Bluedrop Performance Learning Inc.

Consolidated Financial Statements

Year ended September 30, 2016

Contents

Independent auditor's report

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To the Shareholders of

Bluedrop Performance Learning Inc.

We have audited the accompanying consolidated financial statements of Bluedrop Performance Learning Inc., which comprise the consolidated statements of financial position as at September 30, 2016, and September 30, 2015 and the consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of 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.

Auditor's 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 audit 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial position of Bluedrop Performance Learning Inc. as at September 30, 2016 and September 30, 2015, and its financial performance and its cash flows for the years ended September 30, 2016 and September 30, 2015 in accordance with International Financial Reporting Standards.

Grant Thornton LLP

St. John's, Canada

January 30, 2017 — Chartered Professional Accountants

Bluedrop Performance Learning Inc.

Consolidated Statements of Financial Position

In Canadian dollars

		September 30 2016	September 30 2015
ASSETS			
Current assets			
Cash and cash equivalents	$	3,111,352	3,196,631
Accounts receivable (Note 5)		4,639,550	4,613,225
Unbilled revenue		81,029	1,461,286
Other current assets (Note 6)		1,145,560	499,165
		8,977,491	9,770,307
Other long-term assets		550,226	169,816
Restricted cash (Note 7)		3,000,000	-
Deferred tax assets (Note 8)		4,375,509	4,793,920
Goodwill and other intangible assets (Note 9)		4,510,113	5,706,941
Property and equipment (Note 10)		593,164	676,356
	$	22,006,503	21,117,340
LIABILITIES AND EQUITY			
Current liabilities			
Accounts payable and accruals	$	3,377,526	2,995,067
Deferred revenue		3,507,748	4,342,926
Deferred development funding (Note 11)		822,809	1,806,020
Current portion of long-term debt (Note 12)		1,461,175	1,426,660
Other current liabilities		648,802	347,549
		9,818,060	10,918,222
Long-term debt (Note 12)		7,094,321	5,534,617
Other financial liabilities (Note 14)		3,096,362	2,827,298
Deferred revenue		117,812	905,404
Deferred tax liabilities (Note 8)		502,498	571,808
Other long-term liabilities		31,789	11,558
		20,660,842	20,768,907
Equity			
Share capital (Note 15)		5,087,066	5,053,021
Reserves		1,619,718	1,543,495
Deficit		(5,361,123)	(6,248,083)
		1,345,661	348,433
	$	22,006,503	21,117,340

Approved on Behalf of the Board

Derrick H. Rowe	Emad Rizkalla
Director	Director

See notes to the consolidated financial statements

Bluedrop Performance Learning Inc.

Consolidated Statements of Comprehensive Income

Year ended September 30		**2016**	**2015**
In Canadian dollars			
Revenue			
Services revenue	$	16,686,293	16,528,234
Product sales		8,144,071	4,644,618
		24,830,364	21,172,852
Direct costs		13,413,174	11,899,960
Gross profit		11,417,190	9,272,892
Expenses			
Sales and marketing		2,012,795	2,056,101
General and administration		4,800,577	4,846,581
Research and development costs		3,851,816	126,582
Government assistance and other funding (Note 16)		(4,235,059)	(558,147)
Share-based compensation (Note 15)		82,068	194,843
Finance costs (Note 17)		1,933,590	1,997,525
Depreciation and amortization (Notes 9 and 10)		1,110,674	897,507
Other (gains) and losses (Note 18)		469,138	(662,818)
		10,025,599	8,898,174
Profit before income taxes		1,391,591	374,718
Income tax expense (Note 8)			
Current		-	-
Deferred		349,101	60,956
		349,101	60,956
Net profit and comprehensive income	$	1,042,490	313,762
Net profit per share (Note 15)			
Basic		0.0106	0.0032
Diluted		0.0104	0.0032
Weighted average number of shares outstanding (Note 15)			
Basic		98,636,453	98,986,609
Diluted		100,582,560	99,110,449

See notes to the consolidated financial statements

Bluedrop Performance Learning Inc.

Consolidated Statements of Changes in Equity

Year ended September 30

In Canadian dollars

	Ordinary Common Shares	Share Capital	Share Option Reserve	Convertible Notes	Retained Earnings	Total
October 1, 2014	98,986,609	$ 5,053,021	1,120,884	201,466	(6,561,845)	(186,474)
Share-based compensation	-	-	194,843	-	-	194,843
Issue of convertible note, net of tax	-	-	-	26,302	-	26,302
Net profit and comprehensive income	-	-	-	-	313,762	313,762
September 30, 2015	98,986,609	5,053,021	1,315,727	227,768	(6,248,083)	348,433
Share-based compensation	-	-	82,068	-	-	82,068
Repurchase of shares under normal course issuer bid (Note 15)	(969,500)	(71,800)	-	-	(155,530)	(227,330)
Conversion of debenture	666,667	105,845	-	(5,845)	-	100,000
Net profit and comprehensive income	-	-	-	-	1,042,490	1,042,490
September 30, 2016	98,683,776	$ 5,087,066	1,397,795	221,923	(5,361,123)	1,345,661

Bluedrop Performance Learning Inc.

Consolidated Statements of Cash Flows

Year ended September 30		2016	2015
In Canadian dollars			
Increase (decrease) in cash and cash equivalents			
Operating activities			
Net profit for the period	$	1,042,490	313,762
Items not affecting cash:			
Share-based compensation		82,068	194,843
Depreciation and amortization		1,110,674	897,507
Non-cash government assistance		-	(192,567)
Gain on settlement of long-term debt		-	(470,422)
Finance costs		1,933,590	1,997,525
Deferred taxes		349,101	60,956
Unrealized (gain) loss on derivative instruments		(2,897)	19,535
Loss on disposal of property and equipment		1,219	42,245
Impairment of intangible assets		320,366	-
Interest paid		(70,337)	(59,550)
		4,766,274	2,803,834
Changes in non-cash working capital (Note 19)		(1,896,395)	3,324,301
Net change in cash from operating activities		2,869,879	6,128,135
Investing activities			
Proceeds on disposal of property and equipment		-	11,500
Purchase of property and equipment, net of government assistance		(119,986)	(57,508)
Increase in restricted cash		(3,000,000)	-
Purchase of intangible assets, net of government assistance		-	(1,283,017)
		(3,119,986)	(1,329,025)
Changes in non-cash working capital (Note 19)		-	521,958
Net change in cash from investing activities		(3,119,986)	(807,067)
Financing activities			
Repayment of obligations under finance lease		(29,888)	(49,737)
Advances of long-term debt		3,000,000	1,225,000
Repayment of long-term debt		(1,508,340)	(1,665,843)
Advances of other financial liabilities		-	257,700
Repayment of other financial liabilities		(323,416)	(275,968)
Decrease in other long-term liabilities		-	(28,167)
Repurchase of shares under normal course issuer bid		(227,330)	-
Interest paid		(746,198)	(519,822)
Net change in cash from financing activities		164,828	(1,056,837)
(Decrease) increase in cash and cash equivalents		(85,279)	4,264,231
Cash and cash equivalents (bank indebtedness), beginning of period		3,196,631	(1,067,600)
Cash and cash equivalents, end of period	$	3,111,352	3,196,631

See notes to the consolidated financial statements

1. Nature of operations

Bluedrop Performance Learning Inc. ("Bluedrop" or "the Company") was continued under the Corporations Act of Newfoundland and Labrador on January 26, 2012. These consolidated financial statements comprise the Company and its 100% owned operating subsidiaries as follows:

Bluedrop Training & Simulation Inc.
Bluedrop Learning Networks Inc.
Bluedrop Simulation Services Inc.

The Company provides e-learning and course development services and offers online training solutions for businesses and individuals through cloud-based learning management solutions and traditional learning management systems. In addition, the Company provides custom courseware development, training products, low cost simulation and resource augmentation solutions to improve the safety, productivity and efficiency of military and civil aviation personnel through its Training and Simulation operations. The Company is domiciled in Canada and its registered office is located at 18 Prescott Street, St. John's, Newfoundland and Labrador, A1C 3S4.

These consolidated financial statements were approved and authorized for issuance by the Board of Directors on January 30, 2017.

2. Basis of presentation

These consolidated financial statements present the Company's financial position and financial results under International Financial Reporting Standards (IFRS) using accounting policies consistent with IFRS as issued by the International Accounting Standards Board (IASB).

These consolidated financial statements have been prepared on the historical cost basis except for the revaluation of certain financial assets and liabilities, which are measured at their fair value, and are presented in Canadian dollars.

The accounting policies set out below have been applied consistently in the preparation of the consolidated financial statements of all periods presented.

3. Significant accounting policies

(a) Cash and cash equivalents

Cash and cash equivalents include cash on hand and balances with banks. Bank borrowings are considered to be financing activities.

(b) Intangible assets

Intangible assets are stated at cost less accumulated amortization. Except where they have indefinite lives, intangible assets are amortized on a straight-line basis over their estimated useful lives or licence contract period at the following rates:

Licences	3 - 5 years
Technology	5 years
Customer relationships	7 - 10 years
Courseware and other	3 years

Government contributions toward intangible assets are recorded as a reduction in the cost of the asset.

3. **Significant accounting policies** (continued)

(c) Foreign currencies

The Company's consolidated financial statements are presented in Canadian dollars, which is also the Company's functional currency. Functional currency is the currency of the primary economic environment in which the entity operates.

Revenue, expenses and non-monetary assets and liabilities denominated in foreign currencies are recorded at the rate of exchange prevailing at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates prevailing at the balance sheet date. Unrealized and realized translation gains and losses are included in the consolidated statements of earnings in Other (gains) and losses.

(d) Property and equipment

Property and equipment is carried at cost less accumulated depreciation. Property and equipment is depreciated on a straight-line basis over the following estimated useful lives:

Computer equipment and software	3 - 5 years
Equipment - simulation equipment	10 years
Equipment - other	5 years
Furniture and fixtures	7 years
Vehicles	5 years

Leasehold improvements are amortized over the lesser of the useful life of the asset and the remaining lease period.

Government contributions toward property and equipment are recorded as a reduction in the cost of the asset.

(e) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Where the Company is a lessee in a finance lease, the related asset is recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance lease liability. The leased assets are depreciated in accordance with the Company's policy for owned assets of the same type. For operating leases, payments are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

(f) Provisions

Provisions are recognized when there is a present legal or constructive obligation as a result of a past event, for which it is probable that a transfer of economic benefits will be required to settle the obligation, and where a reliable estimate can be made of the amount of the obligation. No provision is recognized where the possible outflow of economic resources as a result of present obligations is improbable or remote.

Provisions are discounted using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability. Where discounting is used, the increase in the provision due to passage of time is recognized within finance costs in the statement of comprehensive income.

(g) Revenue recognition

Multiple-element arrangements

The Company often enters into sales transactions involving the supply of multiple products and services including the supply of courseware, professional services, hosted services and software licence arrangements. The consideration received from multiple-component transactions is allocated to each separately identifiable component in proportion to its relative fair value as determined by an internal pricing analysis, or based on the residual method, as applicable. The Company applies the revenue recognition criteria set out below to each separately identifiable component of the sales transaction.

3. Significant accounting policies (continued)

(g) Revenue recognition (continued)

Services revenue

Service revenues are generated from services rendered in custom courseware development and consulting services.

Revenues from custom courseware development contracts are recognized on a percentage of completion basis, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Revenues are recognized as services are rendered when the revenue and costs incurred and to be incurred in respect of the transaction can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. Costs incurred during the year in connection with work in progress are excluded from costs incurred to date when determining the stage of completion. Such costs are classified as current assets on the statement of financial position unless it is not probable that such costs are recoverable from the customer, in which case, such costs are recognized as an expense immediately.

The timing of revenue recognition often differs from contract payment schedules. Amounts billed in accordance with customer contracts but in advance of completion of services are recorded as deferred revenue. The value of unbilled services performed is recorded as unbilled revenue.

Revenues from consulting services are recognized as services are rendered when the revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company.

Product sales

Product sales include the sale of simulation products, courseware licensing and commercial off-the-shelf courseware. Revenues from the sale of goods are recognized when risks and rewards of ownership have transferred to the buyer, the Company retains neither continuing managerial involvement nor effective control over the goods sold, the amount of revenue and costs incurred in respect to the transaction can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the Company.

The Company develops and sells simulators and simulation related products. Revenues from the sale of such products are recognized when the product has been delivered to the customer and the recognition criteria noted above are met. Associated warranty and support revenues are deferred and recognized over the term specified in the arrangement.

The Company offers online training solutions for businesses and individuals through *CoursePark*™ and *Bluedrop360*™, cloud-based learning management solutions and *Campus*™, a traditional learning management system. Revenues from commercial off-the-shelf courseware, and learning management system licencing is recognized over the term of the licence arrangement. Amounts billed but not recognized are recorded as deferred revenue.

(h) Development costs

Costs incurred on development projects, which in management's view have clearly defined market prospects, are technically feasible and for which the Company intends to commit resources, are capitalized as intangible assets. Capitalized development costs represent expenditures incurred by the Company primarily related to the development of the *CoursePark™* and *Bluedrop360™* learning management systems and associated courseware.

Costs associated with projects in the condition necessary for them to be capable of operating in the manner intended by management are amortized over their estimated useful lives. If capitalized expenditures are deemed to be no longer commercially viable or facts and circumstances suggest that the carrying amount exceeds the recoverable amount, the balance of capitalized development costs is expensed. Any research and development costs that do not meet the criteria for capitalization are expensed as incurred.

3. Significant accounting policies (continued)

(i) Government assistance

The Company receives government assistance in the form of non-repayable contributions, conditionally-repayable contributions, forgivable loans and credits under the Scientific Research and Experimental Development (SRED) and Digital Media Tax Credit (DMTC) programs. Contributions toward property and equipment and capitalized development projects are recorded as a reduction in the cost of the asset. Contributions toward operating costs are recorded in government assistance on the statement of comprehensive income.

Government grants are recognized when there is reasonable assurance that the grant will be received and all significant conditions will be achieved. Credits under the SRED and DMTC programs are recorded when amounts can be reasonably estimated and receipt is reasonably assured.

The benefit of government loans at below-market rates of interest are treated as a government grant. The loan is recognized and measured in accordance with *IAS 39 Financial Instruments: Recognition and Measurement*. The benefit of the below-market rate of interest is measured as the difference between the initial carrying value of the loan determined in accordance with *IAS 39* and the proceeds received.

(j) Share-based compensation

The Company has an equity settled share-based compensation plan and records compensation expense for share options using the fair value method. The compensation expense for options granted to employees is determined based on the estimated fair value of the share options at the time of grant using the Black-Scholes option pricing model and is amortized over the vesting period with an offset to share option reserve. When options are exercised, the corresponding share option reserve and the proceeds received by the Company are credited to share capital. The amount recognized as expense is adjusted to reflect the number of options expected to vest.

(k) Income taxes

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity.

Current income tax assets and/or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting periods, that are unpaid at the reporting date. Current tax is payable on taxable profit, which differs from profit or loss in the consolidated financial statements. Calculation of current tax is based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Deferred income taxes are calculated using the liability method on temporary differences between the carrying amounts of assets and liabilities and their tax bases. However, deferred tax is not provided on the initial recognition of goodwill or on the initial recognition of an asset or liability unless the related transaction is a business combination or affects tax or accounting profit. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realization, provided they are enacted or substantively enacted by the end of the reporting period.

Deferred tax assets are recognized to the extent that it is probable that they will be able to be utilized against future taxable income, based on the Company's forecast of future operating results which is adjusted for significant non-taxable income and expenses and specific limits to the use of any unused tax loss or credit. Deferred tax liabilities are always provided for in full.

Deferred tax assets and liabilities are offset only when the Company has a right and intention to set off current tax assets and liabilities from the same taxation authority.

Changes in deferred tax assets or liabilities are recognized as a component of tax income or expense in profit or loss, except where they relate to items that are recognized in other comprehensive income or directly in equity, in which case the related deferred tax is also recognized in other comprehensive income or equity, respectively.

3. Significant accounting policies (continued)

(l) Financial instruments

The Company classifies all financial instruments as either held for trading, available for sale, held to maturity, loans and receivables, or other financial liabilities. All financial instruments are initially measured at fair value. Financial instruments classified as held for trading or available for sale are subsequently measured at fair value, with any change in fair value recognized in earnings and other comprehensive income, respectively. All other financial instruments are subsequently measured at amortized cost using the effective interest method.

The Company's financial assets and liabilities are generally classified and measured as follows:

Asset/Liability	**Classification**	**Measurement**
Cash and cash equivalents	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accruals	Other financial liabilities	Amortized cost
Long term debt	Other financial liabilities	Amortized cost
Other financial liabilities	Other financial liabilities	Amortized cost

Government loans with below-market interest rates are measured at amortized cost using the effective interest method. The difference between the fair values at inception and the loan proceeds received is recorded as government assistance.

Transaction costs other than those related to financial instruments classified as fair value through profit or loss, which are expensed as incurred, are added to or deducted from the fair value of the financial asset or financial liability, as appropriate, on initial recognition and amortized using the effective interest method.

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or if the Company transfers the financial asset to another party without retaining control or substantially all the risks and rewards of ownership of the financial asset. A financial liability is derecognized when its contractual obligations are discharged, cancelled or expire.

Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counter party will default.

(m) Compound financial instruments (convertible notes)

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder at a fixed conversion rate.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition.

Interest related to the financial liability is recognized in profit or loss. On conversion, the financial liability is reclassified to equity and no gain or loss is recognized.

3. Significant accounting policies (continued)

(n) Business combinations

The Company applies the acquisition method in accounting for business combinations. The consideration transferred by the Company to obtain control of a subsidiary is calculated as the sum of the acquisition-date fair values of assets transferred, liabilities incurred and the equity interests issued by the Company, which includes the fair value of any asset or liability arising from a contingent consideration arrangement. Acquisition costs are expensed as incurred.

The Company recognises identifiable assets acquired and liabilities assumed in a business combination regardless of whether they have been previously recognized in the acquiree's financial statements prior to the acquisition. Assets acquired and liabilities assumed are generally measured at their acquisition-date fair values.

Goodwill is stated after separate recognition of identifiable intangible assets. It is calculated as the excess of the sum of the fair value of consideration transferred, the recognized amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any existing equity interest in the acquiree, over the acquisition-date fair values of identifiable net assets. If the fair values of identifiable net assets exceed the sum calculated above, the excess amount (i.e. gain on a bargain purchase) is recognized in profit or loss immediately.

(o) Earnings per share

Basic earnings per share are computed by dividing earnings (loss) by the weighted average shares outstanding during the reporting period. The Company calculates diluted earnings per share under the treasury share method for warrants and share options. Under the treasury share method, the proceeds from the exercise of warrants and options are assumed to be used to repurchase the Company's shares on the open market. The difference between the number of shares assumed purchased and the number of warrants and options exercised is added to the number of basic shares outstanding to determine diluted shares outstanding for purposes of calculating diluted earnings per share.

(p) Impairment of assets

For impairment assessment purposes, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level. Goodwill is allocated to those cash-generating units that are expected to benefit from synergies of the related business combination and represent the lowest level within the Company at which management monitors goodwill.

Impairment losses for cash-generating units reduce first the carrying amount of any goodwill allocated to that cash-generating unit. Any remaining impairment loss is charged pro rata to the other assets in the cash-generating unit. With the exception of goodwill, all assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment charge is reversed if the cash-generating unit's recoverable amount exceeds its carrying amount.

Cash-generating units to which goodwill has been allocated (determined by the Company as equivalent to its operating segments) are tested for impairment at least annually. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in use. To determine the value-in-use, management estimates expected future cash flows from each cash-generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risks factors.

3. Significant accounting policies (continued)

(q) Significant management judgement and estimation uncertainty

In the process of applying the Company's accounting policies, management has made certain judgments, estimates, and assumptions which affect the amounts recognized in these consolidated financial statements. The Company has identified the following policies where critical judgments, estimates and assumptions are made and where actual results could be materially

Significant management judgements

The following are significant management judgements in applying the accounting policies that have the most significant impact on the consolidated financial statements:

i) Revenue recognition

Revenue from services contracts is recognized on a percentage of completion basis, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Judgement is used in determining the stage of completion and estimates of costs to complete. The Company employs sophisticated project management tools to assist with the management of projects and the recognition of revenue on a percentage completion basis. Management regularly reviews the systems, processes, and calculations relating to percentage completion on significant contracts, making adjustments as required.

ii) Income taxes

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. The Company recorded current and deferred tax expense based on management's interpretation of the tax regulations and its assumptions about the timing of income and expenses for tax purposes. Actual tax assessments or future changes to assumptions could result in future adjustments to recorded tax expense.

The Company has recognized deferred tax assets. Management considers that it is probable that the tax assets will be realized. The ultimate realization of the assets is dependent upon the Company's ability to generate sufficient taxable income to utilize the tax losses recognized. If future circumstances indicate that it is no longer probable that these tax assets will be realized, the carrying value of the tax assets will be reduced, resulting in a charge against income and a reduction of equity.

iii) Government assistance

The Company receives government assistance pursuant to specific contractual funding agreements and is also eligible to receive cash tax credits under the SRED and DMTC programs. Claims relating to specific funding agreements are based on the defined eligible costs pursuant to the agreements. Contributions are recognized when the related expenditures are incurred and/or when significant milestones have been achieved in a funded project. Government assistance may be overstated if the costs claimed are determined to be ineligible.

Government assistance is recorded when amounts can be reasonably estimated and receipt is reasonably assured. Government assistance may be overstated if the underlying project is determined to be ineligible or if certain costs claimed are determined to be ineligible.

iv) Development costs

Distinguishing the research and development phases of internal development projects and determining whether the recognition requirements for the capitalization of development costs are met requires judgement. After capitalization, management monitors whether the recognition requirements continue to be met and whether there are any indicators that capitalized costs may be impaired.

v) Classification of financial arrangements

The Company has entered into complex financing arrangements in the form of conditionally repayable government grants with below-market interest rates. Management uses significant judgement in selection and application of accounting policies related to these arrangements.

3. Significant accounting policies (continued)

(q) Significant management judgement and estimation uncertainty (continued)

vi) Deferred development funding

The Company has entered into an arrangement with a third party whereby the third party has provided Bluedrop with funding towards development costs under Canada's Industrial and Regional Benefits (IRB) Policy in a non-exchange transaction. While the funding is not provided directly from government, the substance of the transaction is an indirect form of government assistance with the third party acting as an intermediary between a Government agency and Bluedrop. As such the arrangement has been accounted for in accordance with *IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance.*

Estimation uncertainty

The following are significant estimates used in recognition and measurement of assets, liabilities, income and expense. The actual results may differ from these estimates:

i) Fair value of financial liabilities

The Company has received long term debt financing at below-market interest rates as well as compound financial liabilities. The fair value of these financial liabilities is determined using discount rates expected to be incurred on similar debt in a fair market. Management has exercised judgement in estimating the applicable discount rate used in measuring the fair value of financial liabilities at below-market interest rates.

In addition, certain royalty arrangements classified as financial liabilities are subject to significant estimates including the amount and timing of future cash flows and discount rates used in measurement of the fair value.

ii) Impairment of non-financial assets

In assessing impairment, management estimates the recoverable amount of each asset or cash-generating units based on expected future cash flows and uses an interest rate to discount them. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate.

iii) Revenue recognition

Revenue from services contracts is recognized on a percentage of completion basis, measured by the percentage of costs incurred to date to the estimated total costs for each contract. Changes to the estimate of percentage complete or estimated costs to complete could have a material impact on the carrying values of unbilled revenue or deferred revenue and a material impact on future revenue.

iv) Share-based compensation

Management has made certain estimates and assumptions when calculating the fair value of share options. The significant assumptions include estimates of expected volatility, expected life and expected risk-free rate of return. Management also makes certain assumptions with respect to the number of options expected to vest. Changes in these assumptions may result in a material change to share-based compensation expense.

4. New and future accounting standards

The following new or amended standards are effective for annual periods beginning on or after the dates indicated below, with earlier adoption permitted. The Company has not early adopted these standards and is currently assessing the impact they will have on its consolidated financial statements.

IFRS 9 *Financial Instruments*
IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of the consolidated financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. [January 1, 2018]

In Canadian dollars

4. New and future accounting standards (continued)

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 presents new requirements for the recognition of revenue and provides additional guidance in many areas not covered in detail under existing IFRSs, including how to account for multiple element arrangements and other complexities. IFRS 15 replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts* and several revenue-related interpretations. [January 1, 2018]

IFRS 16 *Leases*

IFRS 16 sets out a comprehensive model for the identification of lease arrangements and their treatment in the consolidated financial statements of both lessees and lessors. IFRS 16 applies a control model for the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. IFRS 16 replaces IAS 17 Leases. [January 1, 2019]

5. Accounts receivable

		September 30 2016	September 30 2015
Trade	$	2,159,010	3,286,298
Government assistance		2,451,855	1,301,514
Other		28,685	25,413
	$	4,639,550	4,613,225

6. Other current assets

		September 30 2016	September 30 2015
Prepaid expenses	$	637,467	499,165
Work in progress		388,504	-
Current portion of share purchase loan		119,589	-
	$	1,145,560	499,165

7. Restricted cash

At September 30, 2016, the Company raised new debt to preserve working capital for growth and to fund its maturing debt obligations during the next two years. Proceeds of the new debt are held in a Guaranteed Investment Certificate and held by the Royal Bank of Canada under a cash collateral agreement as additional security for the new loan until a decision is made regarding conversion or repayment of the unsecured convertible term notes (Note 12). The proceeds of the loan are presented as restricted cash in long-term assets on the consolidated statements of financial position.

In Canadian dollars

8. Income taxes

A reconciliation of the combined federal and provincial income taxes at statutory rates and the Company's effective income tax expense is as follows:

		2016	2015
Earnings before income tax	$	1,391,591	374,718
Statutory tax rate		30.0%	29.0%
Expected tax expense		417,477	108,668
Non-deductible share based compensation		23,790	55,289
Other non-deductible expenses		20,269	20,934
Effect of difference in statutory tax rates of subsidiaries		(460,517)	(29,968)
Effect of unrecognized deferred tax assets		179,030	(122,042)
Revision of prior year estimates		169,052	28,075
	$	349,101	60,956
Deferred tax expense			
Origination and reversal of temporary differences		192,058	182,998
Change in recognized deductible temporary differences		38,100	190,777
Change in recognition of tax losses		118,943	(312,819)
	$	349,101	60,956
Deferred tax expense included directly in equity	$	-	10,228

Deferred taxes reflect the net tax effects of the temporary differences between the carrying value of assets and liabilities for accounting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax position are as follows:

		September 30 2016	September 30 2015
Intangible assets	$	(805,843)	(256,889)
Property and equipment		588,897	383,362
Long term debt		(105,911)	(186,323)
Other financial liabilities		535,237	309,045
Deferred revenue		607,815	1,321,579
Non-capital losses		3,052,816	2,651,338
	$	3,873,011	4,222,112
Deferred tax assets		4,375,509	4,793,920
Deferred tax liabilities		(502,498)	(571,808)
	$	3,873,011	4,222,112

Deferred tax liabilities of $5,323,858 associated with investments in subsidiaries have not been recognized, as the Company controls the timing of the reversal and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are recognised for tax losses and deductible temporary differences to the extent that it is probable that future taxable profit will be available against which the balances can be utilized. Management have based their assessment on forecasted future taxable income as a result of growth in operations and tax planning activities undertaken in the period. The following items have not been recognized as deferred tax assets as at September 30, 2016:

		September 30 2016	September 30 2015
Deductible temporary differences	$	694,777	566,768
Non-capital losses		4,478,718	5,551,232

In Canadian dollars

9. Goodwill and other intangible assets

		Licences	Courseware and other	Technology	Customer Relationships	Goodwill	Total
Cost							
October 1, 2014	$	265,500	61,815	1,964,389	2,905,000	1,853,131	7,049,835
Additions		-	-	1,117,489	-	-	1,117,489
Government assistance		-	-	60,225	-	-	60,225
September 30, 2015		265,500	61,815	3,142,103	2,905,000	1,853,131	8,227,549
September 30, 2016	$	265,500	61,815	3,142,103	2,905,000	1,853,131	8,227,549
Accumulated amortization and impairment losses							
October 1, 2014	$	265,500	61,815	1,142,203	396,857	-	1,866,375
Amortization		-	-	338,661	315,572	-	654,233
September 30, 2015		265,500	61,815	1,480,864	712,429	-	2,520,608
Amortization		-	-	560,891	315,571	-	876,462
Impairment loss		-	-	320,366	-	-	320,366
September 30, 2016	$	265,500	61,815	2,362,121	1,028,000	-	3,717,436
Carrying values							
October 1, 2014	$	-	-	822,186	2,508,143	1,853,131	5,183,460
September 30, 2015	$	-	-	1,661,239	2,192,571	1,853,131	5,706,941
September 30, 2016	$	-	-	779,982	1,877,000	1,853,131	4,510,113

Effective October 1, 2016, the Company commenced the commercialization phase of the *Bluedrop360™* Platform. No development expenditures, or related government assistance, have been included in intangible assets during the year.

(a) Impairment test - Goodwill

For the purpose of annual impairment testing goodwill is allocated to the operating segments expected to benefit from the synergies of the business combinations in which the goodwill arises. At September 30, 2016, $1,415,007 of goodwill has been allocated to the Bluedrop Learning Networks operating segment and $438,124 has been allocated to the Bluedrop Training and Simulation operating segment.

The recoverable amount of the operating segments was based on value-in-use calculations covering a five-year forecast using estimated cash flows as determined by management. Management's key assumption includes annual growth in revenue reflective of the historical experience and consideration of trends in the market.

The present value of the expected cash flows of the operating segment was determined by applying a discount rate which reflects adjustments relating to market risk and risks specific to each operating segment.

(b) Impairment loss

During 2016, management assessed the future strategic plans for both the Bluedrop Learning Networks and Bluedrop Training and Simulation segments. The Company began transitioning customers from its *CoursePark™* platform to the newly developed *Bluedrop360™* platform. As a result of the migration and assessment, management has determined that certain technology assets within the Bluedrop Learning Networks segment related to *CoursePark™* platform have a reduced future recoverable amount. For the year ended September 30, 2016, management has recorded an impairment loss of $320,366 (2015 - nil) related to these assets. The impairment loss is included in Other (gains) and losses on the consolidated statements of comprehensive income.

In Canadian dollars

10. Property and equipment

		Equipment and software	Fixtures and equipment	Vehicles	Leasehold improvements	Total
Cost						
October 1, 2014	$	490,968	869,752	46,967	204,201	1,611,888
Additions		50,330	7,178	-	-	57,508
Disposals		-	(94,054)	-	(10,245)	(104,299)
September 30, 2015		541,298	782,876	46,967	193,956	1,565,097
Additions		119,985	32,254	-	-	152,239
Disposals		-	(9,244)	-	-	(9,244)
September 30, 2016	$	661,283	805,886	46,967	193,956	1,708,092
Accumulated depreciation						
October 1, 2014	$	233,452	278,362	45,473	138,734	696,021
Depreciation		122,454	103,237	1,494	16,089	243,274
Disposals		-	(40,309)	-	(10,245)	(50,554)
September 30, 2015		355,906	341,290	46,967	144,578	888,741
Depreciation		119,091	99,033	-	16,088	234,212
Disposals		-	(8,025)	-	-	(8,025)
September 30, 2016	$	474,997	432,298	46,967	160,666	1,114,928
Carrying values						
October 1, 2014	$	257,516	591,390	1,494	65,467	915,867
September 30, 2015	$	185,392	441,586	-	49,378	676,356
September 30, 2016	$	186,286	373,588	-	33,290	593,164

11. Deferred development funding

		September 30 2016	September 30 2015
Opening balance	$	1,806,020	-
Funding provided		1,417,687	1,932,602
Development costs incurred		(2,400,898)	(126,582)
Ending balance	$	822,809	1,806,020

On July 8, 2015, Bluedrop and The Boeing Company (Boeing) entered into an agreement whereby Boeing would contribute US$2.29 million to the Company to support the development of the next generation rear crew trainer for the CH-47 Chinook helicopter. In addition, the Company has received $324,768 of funding from the National Research Council associated with the project.

During the year ended September 30, 2016, the Company expensed $2,400,898 (2015 - $126,582) of costs related to the development of the trainer. The funding related to these costs was recognized in the period with the remainder deferred to fund future development costs associated with the simulator.

In Canadian dollars

12. Long-term debt

	Maturity		September 30 2016	September 30 2015
Unsecured convertible term notes - 14%	2013-2017	$	3,442,909	3,590,031
Term loan - 4.09%	2016-2019		3,000,000	-
Unsecured term loan - 16%	2015-2016		-	600,000
Government assistance debt:				
Province of Newfoundland and Labrador - 4.75%	2016-2019		417,986	474,942
Government of Nova Scotia - 5%	2013-2021		992,663	1,145,761
Atlantic Canada Opportunities Agency - non-interest bearing	2012-2017		94,802	180,600
Atlantic Canada Opportunities Agency - non-interest bearing	2013-2018		169,683	242,682
Atlantic Canada Opportunities Agency - non-interest bearing	2015-2019		244,712	295,567
Atlantic Canada Opportunities Agency - non-interest bearing	2016-2017		192,741	431,694
			8,555,496	6,961,277
less: current portion			(1,461,175)	(1,426,660)
Total long-term debt		$	7,094,321	5,534,617

(a) Unsecured convertible term notes - 14%

On December 11, 2015 the company entered into an agreement to amend the maturity date of $3,000,000 of the unsecured convertible term notes from December 30, 2016 to December 30, 2017.

On September 14, 2016, $100,000 of the unsecured convertible term notes were converted into common shares at a price of $0.15 per share for a total issuance of 666,667 common shares. Subsequent to the balance sheet date, $525,000 of additional unsecured convertible term notes were converted (Note 27).

(b) Term loan - 4.09%

On September 30, 2016 the company secured a $3.0 million term loan with the Royal Bank of Canada. The loan bears interest at 4.09% per annum and matures on September 30, 2019. Monthly blended payments on the loan are $30,000 per month in the first twelve months and $120,357 per month during the following twenty-four months. The loan is secured by the $3.0 million Guaranteed Investment Certificate (Note 7).

(c) Unsecured term loan - 16%

On March 31, 2016, the company repaid the 16% unsecured term loan pursuant to an early repayment agreement entered into with the lender. The term loan had an original maturity date of August 2016.

13. Operating loans

The Company has a short-term bank operating line of credit to a maximum of the lesser of $3,500,000 and defined marginable accounts receivable minus specified liabilities. The revolving operating facility is repayable on demand and bears interest at Royal Bank prime plus 1.95%. The Company has provided a General Security Agreement as security for this indebtedness. The line of credit was undrawn as at September 30, 2016 (September 30, 2015 - undrawn).

In Canadian dollars

14. Other financial liabilities

		September 30 2016	September 30 2015
Unsecured royalty obligation	$	1,845,647	1,103,733
ACOA-AIF unsecured royalty obligation		1,870,095	2,020,928
		3,715,742	3,124,661
less: current portion		(619,380)	(297,363)
Total long-term other financial liabilities	$	3,096,362	2,827,298

(a) Unsecured royalty obligation

During the year ended September 30, 2014, the Company received $1,000,000 of financing in the form of an unsecured royalty arrangement. The agreement requires Bluedrop to pay a royalty of 1.0% of revenues in exchange for the principal provided.

During the year, the Company amended certain terms of the unsecured royalty obligation. The amended terms include a buyout option allowing the Company to extinguish 100% of all amounts owing upon payment of two times the royalty acquisition amount. Under the amended terms, the Company will pay a minimum royalty of $40,000 per month until May 31, 2017, after which time it will pay the lender 1% of monthly revenue in perpetuity. The amendment resulted in a $673,869 charge to finance costs associated with revaluation of the financial liability.

(b) ACOA-AIF unsecured royalty obligation

To September 30, 2016 the Company had recognized Atlantic Canadian Opportunities Agency - Atlantic Innovation Fund (ACOA-AIF) contributions of $2,531,111 pursuant to a 2008 agreement, as amended and ACOA-AIF contributions of $2,984,419 pursuant to a 2012 agreement. The Company must repay the contributions by annual instalments calculated as 5% of the gross revenues generated from products and product related services resulting from the research funded.

15. Share capital

(a) Authorized

Unlimited common shares without par value

(b) Common shares issued and outstanding	Number of Shares	Share capital
Issued and outstanding at October 1, 2014 and September 30, 2015	98,986,609	$ 5,053,021
Shares repurchased under normal course issuer bid	(1,436,000)	(71,800)
Shares issued upon exercise of convertible debenture	666,667	105,845
Issued and outstanding at September 30, 2016	98,217,276	$ 5,087,066

On March 31, 2016, the Company commenced a normal course issuer bid to acquire up to an aggregate of 4,949,330 outstanding common shares. The bid will expire on March 30, 2017. The company accounts for purchases under the constructive retirement method whereby shares are treated as cancelled upon repurchase in line with managements intention to subsequently cancel the purchased shares within a reasonable period.

As of September 30, 2016, 1,436,000 common shares had been repurchased, with 969,500 of those common share cancelled as of that date. The 466,500 common shares repurchased in September were cancelled on October 6, 2016. The purchases resulted in a decrease to share capital and retained earnings of $71,800 and $155,530, respectively.

In Canadian dollars

15. Share capital (continued)

(c) Share options (2010 Stock Option Plan)	**Number of options**	**Exercise price per share**
Outstanding at October 1, 2014 and September 30, 2015	237,375	$0.40
Expired	(237,375)	$0.40
Outstanding and exercisable at September 30, 2016	-	-

(d) Share options (2011 Stock Option Plan)	**Number of options**	**Exercise price per share**
Outstanding at October 1, 2014	13,654,191	$0.18
Granted	3,508,747	$0.07
Forfeitures	(285,608)	$0.13
Expired	(554,314)	$0.23
Outstanding at September 30, 2015	16,323,016	$0.15
Granted	800,000	$0.12
Forfeitures	(974,178)	$0.12
Expired	(1,545,401)	$0.18
Outstanding at September 30, 2016	14,603,437	$0.15
Exercisable at September 30, 2016	5,049,442	$0.14

Pursuant to the 2011 Stock Option Plan, the Company has reserved a maximum of 16,827,718 of common shares of the Company for issuance on the exercise of share options. These options expire five years after the date of grant and vest over a three year period as follows: 10% at time of grant; 20% on the first anniversary; 20% on the second anniversary and 50% on the third anniversary.

The Company recorded $82,068 of share-based compensation expense for the year ended September 30, 2016, relating to the 2011 Stock Option Plan (2015 - $194,843). The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions used for options granted in the year ended September 30, 2016:

	2016	**2015**
Risk free interest rate	0.59%	0.66%
Expected dividend yield	0%	0%
Share price volatility	37%	37%
Expected life	3.6 years	3.6 years
Average fair value of options granted	$0.0329	$0.0206

As at September 30,2016, 3,053,250 of the options outstanding were subject to restrictions which prevent them from being exercised and as such have been excluded from the amount of exercisable options above.

(e) Employee share purchase plan

The Company has an employee share purchase plan which permits employees to subscribe to common shares of the Company through payroll deductions. The Company may provide financial assistance with respect to the plan by way of loan, guarantee or otherwise. The Company has reserved a maximum of 2,969,597 common shares under the employee share purchase plan. As at September 30, 2016, no shares were outstanding under the plan.

In Canadian dollars

15. Share capital (continued)

(f) Earnings per share

Both the basic and diluted earnings per share have been calculated using the profit (loss) attributable to shareholders as the numerator with no adjustments required. The reconciliation of the weighted average number of shares for the purposes of basic and diluted earnings per share is as follows:

	2016	2015
Common shares issued and outstanding at October 1	98,986,609	98,986,609
Weighted average shares issued through conversion of unsecured term loan	29,224	-
Weighted average shares purchased through normal course issuer bid	(379,379)	-
Weighted average number of shares used in basic earnings per share	98,636,453	98,986,609
Effect of share options on issue	1,946,107	123,840
Weighted average number of shares used in diluted earnings per share	100,582,560	99,110,449

At September 30, 2016, 3,932,087 share options (2015 - 14,943,048) and 23,500,000 shares on convertible notes (2015 - 24,166,667) were excluded from the calculation of diluted weighted average number of shares calculation because there effect would be anti-dilutive.

16. Government assistance and other funding

		2016	2015
Government assistance included in income:			
National Research Council	$	421,976	47,753
Invest New Brunswick		15,905	47,493
Research & Development Corporation		237,400	-
Scientific Research and Experimental Development Credits		-	(334,456)
Digital Media Tax Credits		1,483,648	483,272
Discounts on below-market interest rate financial liabilities		-	187,503
Other indirect government assistance included in income:			
The Boeing Company - Funding under the Government of Canada's IRB Policy		2,076,130	126,582
	$	4,235,059	558,147
Government assistance included in intangible assets:			
National Research Council	$	-	198,725
Scientific Research and Experimental Development Credits		-	(369,317)
Discounts on below-market interest rate financial liabilities		-	110,367
	$	-	(60,225)

During the year ended September 30, 2015, the Company reassessed the eligibility of prior tax year activities relating to the Scientific Research and Experimental Development (SR&ED) tax credit program and recorded a provision against prior year tax credits recognized of $703,773, resulting in a negative impact on income of $333,475. No SR&ED tax credits were recognized for the current year.

In Canadian dollars

17. Finance costs

		2016	2015
Interest on long-term debt	$	645,494	686,680
Interest on finance lease obligations		3,031	3,248
Short-term interest and bank charges		46,598	49,081
Accretion of long-term debt		300,230	360,975
Accretion of other financial liabilities		671,711	578,623
Revaluation of financial liabilities		242,785	308,449
Other financing costs		23,741	10,469
Total finance costs	$	1,933,590	1,997,525

18. Other (gains) and losses

		2016	2015
Impairment of intangible assets	$	320,366	-
Loss on sale of property and equipment		1,219	42,245
Foreign exchange (gain) loss		188,672	(234,641)
Gain on settlement of debt		-	(470,422)
Other		(41,119)	-
Total other (gains) and losses	$	469,138	(662,818)

19. Changes in non-cash working capital

		2016	2015
Accounts receivable	$	(26,325)	2,433,158
Unbilled revenue		1,380,257	(489,948)
Other current assets		(646,395)	(10,945)
Other long-term assets		(380,410)	(50,227)
Accounts payable and accruals		382,459	267,390
Deferred revenue		(1,622,770)	(109,189)
Deferred development funding		(983,211)	1,806,020
	$	(1,896,395)	3,846,259
Changes in non-cash working capital related to:			
Operating activities		(1,896,395)	3,324,301
Investing activities		-	521,958
	$	(1,896,395)	3,846,259

20. Expenses classified by nature

Certain expenses are classified by function in the statement of comprehensive income. These include Direct costs, Sales and marketing, General and administration, and Research and development costs. A schedule of these expenses presented by nature is as follows:

		2016	2015
Salaries and other labour costs	$	15,133,827	13,342,879
Materials, services and supplies		6,312,556	2,831,112
Travel and living		498,453	518,585
Occupancy		785,380	803,818
Professional fees		475,741	700,507
Other costs		872,405	732,323
Total expenses classified by nature	$	24,078,362	18,929,224

In Canadian dollars

21. Related party transactions

Transactions with related parties are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Related party transactions include:

(a) Share purchase loans

The Company has provided share purchase loans to a director of the Company. As collateral for the non-interest bearing share purchase loans, the borrower has granted the Company a security interest in a portion of the shares purchased. The loans are repayable in full on or before dates ranging between June 27, 2017, and January 31, 2018. As at September 30, 2016, the total amount receivable was $169,816 (2015 - $169,816), $119,589 of this amount has been classified as current.

(b) Unsecured term loan

During the year ended September 30, 2015, the Company received financing of $600,000 in the form of an 18-month unsecured term loan from an entity controlled by the Company's beneficial controlling shareholder and director. The term loan beared interest, payable monthly, at 16% per annum and was subordinated to existing senior credit and other term loan facilities (Note 12). During the year, the Company incurred $48,132 (2015 - $85,756) of finance charges associated with the term loan. The loan was repaid in full on March 31, 2016.

(c) Rental lease

Effective October 1, 2011, the Company entered into a rental lease with an entity controlled by the Company's beneficial controlling shareholder. The arrangement provides for the lease of 100% of the premises at 18 Prescott Street, St. John's, NL with an initial term of six years and has a four year renewal option. The lease includes an initial net lease rate for two years with escalation provisions every two years thereafter. During the year, the Company incurred $282,240 (2015 - $262,080) of rent expense associated with the lease.

(d) Key management personnel

Key management personnel include the President and Chief Executive Officer, the Chief Financial Officer and the directors of the Company. The Executive Chairman's fees are paid to a corporation under his control.

	2016	2015
Fees, salaries and benefits to key management personnel	823,542	888,403
Share based compensation to key management personnel	51,403	116,049

22. Financial instruments

<u>Fair value measurement</u>

In the event that the Company has financial instruments required to be recorded at fair value on the consolidated statements of financial position, these would be classified using a fair value hierarchy that reflects the significance of the inputs used in making the fair value estimation measurements. The fair value hierarchy has the following levels:

i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
ii) Level 2 fair value measurement are those derived from inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
iii) Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

22. Financial instruments (continued)

Fair value measurement (continued)

As at September 30, 2016, the Company did not have financial instruments required to be recorded at fair value. The following table sets out the approximate fair values of financial instruments on the statement of financial position as at September 30, 2016, which are all recorded at amortized cost following initial recognition:

	September 30, 2016		September 30, 2015	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Cash and cash equivalents	3,111,352	3,111,352	3,196,631	3,196,631
Accounts receivable	4,639,550	4,639,550	4,613,225	4,613,225
Restricted cash	3,000,000	3,000,000	-	-
Accounts payable and accruals	3,377,526	3,377,526	2,995,067	2,995,067
Long-term debt (including current portion)	8,555,496	8,812,671	6,961,277	6,924,065
Other financial liabilities (including current portion)	3,715,742	3,616,493	3,124,661	3,039,011

The fair values of cash and cash equivalents, accounts receivable and accounts payable and accruals approximates their carrying values due to their short-term maturity.

The fair values of the long-term debt and other financial liabilities are estimated using a discounted cash flow valuation technique. The fair value measurement uses level 3 inputs based on estimates of future cash flows associated with the liabilities and discount rates that reflect market assessments of the performance risk which includes the credit risk of Company at September 30, 2016.

Financial instrument risk

The Company's financial assets and liabilities are exposed to various risk factors that may affect the fair value presentation of the amount ultimately received or paid on settlement of its assets and liabilities.

A summary of the major financial instrument risks and the Company's approach to management of these risks are outlined below:

(a) Interest rate risk

The Company's obligations under finance leases are at fixed interest rates. A significant portion of long-term debt is at interest rates which are fixed or are non-interest bearing. As such, the Company's exposure to fluctuations in interest rates is not considered material.

(b) Currency risk

Currency risk is the risk to the Company's earnings that arise from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company is exposed to foreign currency exchange risk on transactions incurred in US dollars. During the year ended September 30, 2016, the Company recorded a $188,672 loss on foreign currency (2015 - $234,641 gain). The Company monitors fluctuations in exchange rates and uses derivative instruments to reduce its exposure to foreign currency risk.

During the year ended September 30, 2016, the Company recorded revenue of $12,545,933 from contracts denominated in US dollars (2015 - $8,693,205). A 5% change in the U.S. dollar exchange rate would result in a $627,297 impact on revenue recognized (2015 - $434,660).

As at the September 30, 2016, the Company held receivables of $1,128,058 denominated in US dollars (2015 - $996,002). A 5% change in the US dollar exchange rate would result in a $56,403 (2015 - $49,800) impact on revenue recognized.

In Canadian dollars

22. Financial instruments (continued)

Financial instrument risk (continued)

(c) Credit risk

Credit risk arises from the potential that a counter party will fail to perform its obligations. The Company is exposed to credit risk from customers. In order to reduce its credit risk, the Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. The Company's maximum exposure to credit risk corresponds to the carrying value of accounts receivable and unbilled work in progress. Three customers accounted for 55% of revenue (September 30, 2015 – three customers - 50%) and five customers accounted for 80% of the Company's trade receivables at September 30, 2016 (September 30, 2015 – six customers - 80%).

An allowance for doubtful accounts is established based upon factors surrounding the credit risk of specific accounts, historical trends and other information. The allowance for doubtful accounts at September 30, 2016, was nil (September 30, 2015 - $8,374). At September 30, 2016, the Company's trade accounts receivable included amounts over 90 days old totaling $50,356 which were not considered to be impaired and therefore not included in the allowance for doubtful accounts (September 30, 2015 - $130,289).

(d) Liquidity risk

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they come due. The Company actively maintains a committed credit facility to ensure that it has sufficient funds to meet current and foreseeable future financial requirements at a reasonable cost. The contractual maturities (including interest payments where applicable) of the Company's financial liabilities are summarized below:

		1 year	1-5 years	>5 years
Accounts payable and accruals	$	3,377,526	-	-
Obligations under finance leases		16,861	37,506	-
Long term debt		2,218,265	7,547,162	135,116
	$	5,612,652	7,584,668	135,116

23. Capital management

The Company's objectives in terms of capital management are to maintain a sound financial position and to ensure financial flexibility in order to maintain its capacity for growth. The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Company's capital is composed of long term debt, other financial liabilities, and shareholders equity. The primary uses of its capital are to increase working capital to support business growth, support research and development activities, and finance acquisitions.

The Company believes that current cash balances and future funds generated through its operations will be sufficient to meet cash requirements currently and for the foreseeable future. If the Company were to experience a significant reduction in its cash flows from operations, it currently has a variety of options for raising capital for short-term cash needs, including an unused demand operating line of credit facility (Note 13). There were no changes in the Company's approach to capital management during the year ended September 30, 2016. The Company is not subject to any externally imposed capital requirements.

In Canadian dollars

24. Leases

Certain intangibles assets and property and equipment are held under finance lease arrangements. In addition, the Company has entered into operating lease arrangements for office occupancy and equipment. Operating lease expense for the year ended September 30, 2016 was $748,827 (2015 - $822,327). Future minimum lease payments (including interest) at September 30, 2016 are as follows:

		1 year	1-5 years	>5 years
Obligations under finance lease	$	16,861	37,506	-
Operating leases	$	705,131	2,775,691	1,178,090

The Company has entered into a rental lease for office premises in St. John's, NL with an initial term of six years ending September 30, 2017. The lease has a four year renewal option. The lease includes an initial net lease rate for two years with escalation provisions every two years thereafter. The Company incurred $282,240 (2015 - $262,080) associated with the lease.

The Company has entered into a rental lease arrangement for office premises in Halifax, NS, which expires on August 31, 2024. The remaining lease has a fixed net lease rate for the remainder of the term. During the year, the Company incurred $442,229 (2015 - $336,271) in rent expense associated with the lease.

25. Segment reporting

Bluedrop's business is organized and managed as two complementary lines of e-Learning based training businesses.

Bluedrop Training and Simulation is one of Canada's leading providers of comprehensive training solutions for the defence sector. With over 40 years' experience and hundreds of training devices delivered it prides itself on its resume and skilled work force. Bluedrop Training and Simulation provides a full suite of products and services ranging from; training needs analysis and design, courseware and technical documentation, training information management systems, training program delivery, virtual reality based trainers and simulators and in service support for larger simulators and programs. It services all branches of the defence sector including naval, air force and army operations as well as other security agencies.

Bluedrop Learning Networks is pioneering the development and adoption of a SaaS based training and delivery platform providing large scale customers with the ability to engage, track training and monitor training of large users groups spread out of multiple locations. It provides the complete service offering and solutions to meet the operational requirements of its clients from designing the training requirement, to building custom content, to operating and supporting the training and delivery platform. Revenues are generated from, recurring platform licences, custom courseware development, consulting services, and the sale of commercial off-the-shelf courses.

Segment profit or loss includes revenues and costs directly attributable to the operations of the segment. In addition management allocates a portion of shared administrative costs based on the attributable office space of those segments. Segment information for the reporting periods is as follows:

		2016			
		Bluedrop Learning Networks	Bluedrop Training and Simulation	Corporate and Other	Total
Revenue	$	4,863,438	19,966,926	-	24,830,364
Direct costs		2,166,537	11,246,637	-	13,413,174
Gross profit		2,696,901	8,720,289	-	11,417,190
Expenses					
Sales and marketing		1,490,905	511,343	10,547	2,012,795
General and administration		526,649	1,363,068	2,910,860	4,800,577
Research and development costs		1,450,918	2,400,898	-	3,851,816
Government assistance and other funding		(880,158)	(3,354,901)	-	(4,235,059)
Share-based compensation		18,005	(471)	64,534	82,068
Finance costs		-	-	1,933,590	1,933,590
Depreciation and amortization		691,547	406,571	12,556	1,110,674
Other (gains) and losses		320,366	18,740	130,032	469,138
		3,618,232	1,345,248	5,062,119	10,025,599
(Loss) earnings before income taxes	$	(921,331)	7,375,041	(5,062,119)	1,391,591

In Canadian dollars

25. Segment reporting (continued)

		2015			
		Bluedrop Learning Networks	**Bluedrop Training and Simulation**	**Corporate and Other**	**Total**
Revenue	$	3,754,460	17,418,392	-	21,172,852
Direct costs		1,993,372	9,906,588	-	11,899,960
Gross profit		1,761,088	7,511,804	-	9,272,892
Expenses					
Sales and marketing		1,422,746	623,079	10,276	2,056,101
General and administration		687,103	1,169,323	2,990,155	4,846,581
Research and development costs		-	126,582	-	126,582
Government assistance and other funding		20,042	(507,383)	(70,806)	(558,147)
Share-based compensation		32,026	24,433	138,384	194,843
Finance costs		-	-	1,997,525	1,997,525
Depreciation and amortization		462,522	418,869	16,116	897,507
Other (gains) and losses		-	-	(662,818)	(662,818)
		2,624,439	1,854,903	4,418,832	8,898,174
(Loss) earnings before income taxes	$	(863,351)	5,656,901	(4,418,832)	374,718

26. Comparative figures

Comparative figures have been reclassified to conform with the September 30, 2016 financial statement presentation. Specifically, Foreign exchange gains and losses, previously aggregated in general and administration expenses, have been reclassified to Other (gains) and losses

27. Subsequent events

In December 2016, $525,000 of the unsecured convertible term notes (Note 12) were converted into common shares at a price of $0.15 per share for a total issuance of 3,500,000 common shares.