31, 2016	$	243,333	$	68,000	$	311,333
Expense for the year		65,000		-		65,000
At August 31, 2017		308,333		68,000		376,333
Expense for the year		65,000		-		65,000
At August 31, 2018	**$**	**373,333**	**$**	**68,000**	**$**	**441,333**
Net book value						
At August 31, 2017	$	86,667	$	135,000	$	221,667
At August 31, 2018	**$**	**21,667**	**$**	**135,000**	**$**	**156,667**

8. Share Capital

(a) Authorized

An unlimited number of common shares

(b) Issued

	Number of shares		Amount
Issued at August 31, 2016	9,442,890	$	20,061,132
Shares issued for cash	6,333,333		950,000
Issued at August 31, 2017 and 2018	**15,776,223**	**$**	**21,011,132**

In June 2017, the Company raised aggregate gross proceeds of $950,000, issuing an aggregate of 6,333,333 common shares at a price of $0.15 per share to an insider of the Company.

(Expressed in Canadian Dollars)

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	72,500	1.58	72,500
$0.15	700,000	3.96	700,000
Balance at August 31, 2018	**772,500**	**3.74**	**772,500**

In August 2017, the Company granted 700,000 options with an exercise price of $0.15 per share, for a period of 5 years from the date of grant. The options vest 30% upon grant, with the remainder vesting 35% 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 193%; risk-free interest rate of 1.42%; expected life of 5 years; dividend yield of Nil; forfeiture rate of Nil; share price of $0.125.

The total value of options granted was $Nil (2017 - $84,605).

In 2018, the Company recognized share-based payment expense of $55,351 (2017 - $31,653).

(d) Warrants

Weighted average exercise price	Number of warrants	Weighted average remaining life (years)
$0.65	1,251,750	2.94
Balance at August 31, 2018	**1,251,750**	**2.94**

No warrants expired unexercised during the year ended August 31, 2018 (2017 - 25,375 warrants exercisable at $5.00).

(e) Agent options

Nil outstanding agent options expired unexercised during the year ended August 31, 2018 (2017 – 1,309). There were no agent options outstanding as of August 31, 2018.

9. Related Party Balances and Transactions

(a) Balances due to related parties comprise:

(i) Notes payable to a corporation controlled by an officer and director of the Company bearing interest at 12% per annum. During 2016, 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. During the year ended August 31, 2017, the total balance remaining of $97,344 was repaid, which consists of $90,000 in promissory notes and total accrued interest of $7,344.

(ii) A corporation that holds significant influence over the Company was owed $125,000 on August 31, 2016, which was outstanding consideration payable for the qualifying transaction. This amount was non-interest and was due on demand. During the year ended August 31, 2017, this amount owing was settled for $30,000, resulting in a gain on settlement of debt of $95,000.

(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, 2017, total balance remaining of $166,564 was repaid including the principal amount of $152,250 and $14,314 total accrued interest.

Additional related party disclosures

(b) Remuneration of key management personnel of the Company for the year ended August 31, 2018, included $350,000 of short-term compensation (2017 - $350,000).

In 2018, Nil stock options (2017 – 500,000) were issued to key management and Nil stock options (2017 – 200,000) were issued to directors. $26,096 of share-based compensation expense was recognized in 2018 due to the vesting of the options granted in 2017 (2017 - $29,254).

Included in accounts payable is $120,276 payable to key management personnel (2017 - $26,250).

10. Financial Instruments and Risk Management

Capital management

The Company's capital consists of debt and equity at August 2018 and 2017. 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 (note 1).

The carrying value of accounts receivable, trade payables and accrued liabilities, bank indebtedness, acquisition payable, notes and debentures 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.

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 recorded amounts will be collected. Holdbacks are received upon substantial completion of the projects.

Accounts receivable aging		**August 31, 2018**		August 31, 2017
Within 30	**$**	**1,871,517**	$	1,323,603
31 to 60		**937,020**		797,523
61 to 90		**352,591**		518,763
Over 90		**553,022**		500,194
Holdbacks		**266,157**		437,713
Total accounts receivable	**$**	**3,980,307**	$	3,577,796

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

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 bearing 0% 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.

(Expressed in Canadian Dollars)

11. General and Administrative Expense

	For the years ended August 31,	
	2018	2017
Salaries and wages	**$ 1,887,132**	$ 1,727,377
Office expense	**777,853**	841,168
Professional and consulting fees	**198,744**	307,241
Travel	**133,471**	135,305
Bad debts	**84,123**	88,077
	$ 3,081,323	$ 3,099,168

12. Bank Indebtedness

As at August 31, 2018, bank indebtedness was $352,909 (August 31, 2017 - $Nil).

The demand operating loan bears interest at the Royal Bank prime rate plus 1.6% (3.60% at August 31, 2017), Security for the above indebtedness is comprised of a general security agreement, and postponement and assignment of claim of amounts due to related parties.

During the year ended August 31, 2018, interest of approximately $4,029 (2017 - $5,082) 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, 2018, VCI is in compliance with this financial covenant.

13. Notes Payable

The Company was advanced $100,000 as notes payable during 2016. The notes are repayable upon demand and are non-interest bearing. The Company repaid $24,500 (2017 - $25,500) of notes payable during the year ended August 31, 2018, leaving $50,000 (2017 - $74,500) outstanding.

In August 2016, in connection with the extinguishment of debentures, 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 repaid $Nil of the principal amount of the promissory notes payable during the year ended August 31, 2018 (2017 - $157,900), and the principal balance remaining was $676,600 (August 31, 2017 - $676,600). The Company recognized accretion interest of $65,003 during the year ended August 31, 2018 (2017 - $111,776) resulting in a carrying value of $618,330 as of August 31, 2018 (2017 - $553,327).

(Expressed in Canadian Dollars)

14. Contingent Liabilities and Commitments

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:

2019	$	189,768
2020		99,719
2021		75,589
2022		38,302
2023		6,437
Total	**$**	**409,815**

15. Revenues

	Year ended August 31,			
		2018		2017
Construction and other project revenue	**$**	**9,808,458**	$	9,903,867
Repairs revenue		**1,353,412**		1,472,873
Service revenue		**2,508,873**		2,426,932
Product revenue		**16,648**		20,543
	$	**13,687,391**	$	13,824,215

Certain prior year balances have been reclassified to conform to the current year's presentation.

(Expressed in Canadian Dollars)

16. Segmented Information

Year ended August 31, 2018	**Corporate**	**Geoexchange services**	**Controls and Mechanical contracting**	**Total**
Capital expenditures	$ -	$ 20,629	$ 23,955	**$ 44,584**
Total assets	254,396	574,569	5,183,532	**6,012,497**
Statement of operations				
Revenue	-	954,321	12,733,070	**13,687,391**
Cost of sales	-	(759,525)	(9,759,401)	**(10,518,926)**
General and administrative	(517,718)	(148,981)	(2,414,624)	**(3,081,323)**
Finance expense	(65,175)	(2,915)	(4,956)	**(73,046)**
Share-based payments	(55,351)	-	-	**(55,351)**
Gain on disposal of equipment	-	-	296	**296**
Amortization and depreciation	-	(1,053)	(91,771)	**(92,824)**
Gain on settlement of payables	-	-	64,000	**64,000**
Income tax expense	-	-	(54,074)	**(54,074)**
Segmented income (loss)	**$ (638,244)**	**$ 41,847**	**$ 472,540**	**$ (123,857)**

Year ended August 31, 2017	Corporate	Geoexchange services	Controls and Mechanical contracting	**Total**
Capital expenditures	$ -	$ 13,092	$ 12,688	**$ 25,780**
Total assets	81,420	653,683	5,255,081	**5,990,184**
Statement of operations				
Revenue	-	827,294	12,996,921	**13,824,215**
Cost of sales	-	(668,141)	(9,560,938)	**(10,229,079)**
General and administrative	(515,346)	(194,823)	(2,388,999)	**(3,099,168)**
Finance expense	(119,130)	9	(13,421)	**(132,542)**
Share-based payments	(31,653)	-	-	**(31,653)**
Amortization and depreciation	-	(375)	(120,958)	**(121,333)**
Gain on disposal of equipment	-	-	3,887	**3,887**
Gain on settlement of payables	95,000	-	-	**95,000**
Income tax expense	-	-	(164,474)	**(164,474)**
Segmented income (loss)	$ (571,129)	$ (36,036)	$ 752,018	**$ 144,853**

17. Gain on Settlement of Payables

The Company recognized a gain on settlement of payables of 64,000 during the year (2017 - $95,000) based on negotiations with various vendors and service providers.

(Expressed in Canadian Dollars)

18. Deferred Revenue

Included in deferred revenue is $121,544 (2017 - $Nil) of accrued contract loss.

19. Income Taxes

Current Income Taxes

The reconciliation of the combined Canadian federal and provincial statutory income taxes rate of 26.5% (2017 – 26.5%) to the effective tax rate is as follows:

		2018		2017
Net income (loss) before recovery of income taxes	**$**	**(69,783)**	$	309,327
Expected income tax expense (recovery)	**$**	**(18,427)**	$	81,972
Tax rate changes and other adjustments		**(236)**		43,884
Share based compensation and non-deductible expenses		**22,648**		(14,753)
Change in tax benefits not recognized		**50,089**		53,371
Income tax expense	**$**	**54,074**	$	164,474

The Company's income tax expense (recovery) is allocated as follows:

		2018		2017
Current tax expense	**$**	**65,296**	$	153,159
Deferred tax expense (recovery)		**(11,222)**		11,315
	$	**54,074**	$	164,474

(Expressed in Canadian Dollars)

19. Income Taxes - continued

Deferred Tax

The following table summarizes the components of deferred tax:

		2018		2017
Deferred Tax Assets				
Property and equipment	**$**	**-**	$	12,964
Share issuance costs		**-**		871
Schedule 13 Reserves		**9,150**		13,567
Non-capital losses carried forward		**17,473**		64,602
	$	**26,623**	$	92,004
Deferred Tax Liabilities				
Intangible assets	**$**	**(41,869)**	$	(92,004)
Notes payable		**(15,441)**		-
Property and equipment		**(7,735)**		-
Revenue reserves		**(2,031)**		-
Net deferred tax liability	**$**	**(40,453)**	$	-

Net Deferred Tax Liability

Deferred tax assets and liabilities have been offset where they relate to income taxes levied by the same taxation authority and the Company has the legal right and intent to offset.

Movement in Net Deferred Tax Liabilities

		2018
Balance at the beginning of the year	**$**	**(51,675)**
Recognized in profit/loss		**11,222**
Balance at the end of the year	**$**	**(40,453)**

(Expressed in Canadian Dollars)

19. 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	**2018**	2017
Property and equipment	**$ 51,571**	$ 49,019
Intangible assets	**219,564**	220,064
Share issuance costs	**2,906**	65,706
Non-capital losses carried forward	**9,514,893**	9,246,146
Net capital losses carried forward	**5,910,090**	5,910,090

The Canadian non-capital loss carry forwards expire as noted in the table below. Share issue and finance costs will be fully amortized in 2020. The net capital loss carry forward may be carried forward indefinitely, but can only be used to reduce capital gains. 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	$ 1,105,756
2032	227,870
2033	2,627,823
2034	2,318,685
2035	1,571,604
2036	1,192,999
2037	334,276
2018	209,482
	$ 9,588,494