



VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of VirtualArmour International Inc.

We have audited the accompanying consolidated financial statements of VirtualArmour International Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, and the consolidated statements of comprehensive loss, statements of changes in equity and 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 Consolidated 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 financial position of VirtualArmour International Inc. and its subsidiaries as at December 31, 2016 and December 31, 2015, and their financial performance and cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to note 1 in the consolidated financial statements which the existence of a material uncertainty that may cast significant doubt about VirtualArmour International Inc. and its subsidiaries' ability to continue as a going concern.

"Wolrige Mahon LLP"

CHARTERED PROFESSIONAL ACCOUNTANTS

May 1, 2017
Vancouver, B.C.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Consolidated Statements of Financial Position
(Expressed in U.S. Dollars)

		December 31, 2016 \$	December 31, 2015 \$
	Notes		
ASSETS			
Current			
Cash		144,530	250,812
Accounts receivable	17	1,646,663	1,705,268
Other receivables	17	271,771	270,806
Prepaid expenses		150,253	55,874
		2,213,217	2,282,760
Office facilities and equipment	4	277,403	417,679
Intangible assets	5	36,857	46,069
Total Assets		2,527,477	2,746,508
LIABILITIES			
Current			
Accounts payable and accrued liabilities	6	2,157,864	2,263,556
Deferred revenue		84,000	126,000
Warrant derivative liabilities	7	29,762	504,593
Line-of-credit arrangements	8	445,000	315,000
Leases	9	72,777	101,606
Due to related parties	16	152,206	174,772
		2,941,609	3,485,527
Leases	9	80,817	136,937
Due to related parties	16	-	185,615
Total Liabilities		3,022,426	3,808,079
DEFICIT ATTRIBUTABLE TO SHAREHOLDERS			
Share capital	12	6,284,418	3,650,715
Contributed surplus		1,664,490	1,432,743
Accumulated deficit		(8,443,857)	(6,145,029)
Total Deficit		(494,949)	(1,061,571)
Total Liabilities and Deficit		2,527,477	2,746,508

Going concern (Note 1)
Subsequent events (Note 18)

On behalf of the Board:

"Todd Kannegieter"

"Christopher Blisard"

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Consolidated Statements of Comprehensive Loss
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars)

	Notes	2016 \$	2015 \$
Revenue	14	8,897,092	7,366,309
Cost of sales	15	(6,624,066)	(5,234,615)
Gross Profit		2,273,026	2,131,694
Expenses	15		
General and administrative		1,507,404	1,296,891
Research and development		121,242	56,305
Sales and marketing		1,727,426	1,123,889
Total Expenses		3,356,072	2,477,085
Loss from Operations		(1,083,046)	(345,391)
Other Income (Expenses)			
Interest expense	8, 9, 16	(56,065)	(61,466)
Listing expense		-	(4,166,285)
Change in fair value of warrant derivative liabilities	7	(1,310,520)	1,169,751
Gain on debt settlement, net	16	150,803	-
Net and Comprehensive Loss for the year		(2,298,828)	(3,403,391)
Loss per share – basic and diluted	12(f)	(0.04)	(0.09)
Weighted average number of shares outstanding – basic		52,970,099	38,718,147

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Consolidated Statements of Changes in Deficit
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars)

	Common Shares / Membership Units #	Share Capital / Members' Contributions \$	Contributed Surplus \$	Accumulated Deficit \$	Total \$
Balance, December 31, 2014	2,000,000	905,991	1,444,998	(2,601,868)	(250,879)
Fair value of membership unit purchase warrants issued for financing fees	-	-	17,682	-	17,682
Fair value of membership unit purchase warrants issued	-	-	4,987	-	4,987
Reclassification of share based compensation liability related to Phantom Plan Units to equity	-	-	1,343	-	1,343
Incremental cost of Phantom Plan Units	-	-	868	-	868
Repurchase of membership units, Phantom Plan units and warrants	(220,000)	-	(260,230)	(139,770)	(400,000)
Exercise of membership unit purchase warrants	934,905	170,724	(170,724)	-	-
Share exchange agreement	40,000,000	-	-	-	-
Shares issued for Reverse Takeover Transaction	11,700,000	2,574,000	-	-	2,574,000
Cancellation of original Membership Units	(2,714,905)	-	-	-	-
Modification of options	-	-	324,596	-	324,596
Share-based-payments . vesting of options	-	-	69,223	-	69,223
Net loss	-	-	-	(3,403,391)	(3,403,391)
Balance, December 31, 2015	51,700,000	3,650,715	1,432,743	(6,145,029)	(1,061,571)
Pursuant to private placement (Note 12b)	865,500	316,607	-	-	316,607
Less:					
Fair value of warrants issued as part of units (Notes 7, 12b)	-	(52,649)	-	-	(52,649)
Fair value of finders warrants	-	(5,143)	5,143	-	-
Cash finders fees	-	(15,465)	-	-	(15,465)
Share issuance costs	-	(11,257)	-	-	(11,257)
Exercise of share purchase warrants	6,202,339	569,666	-	-	569,666
Share issuance costs	-	(6,056)	-	-	(6,056)
Cancellation of shares (Note 12e)	(2,998,392)	-	-	-	-
Transfer value on exercise of share purchase warrants (Note 7)	-	1,838,000	-	-	1,838,000
Share-based payments . vesting of options	-	-	226,604	-	226,604
Net loss	-	-	-	(2,298,828)	(2,298,828)
Balance, December 31, 2016	55,769,447	6,284,418	1,664,490	(8,443,857)	(494,949)

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Consolidated Statements of Cash Flows
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars)

	2016	2015
	\$	\$
Cash Flows (Used In) Provided By Operating Activities		
Net loss for the year	(2,298,828)	(3,403,391)
Non-cash expenses:		
Depreciation and amortization	209,558	161,763
Bad debt expense	9,000	-
Share-based payments	226,604	399,674
Share-based compensation issued for financing fees	-	17,682
Listing expense	-	4,166,285
Change in fair value of share based compensation liabilities	-	1,007
Change in fair value of warrant derivative liabilities	1,310,520	(1,169,751)
Gain on debt settlement, excluding legal fees	(215,681)	-
Cash (used in) provided by operating activities, before changes in operating assets and liabilities	(758,827)	173,269
Changes in operating assets and liabilities:		
Accounts receivable	58,605	(1,162,057)
Other accounts receivable	(9,965)	(109,837)
Prepaid expenses	(94,379)	(48,161)
Accounts payable and accrued liabilities	(169,573)	1,331,814
Deferred revenue	(42,000)	126,000
	(1,016,139)	311,028
Interest paid	(63,881)	(30,396)
Net Cash (Used In) Provided By Operating Activities	(952,258)	280,632
Cash Flows (Used In) Provided By Investing Activities		
Purchase of office facilities and equipment	(60,070)	(72,199)
Cash received from RTO	-	113,011
Net Cash (Used In) Provided By Investing Activities	(60,070)	40,812
Cash Flows Provided By (Used In) Financing Activities		
Proceeds from the exercise of warrants	569,666	-
Proceeds from a private placement of units	316,607	-
Share issuance costs	(32,778)	-
Advances from line-of-credit arrangements	805,000	275,000
Repayment of line-of-credit arrangements	(675,000)	(260,000)
Repayment of leases	(84,949)	(109,154)
Due to related parties	7,500	(72,456)
Net Cash Provided By (Used In) Financing Activities	906,046	(166,610)
(Decrease) Increase In Cash	(106,282)	154,834
Cash . Beginning of the Year	250,812	95,978
Cash . End of the Year	144,530	250,812
Non-cash Investing and Financing Activities:		
42,275 finderswarrants issued	5,143	-
Transfer value on exercise of share purchase warrants	1,838,000	-
Office facilities and equipment financed under financing leases	-	214,298
Notes payable issued to repurchased membership units, Phantom Plan units and warrants	-	400,000

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

1. Organization, Nature of Operations and Going Concern

VirtualArmour International Inc. (formerly VirtualArmor International Inc.) (~~%A Intl+~~or the ~~%Company+~~) was incorporated on March 4, 2015 in the State of Colorado. The registered office of the Company is 8085 S. Chester Street, Suite 108, Centennial, Colorado, United States. Effective October 25, 2016, the Company changed its name from VirtualArmor International Inc. to VirtualArmour International Inc. The Company sells advanced networking and cybersecurity products and solutions to large enterprise and service provider markets. The solutions provided by the Company run the full project life cycle from initial design, through professional and managed services. The Company delivers its products and services by working as a Business Partner with well-established and respected technology partners such as: Juniper Networks, IBM Security, Netskope, Palo Alto Networks and others. The Company's shares trade on the Canadian Securities Exchange (the "CSE") under the symbol ~~%AI+~~.

The Company's consolidated financial statements are presented in U.S. dollars. The functional currency of the Company and all of its wholly-owned subsidiaries is the U.S. dollar.

On July 27, 2015, VA Intl completed a reverse takeover transaction (the ~~%RTO+~~or the ~~%Transaction+~~) with VirtualArmor LLC (~~%A LLC+~~). In connection with the closing of the transaction, VA LLC and VirtualArmor Capital Inc. (~~%A Capital+~~) became wholly-owned subsidiaries of VA Intl. Upon completion of the RTO, the shareholders of VA LLC obtained control of the consolidated entity. Under the purchase method of accounting, VA LLC was identified as the acquirer, and accordingly the entity is considered to be a continuation of VA LLC with the net assets of VA Intl at the date of the RTO deemed to have been acquired by VA LLC.

These consolidated financial statements have been prepared on a going concern basis which contemplates that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. The Company had a net loss of \$2,298,828 during the year ended December 31, 2016. As of December 31, 2016, the Company has a working capital deficiency of \$728,392 and an accumulated deficit of \$8,443,857. A significant portion of the working capital deficiency is comprised of the line of credit arrangements (\$445,000). A significant portion of the accumulated deficit is comprised of non-cash accounting expenses such as listing expense (\$4,166,285) and the change in fair value of warrant derivative liabilities (\$140,769). The Company has funded losses with external debt and related party advances, share issuances and working capital. The existence of these matters creates a material uncertainty that raises significant doubt about the Company's ability to continue as a going concern. The continuation of the Company as a going concern is dependent upon the obtaining of financing necessary to continue operations and, ultimately, on sustaining profitable operations. These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amount and classification of liabilities and the reported revenue and expenses that would be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

Subsequent to the year ended December 31, 2016, the Company entered into an Invoice Purchase Agreement dated April 20, 2017 (Note 18) which will provide the Company with working capital as well as credit and collections support for the related accounts receivables.

2 Basis of Presentation

Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (~~%IFRS+~~) as issued by the International Accounting Standards Board and Interpretations of the IFRS Interpretations Committee, effective for the Company's reporting for the year ended December 31, 2016.

These consolidated financial statements were approved by the board of directors for issue on May 1, 2017.

Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis except for financial instruments classified as at fair value through profit or loss which are carried at fair value. In addition, these consolidated financial statements are prepared using the accrual basis of accounting except for cash flow information.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies.

Basis of consolidation

These consolidated financial statements include the financial statements of all subsidiaries subject to control by the Company, which include VA LLC and VA Capital.

Control is achieved when the Company (i) has power over an investee, (ii) is exposed, or has rights, to variable returns from its involvement with the investee and (iii) has the ability to affect those returns through its power over an investee entity. Subsidiaries are fully consolidated from the date on which control is obtained and continue to be consolidated until the date that such control ceases. Intercompany balances, transactions and unrealized intercompany gains and losses are eliminated upon consolidation.

Summary of significant accounting policies

Cash and cash equivalents

The Company considers all highly liquid instruments with a maturity of three months or less at the time of acquisition to be cash equivalents. As at December 31, 2016 and 2015, the Company had no cash equivalents.

Accounts receivable

Accounts receivable, net of allowance for doubtful accounts, includes amounts due from customers and amounts owed from vendors.

Office facilities and equipment

Office facilities and equipment consist of computer equipment and office furniture and fixtures and are measured at cost less accumulated depreciation and impairment losses. Office facilities and equipment are depreciated on a straight-line basis over their expected useful life. The estimated useful lives for the current and comparative periods are as follows:

Computer equipment: 4 years
 Furniture and fixtures: 5 years

Residual values and useful economic lives are reviewed at least annually, and adjusted if appropriate, at each financial year end. Subsequent expenditures relating to an item of office facilities and equipment are capitalized when it is probable that future economic benefits from the use of the assets will flow to the Company and the costs can be measured reliably. All other subsequent expenditures are recognized as repairs and maintenance expenses during the period in which they are incurred. Assets are derecognized when they are no longer in use. Gains and losses on disposal of office facilities and equipment are determined by comparing the proceeds from disposal with the carrying amount of the asset and are recognized net within other income in profit or loss.

Intangible assets

Intangible assets include software development costs and are measured at cost less accumulated depreciation and accumulated impairment losses. Amortization is recognized in profit or loss on a straight-line basis over the estimated useful life of 8 years, from the date that they are available for use, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets, other than certain intangible assets noted below, are reviewed at each reporting date to determine whether there is any indication of impairment in accordance with IAS 36, *Impairment of Assets*. If any such indication exists, then the asset's recoverable amount is estimated.

Intangible Assets

The recoverable amounts of the following types of intangible assets are measured annually whether or not there is any indication that they may be impaired.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

- an intangible asset with an indefinite useful life
- an intangible asset not yet available for use
- goodwill acquired in a business combination

Recoverable Amount

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit, or CGU).

The Company's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs. An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

Reversals of Impairment

In respect of non-financial assets, other than goodwill, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Share-based payments

The fair value of all equity settled stock options granted is recorded as a charge in profit or loss and a credit to contributed surplus under the graded attribution method. The fair value of warrants classified as equity that are issued as share issuance costs are recorded as a deduction from equity and a credit to contributed surplus. The fair value of stock options, as adjusted for the expected forfeiture rate, is recognized over the vesting period of the options. Stock options granted to non-employees are measured at the estimated value of services received. The fair value of warrants is recognized on the issuance date.

Any consideration received on the exercise of stock options or warrants, together with the related portion of contributed surplus, is credited to share capital. The fair value of stock options and warrants is estimated using the Black-Scholes option pricing model.

Share capital

Common shares are classified as equity. Transaction costs directly attributable to the issuance of common shares are recognized as a deduction from equity.

When the Company issues units comprised of common shares and warrants, the warrants, where the exercise price is not stated in the Company's functional currency, are classified as financial liabilities measured at fair value through profit and loss, measured using the Black-Scholes option model. The residual value of the units is allocated to share capital.

Revenue recognition

i) Sale of goods:

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and the amount of revenue can be measured reliably. In addition, revenue is only recognized when the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

- ii) Rendering of managed security services, products support services and other consulting services:

Revenue from services is recognized by the Company when it has the primary responsibility for providing the services to the customer or for fulfilling the order. Revenue from such service contracts is recognized over the periods during which the services are rendered. In instances when the Company is selling services in an agency capacity the gross inflows collected on behalf of the principal service provider are not recognized as revenue, instead, revenue is the amount of commission earned by the Company and is recognized when the Company has sold the service contract to the end customer. Revenue is only recognized when the amount of revenue can be measured reliably, when it is probable that the economic benefits of the transaction will flow to the Company, when the stage of completion of the transaction at the end of the reporting period can be measured reliably and when the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in profit or loss over the period of the borrowing using the effective interest method.

Borrowings are shown as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the statement of financial position date.

Leases

Leases are classified as either financing or operating in nature. Finance leases are those which substantially transfer the benefits and risks of ownership of an asset to the lessee. At the commencement of the lease term, the Company recognizes finance leases as assets (office facilities and equipment) and liabilities in the statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Obligations under finance leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to profit or loss as interest expense. Payments required under operating leases are recorded as an expense over the period of the operating lease.

Provisions

Provisions are recognized for liabilities of uncertain timing or amounts that have arisen as a result of past transactions, including legal or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of the Company and all of its wholly-owned subsidiaries is the U.S. dollar. The financial statements are presented in U.S. dollars, the Company's presentation currency.

Transactions in currencies other than the functional currency are translated into the functional currency using the exchange rates prevailing at the dates of the transaction. Monetary assets and liabilities not denominated in the functional currency are translated at the year-end rates of exchange. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise.

Financial instruments

The Company's financial instruments consist of cash, accounts receivable, other receivables, accounts payable and accrued liabilities, due to related parties, line-of-credit arrangements and warrant derivative liabilities.

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Financial instruments in this category are recognized at fair value and subsequently carried at fair value. Gains and losses arising from changes in fair value are recorded in profit or loss in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except if they are expected to be realized beyond twelve months of the statement of financial position date, where they are classified as non-current. The Company classifies cash and warrant derivative liabilities as financial instruments at fair value through profit or loss.

Held-to-maturity investments: Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and the Company has the ability and the intention to hold these investments to maturity. Such assets are recognized initially at fair value plus any directly attributable transaction costs. They are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Held-to-maturity investments are included in noncurrent assets, except for those which are expected to mature within 12 months after the end of the reporting period which are recorded in current assets. The Company does not hold any financial assets in this category.

Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method. The Company classifies accounts receivable and other receivables as loans and receivables.

Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. Available-for-sale investments are recognized at fair value and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income (loss). Available-for-sale investments are classified as current except if they are expected to be realized beyond twelve months of the statement of financial position date, where they are classified as non-current. The Company does not hold any financial assets in this category.

Financial liabilities at amortized cost: Financial liabilities are classified as other financial liabilities, based on the purpose for which the liability was incurred, and comprise accounts payable and accrued liabilities, amounts due to related parties and line-of-credit arrangements. These liabilities are initially recognized on the trade date at fair value when the Company becomes a party to the contractual provisions of the instrument and are subsequently carried at amortized cost using the effective interest rate method. The liabilities are derecognized when the Company's contractual obligations are discharged or cancelled or, they expire.

Impairment of financial assets

At each reporting date, the Company assesses whether there is any objective evidence that a financial asset or a group of financial assets, other than those carried at fair value through the profit or loss, is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or group of financial assets. The carrying amount of the financial asset shall be reduced either directly or through the use of an allowance account. The Company records the impairment of financial assets in profit or loss.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

The Company maintains allowances for potential credit losses related to doubtful accounts. Current economic conditions, historical information, reasons for the accounts being past-due and line of business from which the customer accounts receivable arose are all considered when determining whether allowances should be made for past-due accounts; the same factors are considered when determining whether to write off amounts charged to the allowance for doubtful accounts against the customer accounts receivable. The Company establishes an allowance for doubtful accounts based on the age of the receivable and the specific identification of receivables the Company considers at risk. No customer accounts receivable are written off directly to the bad debt expense unless the customers file for bankruptcy or the Company has confirmed that the receivable is uncollectible.

Income taxes

Income tax on the income or loss for the periods presented comprises current and deferred tax. Income tax is recognized in income or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax expense is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous periods.

Deferred tax is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The Company does not provide for temporary differences relating to investments in subsidiaries, associates, and joint ventures to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the date of the statement of financial position applicable to the period of expected realization or settlement.

A deferred tax asset is recognized only to the extent that it is probable that future taxable income will be available against which the asset can be utilized.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Critical accounting judgments and estimates

The preparation of these consolidated financial statements in accordance with IAS 1, Presentation of Financial Statements, requires management to make certain critical accounting estimates and to exercise judgment in applying the Company's accounting policies. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions. Critical accounting estimates include the determination of the fair value of share based compensation and warrant derivative liabilities as well as the amount to recognize as an allowance for doubtful accounts.

Critical judgments in applying accounting policies that have the most significant risk of causing material adjustments to the carrying amounts of assets and liabilities include the accounting for revenue recognition, the assessment of the going concern assumption, the determination of impairment of financial and non-financial assets, determining whether contingent assets or liabilities exist, the accounting for the reverse takeover transaction and the assessment of VA LLC as the acquirer.

The Company must apply judgment in the application of its revenue recognition accounting policy. Judgment is required in order to determine when the significant risks and rewards of ownership have been transferred to the buyer as well as the other criteria required to be assessed as part of the sale of goods. Rendering of services requires the Company to make considerable judgments as to whether the Company has the primary responsibility for providing services to the customer or whether the Company is acting as an agent.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

Standards, amendments and interpretations not yet effective

The following new IFRSs have not been early adopted in these financial statements. Management does not intend to adopt these standards prior to the effective date and has not yet assessed the effect on the Company's future results and financial position of adopting these standards:

- i) IFRS 9, *Financial Instruments* (New; to replace IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRIC 9, *Reassessment of Embedded Derivatives*), applicable January 1, 2018.
- ii) IFRS 15, *Revenue from Contracts with Customers*, applicable January 1, 2018.
- iii) IFRS 16, *Leases*, applicable January 1, 2019.

Other accounting standards or amendments to existing accounting standards that have been issued but have future effective dates are either not applicable and/or are not expected to have a significant impact on the Company's financial statements.

3 Reverse Takeover Transaction

On March 4, 2015, Blueprint Corporate Services Inc. (~~Planco~~), VA Intl, VA Capital and VA LLC entered into an Arrangement Agreement, whereby all parties agreed to consummate the purchase of VA Intl by VA LLC by way of a share exchange, with VA LLC and VA Capital becoming wholly-owned subsidiaries of VA Intl. Pursuant to the Transaction the following transactions took place:

- " VA Capital acquired from Planco 10,000 common shares of VA Intl, representing 100% of the outstanding shares of VA Intl (the ~~Purchased Shares~~), for consideration of CAD\$10,000.
- " The holders of the issued and outstanding VA Capital common shares received one VA Intl common share for each one VA Capital common share. As a result, VA Intl issued 11,400,000 common shares and 11,400,000 common share purchase warrants in exchange for all the outstanding common shares and share purchase warrants of VA Capital. The terms of the VA Intl warrants are the same as the original terms of the VA Capital warrants. This exchange has been accounted for as a recapitalization of VA Intl.
- " VA Intl issued 300,000 of its common shares (the ~~Distribution Shares~~) to Planco in exchange for 1,000 common shares of Planco (the ~~Exchange Shares~~).
- " The Distribution Shares were distributed to the shareholders of Planco on a one-to-one basis according to their shareholdings.
- " The 10,000 Purchased Shares were cancelled.
- " VA Intl issued 40,000,000 common shares to acquire 2,714,905 membership units of VA LLC, representing 100% of the outstanding membership units of VA LLC. In addition, VA Intl granted 3,587,418 stock options in exchange for the existing 1,781,418 membership unit purchase warrants of VA LLC. VA LLC also cancelled 1,214,357 existing membership unit purchase warrants for no consideration.

Upon completion of the Transaction on July 27, 2015, the consolidated entity continued to carry on the business of VA LLC and became a reporting issuer in Alberta and British Columbia.

As a result of the Transaction, the former members of VA LLC, for accounting purposes, were considered to have acquired control of VA Intl and VA Capital. Accordingly, the Transaction was accounted for as a reverse takeover that was not a business combination and effectively was a capital transaction of VA LLC. VA LLC, as a result of having obtained control of VA Intl and VA Capital, has been treated as the accounting parent company (legal subsidiary) and VA Intl and VA Capital have been treated as the accounting subsidiaries (legal parent) in these consolidated financial statements. As VA LLC was deemed to be the acquirer for accounting purposes, its assets, liabilities and operations since incorporation are included in these consolidated financial statements at their historical carrying values. VA Intl and VA Capital's results of operations have been included from July 27, 2015, the date of the Transaction.

For purposes of the Transaction, the consideration received was the fair value of the net assets of VA Intl and VA Capital, which on July 27, 2015 was \$82,059. This amount was calculated as follows:

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

	\$
Fair value of 11,700,000 shares issued at \$0.22 per share	2,574,000
Fair value of 11,400,000 warrants issued	1,674,344
Aggregate fair value of consideration paid	4,248,344
Cash	113,011
Prepays	7,713
Accounts payable and accrued liabilities	(38,665)
Net assets acquired	82,059
Listing expense	4,166,285

The fair value of the shares issued was based on management's assessment of the fair value per share.

The fair value of 11,400,000 warrants was estimated using the Black-Scholes option pricing model with the following assumptions: stock price - \$0.22; exercise price - \$0.08; risk-free interest rate . 0.85%; expected life . 0.7 years; expected volatility . 100%; and expected dividends - \$nil.

4 Office Facilities and Equipment

Cost	Computer equipment \$	Furniture and Fixtures \$	Total \$
Balance at December 31, 2014	640,999	27,564	668,563
Additions	283,475	3,022	286,497
Dispositions	(111,654)	-	(111,654)
Balance at December 31, 2015	812,820	30,586	843,406
Additions	60,070	-	60,070
Balance at December 31, 2016	872,890	30,586	903,476
Accumulated Depreciation			
Balance at December 31, 2014	358,065	26,767	384,832
Depreciation for the year	151,672	877	152,549
Dispositions	(111,654)	-	(111,654)
Balance at December 31, 2015	398,083	27,644	425,727
Depreciation for the year	197,404	2,942	200,346
Balance at December 31, 2016	595,487	30,586	626,073
Carrying Amounts			
Balance at December 31, 2015	414,737	2,942	417,679
Balance at December 31, 2016	277,403	-	277,403

The depreciation expense recognized by the Company in each period presented is included in general and administrative expenses.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

5. Intangible Assets

	Software Development Cost \$
Cost	
Balance at December 31, 2015 and 2014	73,711
Development costs for the year	-
Balance at December 31, 2016	73,711
	Total \$
Accumulated Depreciation	
Balance at December 31, 2014	18,428
Depreciation for the year	9,214
Balance at December 31, 2015	27,642
Depreciation for the year	9,212
Balance at December 31, 2016	36,854
	Total \$
Carrying Amounts	
Balance at December 31, 2015	46,069
Balance at December 31, 2016	36,857

The depreciation expense recognized by the Company in each year presented is included in general and administrative expenses.

6. Accounts Payable and Accrued Liabilities

	December 31, 2016 \$	December 31, 2015 \$
Trade payables and accrued liabilities	1,841,145	1,968,239
Payroll liabilities	303,735	264,804
Interest payable	-	7,816
Sales tax payable	12,984	22,697
Total accounts payable and accrued liabilities	2,157,864	2,263,556

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

7. Warrant Derivative Liabilities

The Company has share purchase warrants exercisable into common shares at an exercise price denominated in Canadian dollars while the Company's functional currency is the U.S. dollar. As a variable amount of U.S. dollars are exercisable into a fixed number of common shares, the share purchase warrants are classified as derivative liabilities.

	\$
Warrant derivative liabilities . December 31, 2014	-
11,400,000 warrants issued pursuant to the reverse takeover	1,674,344
Change in fair value of warrant derivative liabilities	(1,169,751)
Warrant derivative liabilities – December 31, 2015	504,593
Transfer on exercise of share purchase warrants	(1,838,000)
432,750 warrants issued pursuant to a private placement of units (Note 12b)	52,649
Change in fair value of warrant derivative liabilities	1,310,520

Warrant derivative liabilities – December 31, 2016 **29,762**

As at December 31, 2016 and 2015, the fair value of warrant derivative liabilities was estimated using the Black-Scholes option pricing model with the following assumptions:

	2016	2015
Average stock price	\$0.25	\$0.11
Average exercise price	\$0.56	\$0.08
Average risk-free interest rate	0.73%	0.85%
Expected life	1.03 years	0.6 years
Expected volatility	126%	100%
Expected dividends	\$nil	\$nil

The expected volatility was calculated in comparison to similar junior public companies and using the historical stock price of the Company.

8. Line-of-Credit Arrangements

On February 13, 2014, the Company entered into a line-of-credit arrangement for \$450,000 which was due on February 13, 2015 (the "LOC"). The due date has been extended on multiple occasions, with the current due date being May 25, 2017. The LOC bears interest at a variable interest rate equal to the Wall Street Journal Prime Rate plus 1.00% per annum. The LOC is secured by all assets of the Company and is guaranteed by two members of the Board of Directors.

9. Leases

The Company has equipment leases secured by specific computer equipment. The terms and the outstanding balances as at December 31, 2016 and 2015 are as follows:

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

	December 31, 2016 \$	December 31, 2015 \$
Contrail Cloud, equipment lease repayable in monthly instalments of \$2,517 including interest at 4.47% per annum, due in April 2018.	35,506	64,386
Western Equipment Finance, equipment lease repayable in monthly instalments of \$1,985 including interest at 4.38% per annum, due in November 2020	76,526	96,064
De Lage Landen Financial Services, Inc., equipment lease payable in monthly instalments of \$1,551 including interest at 2.07% per annum, due in June 2017.	8,765	26,295
SHI International, equipment lease repayable in monthly instalments of \$802 including interest at 4.63% per annum, due in January 2018.	9,159	17,614
SHI International, equipment lease repayable in monthly instalments of \$359 including interest at 4.63% per annum, due in March 2018.	4,730	8,515
Western Equipment Finance, equipment lease repayable in monthly instalments of \$600 including interest at 4.58% per annum, due in September 2019	18,908	-
Western Equipment Finance, equipment lease repayable in monthly instalments of \$1,305 including interest at 9.08%, due in June 2016.	-	6,154
Western Equipment Finance, equipment lease repayable in monthly instalments of \$1,951 including interest at 6.67%, due in December 2016.	-	19,515
Subtotal	153,594	238,543
Less: current portion	72,777	101,606
Long-term portion	80,817	136,937
Future minimum lease payments related to capital lease obligations are as follows:		
		\$
Not later than one year		84,471
Later than one year and not later than five years		95,514
Subtotal		179,985
Less: imputed interest		26,391
Subtotal		153,594
Less: current portion		72,777
Long-term portion		80,817

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

10. Membership Units

VA LLC was authorized to issue 10,000,000 Class A and 2,000,000 Class B Membership units without par value.

As at December 31, 2014, VA LLC had 2,000,000 Class A Membership Units issued and outstanding. On June 15, 2015, 220,000 Class A Membership Units were purchased from a related party (Note 16) and cancelled. On July 27, 2015, 1,195,791 membership unit purchase warrants were exercised and VA LLC issued 934,905 Class A Membership Units to the warrant holders. On July 27, 2015, in connection with the RTO (Note 3), VA Intl issued 40,000,000 common shares VA LLC's members in exchange for all 2,714,905 issued and outstanding Class A Membership Units of VA LLC. The Company has no outstanding Class A Membership Units.

As at December 31, 2014, VA LLC had 40,000 Class B Membership Units issued and outstanding. On June 15, 2015, the 40,000 Class B Membership Units were purchased from a related party and cancelled. The Company has no outstanding Class B Membership Units.

11. Membership Unit Purchase Warrants

During the year ended December 31, 2014, VA LLC issued 269,760 membership unit purchase warrants (MUWs) to two officers to purchase 269,760 Class A membership units of the Company. In addition, VA LLC issued 517,940 MUWs to settle accrued compensation of \$192,000 owed to two officers of the Company. The MUWs entitled the holders to purchase, in aggregate, 517,940 Class A membership units of VA LLC.

On June 15, 2015, 706,961 MUWs were purchased from a related party (Note 16) and cancelled.

On July 27, 2015, 1,195,791 MUWs were exercised and VA LLC issued 934,905 Class A Membership Units to the warrant holders.

On July 27, 2015, on completion of the RTO (Note 3), the Company granted 2,136,000 stock options in exchange for the cancellation of 330,000 MUWs exercisable at \$0.60 per Class A Membership Unit. The Company recorded modification of an award expense of \$324,596 as the fair value of the stock options was higher than the MUWs.

On July 31, 2015, the Company issued 1,451,418 stock options in exchange for the cancellation of 1,451,418 MUWs exercisable at \$0.60 per Class A Membership Unit. The Company did not record modification of an award expense as the fair value of the stock options was lower than the MUWs.

On July 31, 2015, the Company cancelled 1,214,357 MUWs for no consideration.

The following table summarizes information about the MUWs at December 31, 2016 and 2015, and the changes for the years then ended:

	Number of Warrants #	Weighted average exercise price \$
Membership Unit Warrants outstanding . December 31, 2014	4,898,527	0.67
Cancelled	(1,921,318)	0.71
Exercised	(1,195,791)	0.71
Cancelled and exchanged for stock options	(1,781,418)	0.60
Membership Unit Warrants outstanding – December 31, 2015 and 2016	-	-

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

12. Share Capital

a) Authorized:

300,000,000 common shares without par value.

b) Financings:

On July 11, 2016, the Company closed a non-brokered private placement by issuing 865,500 units at a price of CAD\$0.48 per unit for aggregate gross proceeds of \$316,607 (CAD\$415,440). Each unit consists of one common share of the Company and one half of one common share purchase warrant. Each whole warrant entitles the holder to acquire one share at a price of CAD\$0.75 per share up to January 11, 2018. The fair value of the warrants embedded in the units was calculated as \$52,649 and allocated to warrant derivative liabilities (Note 7). The Company paid a cash finder's fee of \$15,465 (CAD\$20,292), incurred issuance costs of \$11,257 and issued 42,275 finders' warrants with a fair value of \$5,143. Each finders' warrant entitles the holder thereof to acquire one share at a price of CAD\$0.75 per share up to January 11, 2018. The fair value of the finders' warrants was estimated using the Black-Scholes option pricing model with the following assumptions: stock price . CAD\$0.47; exercise price . CAD\$0.75; risk-free interest rate . 0.85%; expected life . 1.5 years; expected volatility . 100%; and expected dividends - \$nil.

c) Options:

The Board of Directors has adopted a stock option plan (the "Stock Option Plan" or "Plan") whereby a maximum of 10% of the issued and outstanding Shares, from time to time, may be reserved for issuance pursuant to the exercise of options. Under the terms of the Stock Option Plan, options may be granted only to: (i) employees, officers, directors, and consultants of the Company; (ii) employees, officers, directors, and consultants of an affiliate of the Company; and (iii) any other person deemed suitable by the Board to receive options to purchase common shares.

The exercise price of any option when granted may not be less than the greater of the closing market price of the common shares on: (a) the last trading day immediately preceding the date of grant of the option; and (b) the date of grant of the option; provided however, that if the common shares are not listed on any securities exchange, the exercise price may not be less than the fair market value of the common shares as may be determined by the Board of Directors on the day immediately preceding the date of the grant of such option. The options are settled in shares.

The options are non-assignable and non-transferable. Options granted under the Stock Option Plan have a maximum term of five years and can only be exercised by the optionee as long as the optionee remains an eligible optionee pursuant to the Stock Option Plan or within 90 days (or as otherwise determined by the Board of Directors) after ceasing to be an eligible optionee, or, if the optionee dies, within one year from the date of the optionee's death.

A summary of the status of the Company's stock options outstanding as at December 31, 2016 and 2015 and the changes during the years then ended is presented below:

	Outside the Plan Number of options #	Within the Plan Number of options #	Weighted average exercise price \$	Weighted Average Life (Years)
Stock options outstanding . December 31, 2014	-	-	-	-
Granted	-	4,962,418	0.10	
Forfeited	-	(25,000)	0.10	
Stock options outstanding . December 31, 2015	-	4,937,418	0.10	4.58
Granted	1,085,474	384,526	0.32	
Balance outstanding . December 31, 2016	1,085,474	5,321,944	0.15	3.81
Balance exercisable . December 31, 2016	-	4,148,043	0.10	3.58

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

At December 31, 2016, stock options outstanding that entitled the holder thereof to acquire one share for each option held are as follows:

Expiry Date	Exercise Price \$	Number of Options
July 27, 2020	U.S.\$0.10	⁽¹⁾ 2,136,000
July 31, 2020	U.S.\$0.10	⁽²⁾ 2,801,418
March 13, 2021	CAD\$0.46	⁽³⁾ 150,000
April 6, 2021	CAD\$0.47	⁽³⁾ 100,000
August 19, 2021	CAD\$0.44	⁽⁴⁾ 200,000
September 7, 2021	CAD\$0.40	⁽⁴⁾ 1,020,000
		6,407,418

⁽¹⁾ These stock options vested on the date of grant.

⁽²⁾ 1,451,418 of these stock options vested on the date of grant. 1,350,000 of these stock options vest as follows: 30% twelve months after July 31, 2015 and 8.75% every three months thereafter.

⁽³⁾ These stock options vest 12.5% every four months after the date of grant.

⁽⁴⁾ These stock options vest as follows: 30% twelve months after the date of grant and 8.75% every three months thereafter.

During the year ended December 31, 2016, the Company recorded share-based payments expense of \$226,604 (2015 - \$69,223) based on the vesting of stock options. The weighted average fair value of stock options granted during the year ended December 31, 2016 of \$0.240 per option (2015 - \$0.184) was estimated using the Black-Scholes option pricing model with the following assumptions:

	2016	2015
Average stock price	\$0.32	\$0.22
Average exercise price	\$0.32	\$0.10
Average risk-free interest rate	1.38%	1.50%
Expected life	5.0 years	5.0 years
Expected volatility	100%	100%
Expected dividends	\$nil	\$nil

The expected volatility was calculated in comparison to similar junior public companies.

d) Warrants:

A summary of share purchase warrants outstanding as of December 31, 2016 and 2015 and the changes during the period then ended is presented below:

	Number of warrants #	Weighted average exercise price CAD\$	Weighted Average Life (Years)
Share purchase warrants outstanding . December 31, 2014	-	-	-
Issued pursuant to the reverse takeover	11,400,000	0.11	
Share purchase warrants outstanding . December 31, 2015	11,400,000	0.11	0.56
Issued	475,025	0.75	1.50
Exercised	(6,202,339)	0.12	
Expired	(5,197,661)	0.11	
Share purchase warrants outstanding . December 31, 2016	475,025	0.75	1.03

As at December 31, 2016, the Company had 475,025 share purchase warrants outstanding at an exercise price of CAD\$0.75 per share up to January 11, 2018. Of the share purchase warrants outstanding, 42,275 were allocated to equity (Note 12b) and 432,750 were allocated to warrant derivative liabilities (Note 7).

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

e) Escrow shares:

On October 8, 2015, the Company entered into an escrow agreement with certain shareholders of the Company. 35,774,990 common shares of the Company were placed into escrow. On December 22, 2015, an additional 4,088,716 common shares of the Company were placed into escrow. These escrow shares will be released as follows:

Date of Automatic Timed Release	Amount of Escrow Shares Released
On the date that the Company's common shares were listed on the CSE, November 24, 2015	1/10 of the escrow shares
6 months after the listing date	1/6 of the remainder of the escrow shares
12 months after the listing date	1/5 of the remainder of the escrow shares
18 months after the listing date	1/4 of the remainder of the escrow shares
24 months after the listing date	1/3 of the remainder of the escrow shares
30 months after the listing date	1/2 of the remainder of the escrow shares
36 months after the listing date	The remainder of the escrow shares

In addition, there are 184,800 other shares that are in escrow that will be released as to 10% of the escrowed shares three months after the date that the common shares were listed on the CSE, 20% of the remainder of the escrowed shares 6 months after the listing date, 20% of the remainder of the escrowed shares 12 months after the listing date, and the remainder 18 months after the listing date.

On March 15, 2016, the Company cancelled 2,998,392 common shares which were being held in escrow for \$nil consideration. In conjunction with this transaction, existing shareholders agreed to voluntarily escrow 3,000,000 common shares on March 15, 2016, to be released in five equal blocks on a quarterly basis over the next 18 months.

As at December 31, 2016, 24,011,588 (2015 - 36,062,135) common shares remained in escrow.

f) Basic and diluted loss per share:

During the year ended December 31, 2016, potentially dilutive common shares totaling 6,882,443 (2015 - 16,362,418) were not included in the calculation of diluted loss per share because their effect was anti-dilutive.

13. Income Taxes

A reconciliation between the Company's income tax provision computed at statutory rates to the reported income tax provision is as follows:

	Years ended December 31,	
	2016	2015
Effective blended statutory tax rate	38.01%	38.12%
Expected tax expense (recovery) at statutory rate	\$ (858,000)	\$ (1,305,000)
Basis Difference on LLC Tax Conversion	-	38,000
Items not deductible for tax purposes	511,000	1,142,000
Non taxable portion of capital loss	-	(1,000)
Change in estimate	(22,000)	(1,000)
Income tax benefit not recognized	369,000	127,000
Income tax expense (recovery)	-	-

The income tax expense (recovery) above represents deferred tax only.

The significant components of the Company's net deferred tax assets and liabilities as at December 31, 2016 and 2015 are as follows:

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

	2016 \$	2015 \$
Deferred tax assets		
Allowance for doubtful accounts	3,000	16,000
Share-based payments	236,000	150,000
Non capital loss carry forward	268,000	43,000
Accelerated depreciation deduction carry forward	87,000	-
	594,000	209,000
Offset against deferred tax liabilities	(85,000)	(70,000)
Unrecognized deferred tax assets	(509,000)	(139,000)
Deferred tax assets		-
Deferred tax liabilities		
Equipment	(85,000)	(70,000)
Offset with deferred tax assets	85,000	70,000
Deferred tax liabilities	-	-
Net deferred tax balance	-	-

As at December 31, 2016, the Company has estimated non capital loss for US Federal income tax purposes that may be carried forward to reduce taxable income derived in future years. Their expiry dates are as follows:

	\$
2035	91,000
2036	522,000
	613,000

As at December 31, 2016, the Company has estimated non capital loss for Canadian income tax purposes that may be carried forward to reduce taxable income derived in future years. Their expiry dates are as follows:

	CAD\$
2033	57,000
2034	85,000
2035	35,000
2036	8,000
	185,000

14. Revenue

A breakdown of the revenue is presented below:

	2016 \$	2015 \$
Hardware and software sales and product support services	6,827,014	5,780,084
Managed services	1,612,192	1,341,142
Professional services	438,643	235,823
Other revenue	19,243	9,260
	8,897,092	7,366,309

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

15. Cost of Sales and Operating Expenses

A breakdown of the cost of sales is presented below:

	Years ended December 31, 2016	2015
	\$	\$
Cost of sales . hardware and software sales	5,397,993	4,281,846
Cost of sales . managed and professional services		
Salaries and consulting fees	1,055,032	770,667
Other	171,041	182,102
	6,624,066	5,234,615

A breakdown of the general and administrative expense is presented below:

	Years ended December 31, 2016	2015
	\$	\$
Bad debt expense	9,000	-
Depreciation and amortization	209,558	161,763
General and administrative	419,417	270,409
Professional fees	167,642	159,003
Salaries	375,294	287,013
Share-based payments (Note 12(c))	226,604	399,674
Shareholder communications	99,889	19,029
	1,507,404	1,296,891

A breakdown of the research and development expense is presented below:

	Years ended December 31, 2016	2015
	\$	\$
Consulting fees	38,033	-
Salaries	83,209	56,305
	121,242	56,305

A breakdown of the sale and marketing expense is presented below:

	Years ended December 31, 2016	2015
	\$	\$
Salaries and commissions	1,433,105	978,709
Travel	156,819	94,884
Other	137,502	50,296
	1,727,426	1,123,889

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

16. Related Party Transactions

The Company previously entered into two secured promissory notes with a Director of the Company pursuant to which the Director agreed to provide a revolving line of credit (the "LOC") of an aggregate of up to \$290,000. The amounts are secured by a subordinated, second priority lien on all of the assets of the Company, bear interest at 7% per annum and are due on demand. As at December 31, 2016, the Company is indebted to the Director of the Company for \$152,206 (2015 - \$56,097) for advances provided to the Company under this loan and interest accrued on the outstanding balance. During the year ended December 31, 2016, the Company recorded interest of \$8,574 (2015 - \$9,068).

On June 15, 2015, VA LLC issued \$400,000 of promissory notes to a former officer of VA LLC in order to repurchase 706,961 MUWs (Note 11) and 220,000 Class A Units (Note 10). Pursuant to the promissory note agreements, the Company made a payment of \$35,000 on June 15, 2015. The remaining principal amount of the note was payable in 36 equal blended instalments beginning July 1, 2015. During the year ended December 31, 2016, the terms of the promissory notes were amended. Effective February 29, 2016, the Company and the former officer agreed that the Company will pay 25% of the remaining principal balance as part of the resolution of a dispute between the parties. The Company recorded a gain on debt settlement of \$150,803, net of legal fees of \$64,878. The promissory notes were repaid in six equal instalments beginning March 1, 2016 and ending on August 1, 2016. The promissory notes bore interest at 4.5% per annum. As at December 31, 2016, the balance of the promissory notes was \$nil (2015 - \$304,289).

Key management includes the Chief Executive Officer, the Chairman of the Board, the President, the Vice President of Managed Services and the former Chief Technology Officer as well as the directors of the Company. Compensation paid or payable to key management for services during the years ended December 31, 2016 and 2015 is as follows.

	Years ended December 31,	
	2016	2015
	\$	\$
Short-term benefits	700,631	648,041
Share-based payments	115,034	25,927
	815,665	673,968

17. Financial Instruments

Management of Capital

The Company manages its components of shareholders' deficit as capital. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its technology and products and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. The Company does not have any externally imposed capital requirements to which it is subject, other than the continued listing requirements of the CSE.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash.

In order to maximize ongoing development efforts, the Company does not pay out dividends.

The Company will require capital resources to carry out its development plans and operations through its current operating period.

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

Fair Values

Assets and liabilities measured at fair value on a recurring basis were presented on the Company's statements of financial position as at December 31, 2016 and 2015, as follows:

	Fair Value Measurements Using			Balance, December 31, 2016 \$	Balance, December 31, 2015 \$
	Quoted prices in active markets for identical instruments (Level 1) \$	Significant other observable inputs (Level 2) \$	Significant unobservable inputs (Level 3) \$		
Cash	144,530	-	-	144,530	250,812
Warrant derivative liabilities	-	-	(29,762)	(29,762)	(504,593)
	144,530	-	(29,762)	114,768	(253,781)

The fair values of other financial instruments, which include accounts receivable, other receivables, accounts payable and accrued liabilities, due to related parties and line-of-credit arrangements approximate their carrying values due to the relatively short-term to maturity and/or on-demand nature of these instruments.

Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash, accounts receivable and other receivables. The Company limits its exposure to credit loss by placing its cash with high credit quality financial institutions.

The Company's credit risk for accounts receivable is concentrated, as 62% of its accounts receivable owing is from eight customers (2015 . 85% from eight customers). In addition, 50% of its revenue is from six customers (2015 . 57% from six customers). The Company performs ongoing credit evaluations, does not require collateral and establishes an allowance for doubtful accounts based on the age of the receivable and the specific identification of receivables the Company considers at risk. Most sales' payment terms are set in accordance with industry practice.

The following table presents an analysis of the age of accounts receivable for which an allowance has not been made as at the dates of the statements of financial position.

	December 31, 2016 \$	December 31, 2015 \$
Accounts receivable		
Less than 30 days past billing date	1,572,987	1,558,439
31-60 days past billing date	55,447	2,916
61-90 days past billing date	16,851	11,200
Greater than 90 days past billing date	1,378	132,713
	1,646,663	1,705,268
Accounts receivable	1,646,663	1,705,268
Allowance for doubtful accounts	-	-
	1,646,663	1,705,268

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

The following table presents a summary of the activity related to the Company's allowance for doubtful accounts with respect to the accounts receivable.

	December 31, 2016 \$	December 31, 2015 \$
Balance, beginning of the year	-	43,049
Additions (bad debt expense)	-	-
Write-off	-	(43,049)
Balance, end of the year	-	-

The Company's Other Receivables relate primarily to marketing development funds (MDF) and rebates from certain suppliers. These other receivables generally have terms of payment due within 30 days for MDF funds and four to five months for rebates from suppliers. The Company has a history of collecting these amounts in full. As at December 31 2016, the Company had an allowance for doubtful accounts relating to other receivables of \$9,000 (2015 - \$nil).

The carrying amount of financial assets represents the maximum credit exposure.

Foreign Exchange Rate Risk

Foreign exchange rate risk is the risk that exists when a financial transaction is denominated in a currency other than the functional currency of the Company, being the US dollar.

The Company operates in the United States and its cash is held in US dollars and Canadian dollars. At December 31, 2016, the Company had CAD\$10,938 of cash and CAD\$80,790 of accounts payable and accrued liabilities. Accordingly, management of the Company believes there is no significant exposure to foreign currency fluctuations. As management does not believe there is significant exposure to foreign exchange fluctuations, no sensitivity analysis has been presented here.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

In respect to the Company's currently outstanding debt, other than amounts drawn on the LOC, all bear interest at a fixed interest rate. Accordingly, the Company is exposed to cash flow interest rate risk on the LOC and fair value interest rate risk on the other debt. The bank LOC arrangement carries a variable rate of interest, therefore its fair value is not materially affected by changes in market interest rates. However, the associated cash flows representing interest payments on the bank LOC arrangement may change if the LOC arrangement is renewed at maturity. The fair value of the other debt is equal to its carrying value due to its due on demand nature.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company currently settles its financial obligations out of cash. The ability to achieve this relies on the Company raising debt or equity financing in a timely manner, achieving profitable operations and endeavoring to maintain sufficient cash in excess of anticipated needs. The Company's accounts payable are due on normal commercial terms. On April 20, 2017, the Company entered into an Invoice Purchase Agreement (Note 18) which will provide the Company with working capital as well as credit and collections support for the related accounts receivable. Refer to the going concern note for additional disclosure. The Company had working capital (deficiency) as follows:

VirtualArmour International Inc.
(Formerly VirtualArmor International Inc.)
Notes to the Consolidated Financial Statements
For the years ended December 31, 2016 and 2015
(Expressed in U.S. Dollars unless otherwise stated)

	December 31, 2016 \$	December 31, 2015 \$
Current assets	2,213,217	2,282,760
Current liabilities	(2,941,609)	(3,485,527)
Working capital (deficiency)	(728,392)	(1,202,767)

18. Subsequent Events

The following transactions occurred subsequent to December 31, 2016:

Stock Option Grant

On March 23, 2017, the Company granted stock options to directors, officers, employees and consultants of the Company which allow for the purchase of 1,585,000 common shares of the Company at a price of CAD\$0.30 per share for a period of five years. The options vest as to 30% twelve months after the date of grant and 8.75% every three months thereafter.

Invoice Purchase Agreement

On April 20, 2017, the Company entered into an Invoice Purchase Agreement which will provide the Company with working capital as well as credit and collections support for the related accounts receivables.