Kraken Sonar Inc.

(formerly Anergy Capital Inc.)

Consolidated Financial Statements

For the years ended December 31, 2016 and 2015
(Expressed in Canadian Dollars)

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Kraken Sonar Inc.

We have audited the accompanying consolidated financial statements of Kraken Sonar Inc., which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, the consolidated statements of net loss and comprehensive loss, changes in shareholders' equity (deficiency) and cash flows for the years then ended, and notes, comprising 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.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our 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, we consider 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 Kraken Sonar Inc. as at December 31, 2016 and December 31, 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards**.**

Emphasis of matter

Without modifying our opinion, we draw attention to Note 2 to the consolidated financial statements which indicates that Kraken Sonar Inc., has experienced significant losses and negative cash flows from operations in 2016 and 2015 and has a deficit. These conditions, along with other matters as set forth in note 2 in the consolidated financial statements, indicate the existence of a material uncertainty that cast significant doubt about Kraken Sonar Inc.'s ability to continue as a going concern.

KPMG LLP

Chartered Professional Accountants
May 2, 2017
St. John's, Canada

KRAKEN

December 31, 2016

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Consolidated Statements of Financial Position
December 31, 2016 and 2015
(Expressed in Canadian Dollars)

	December 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents (note 6)	**$ 85,650**	$ 771,940
Trade and other receivables (note 7)	**550,696**	376,571
Loans receivable from a director (note 13)	**-**	194,317
Inventory (note 8)	**1,116,429**	507,042
Prepayments	**19,123**	7,863
	1,771,898	1,857,733
Investment (note 9)	**157,320**	-
Property and equipment, net (note 11)	**259,360**	184,943
TOTAL ASSETS	**$ 2,188,578**	$ 2,042,676
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current Liabilities:		
Bank indebtedness (note 12)	**$ 150,000**	$ -
Trade and other payables	**1,266,353**	872,509
Deferred revenue	**-**	201,864
	1,416,352	1,074,373
Shareholders' equity (deficiency):		
Share capital (note 14)	**4,086,270**	3,073,426
Contributed surplus	**1,647,963**	1,437,710
Deficit	**(4,962,008)**	(3,541,833)
	772,225	(968,303)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)	**$ 2,188,578**	$ 2,042,676

Going concern (note 2)
Commitments (note 20)
Subsequent events (note 22)

On Behalf of the Board:

"Karl Kenny" Director ***"Shaun McEwan"*** Director

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Consolidated Statements of Net Loss and Comprehensive Loss
For the Years Ended December 31, 2016 and 2015
(Expressed in Canadian Dollars)

	2016	2015
Product sales	**$ 2,245,318**	$ 1,883,426
Contract research	**22,500**	9,873
	2,267,818	1,893,299
Cost of sales (note 16)	**976,408**	960,542
	1,291,410	932,757
Administrative expenses	**1,262,464**	1,274,686
Share-based payments (note 14(d))	**143,500**	131,000
Employee costs	**1,294,322**	785,001
RTO Listing expense (note 5)	**-**	526,695
	2,700,286	2,717,382
Loss from operating activities	**(1,408,876)**	(1,784,625)
Foreign exchange loss (gain)	**5,599**	(77,062)
Loss on settlement of liability (note 14(f))	**5,700**	-
Transaction costs	**-**	225,000
Finance costs	**-**	59,847
Net loss, being comprehensive loss	**$ (1,420,175)**	**$ (1,992,410)**
Basic and diluted loss income per share	**$ (0.02)**	$ (0.03)
Basic and diluted weighted average number of shares outstanding	**73,948,690**	68,419,330

The accompanying notes form part of the consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Deficiency)
For the Years Ended December 31, 2016 and 2015
(Expressed in Canadian Dollars)

2016

	Number of Shares	Share capital (note 10)	Contributed Surplus	Equity portion of convertible debt	Deficit	Total
Balance at January 1, 2016	**71,068,214**	**$ 3,072,426**	**$ 1,437,710**	**$ -**	**$ (3,541,833)**	**$ 968,303**
Net loss	-	-	-	-	**(1,420,175)**	**(1,420,175)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on private placement (note14(a))	**7,159,534**	**944,630**	**129,300**	-	**-**	**1,073,930**
Issue of common shares on warrant exercises	**58,333**	**13,869**	**(5,119)**	-	**-**	**8,750**
Issue of common shares on debt settlement (note 14(f))	**233,333**	**35,000**	**5,700**	-	**-**	**40,700**
Expiry of share purchase warrants, net of income taxes (note 18)	-	**63,128**	**(63,128)**	**-**	**-**	**-**
Share issue costs (note 14(a))	-	**(42,783)**	**-**	-	**-**	**(42,783)**
Share-based compensation	-	**-**	**143,500**	-	**-**	**143,500**
Shareholders' equity (deficiency) as at December 31, 2016	**78,519,414**	**$ 4,086,270**	**$ 1,647,963**	**$ -**	**$ (4,962,008)**	**$ 772,225**

2015

	Number of Shares	Share capital (note 10)	Contributed Surplus	Equity portion of convertible debt	Deficit	Total
Balance at January 1, 2015	**51,500,000**	**$ 1,226,650**	**$ -**	**$ 215,317**	**$ (1,549,423)**	**$ (107,456)**
Net loss	-	**-**	-	-	**(1,992,410)**	**(1,992,410)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares to former Anergy shareholders (note 5)	**3,893,777**	**584,067**	**-**	-	**-**	**584,067**
Issue of options to former Anergy shareholders (note 5)	**-**	**-**	**4,460**	-	**-**	**4,460**
Issue of common shares and share purchase warrants on conversion of bridge loan (notes 12 & 13)	**14,063,326**	**1,008,293**	**1,312,000**	**(215,317)**	**-**	**2,104,976**
Issue of common shares as Finder's fee (note 5)	**1,500,000**	**225,000**	**-**	-	**-**	**225,000**
Issue of common shares on warrant exercises	**111,111**	**26,416**	**(9,750)**	-	**-**	**16,666**
Reduction of share subscriptions receivable	-	**2,000**	**-**	-	**-**	**2,000**
Share-based compensation	-	**-**	**131,000**	-	**-**	**131,000**
Shareholders' equity (deficiency) as at December 31, 2015	**71,068,214**	**$ 3,072,426**	**$ 1,437,710**	**$ -**	**$ (3,541,833)**	**$ 968,303**

KRAKEN

Consolidated Statements of Cash Flows
(Expressed in Canadian Dollars)

	2016	2015
Cash flows used in operating activities		
Net loss	**$ (1,420,175)**	$ (1,992,410)
Adjustments for items not involving cash:		
Depreciation	**57,534**	38,267
Share-based payments	**143,500**	131,000
Loss on settlement of liability (note 14(f))	**5,700**	-
Finance costs – convertible debt	**-**	59,847
RTO consideration included in listing expenses (note 5)	**-**	526,695
Transaction costs – finder's fee (note 5)	**-**	225,000
Changes in non-cash working capital (note 19)	**(417,792)**	796,821
Net cash flows used in operating activities	**(1,631,233)**	(214,780)
Cash flows from (used in) investing activities		
Investment (note 9)	**(157,410)**	-
Purchase of property, plant and equipment	**(131,951)**	(93,864)
Cash acquired on RTO (note 5)	**-**	61,832
	(289,361)	(32,032)
Cash flows from (used in) financing activities		
Proceeds from private placement	**1,073,930**	-
Proceeds from exercise of warrants	**8,750**	16,666
Decrease in employee stock option receivable	**-**	2,000
Share issue costs	**(42,783)**	-
Increase (decrease) in loans to (from) a director	**194,317**	(343,081)
	1,234,214	(324,415)
Net increase (decrease) in cash	**(686,380)**	(571,227)
Effect of foreign exchange on cash	**90**	-
Cash at beginning of year	**771,940**	1,343,167
Cash at end of year	**$ 85,650**	$ 771,940

1. Corporate Information:

Kraken Sonar Inc. (“Kraken” or the “Company”) (formerly Anergy Capital Inc.) was incorporated on May 14, 2008 under the *Business Corporations Act, British Columbia*), is a publicly traded company, and its registered office is located at Suite 700, 595 Burrard Street, PO Box 49290, Vancouver, BC V7X 1S8.

The Company was incorporated as Anergy Capital Inc. (“Anergy”) under the Business Corporations Act, British Columbia and was classified as a Capital Pool Company (“CPC”) as defined under Policy 2.4 of the TSX Venture Exchange. The principal business of the Company at that time was the identification of an asset or business acquisition that would meet the requirements as a Qualifying Transaction (“QT”) as defined in Policy 2.4.

On February 18, 2015 the Company closed its Qualifying Transaction pursuant to an agreement between Anergy and Kraken Sonar Systems Inc., and Anergy changed its name to Kraken Sonar Inc. (together, “the Company”).

The Company’s principal business is the design, manufacture and sale of software-centric sensors and underwater robotic systems.

2. Going concern:

These consolidated financial statements have been prepared on a going concern basis, which assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the Company’s ability to continue as a going concern, as the Company experienced significant losses and negative cash flows from operations since inception and at December 31, 2016 has a deficit of $4,962,008 (December 31, 2015 - $3,541,833).

The ability of the Company to continue as a going concern and to realize its assets and discharge its liabilities when due is dependent on its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and/or upon securing additional financing. The timing and availability of additional financing will be determined largely by the performance of the Company and market conditions and there is no certainty that the Company will be able to raise funds as they are required in the future.

These consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate, then adjustments would be necessary in the carrying amount of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

3. Basis of presentation:

(a) Statement of compliance:

These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and Interpretations by the International Financial Reporting Interpretations Committee (“IFRIC”).

These consolidated financial statements were approved by the Board of Directors on May 2, 2017.

(b) Basis of measurement:

These consolidated financial statements have been prepared on a historical cost basis.

The consolidated financial statements are presented in Canadian dollars, which is the Company’s functional and presentation currency.

3. Basis of presentation (continued):

(c) Accounting estimates and judgments:

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and may have an impact on future periods. The more significant areas requiring the use of management estimates and judgments are discussed below:

i) Estimates of useful lives of property and equipment

Useful lives and residual value of property and equipment are reviewed by management on a regular basis to ensure assumptions are still valid. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. If an asset's recoverable amount is less than the asset's carrying amount, an impairment loss is recognized.

Any changes in estimates would impact the economic useful lives and the residual values of the assets and, therefore, future depreciation charges could be revised.

ii) Recovery of deferred tax assets

Deferred tax assets, including those arising from tax loss carry-forwards, capital losses and temporary differences are recognized only where it is considered probable that they will be recovered, which is dependent on the generation of sufficient future taxable profits. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows.

Judgments are also required about the application of income tax legislation. These judgments and assumptions are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognized on the statement of financial position and the amount of other tax losses and temporary differences not yet recognized. In such circumstances, some or all of the carrying amounts of recognized deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the statement of net income (loss) and comprehensive income (loss).

iii) Share-based payments

The amounts recorded for share-based compensation are based on estimates. The Black Scholes model is used to estimate the fair value of stock options at the date of grant based on estimates of assumptions for share price, expected volatility, expected number of options to vest, dividend yield, risk-free interest rate, expected forfeitures and expected life of the options. Changes in these assumptions may result in a material change to the amounts recorded for the issuance of stock options.

iv) Revenue

Revenues from certain fixed price sales contracts are recognized using the percentage of completion method. These revenues are recognized proportionally with the degree of completion of work. The Company uses the efforts-expended method to calculate the degree of completion of work based on the labour and material costs incurred as at the balance date compared to the estimated total labour and material costs. Work in progress is valued by taking into consideration the labour and material costs incurred but not yet invoiced and received receipts.

4. Significant accounting policies:

(a) Consolidation:

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Kraken Sonar Systems Inc. and Kraken Robotics GmBH, which was inactive in 2016.

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

The financial statements of the subsidiary are prepared for the same reporting period as the parent company. When necessary, adjustments are made to the financial statements of subsidiary to bring their accounting policies in line with those used by the parent company.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred out of the Company. A change in the ownership interest of a subsidiary that does not result in a loss of control is accounted for as an equity transaction.

(ii) Transactions eliminated on consolidation

Inter-company balances and transactions, and any unrealised income and expenses arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

(b) Revenue recognition:

(i) Sale of goods:

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership have transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be estimated reliably.

(ii) Contract research:

The Company recognizes revenue from rendering of services in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed based on surveys of work performed.

(c) Government grants:

Government grants are initially recognized as deferred income at fair value if there is reasonable assurance that they will be received and the Company will comply with the conditions associated with the grant; they are netted against the cost of the associated assets.

Grants that compensate the Company for expenses incurred are recognized in profit or loss, by way of a reduction of the corresponding expenses, on a systematic basis in the periods in which the expenses are recognized.

(d) Foreign currency transactions:

Transactions in foreign currencies other than the Company's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are generally recognized in profit or loss in the period in which they arise.

4. Significant accounting policies (continued):

(e) Income tax:

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

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

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

(f) Inventories:

Inventories are recorded at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

(g) Property and equipment:

All items of property and equipment are measured at historical cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation is calculated using estimation to allocate their cost, net of estimated residual values, over their estimated useful lives using the following methods and at the following annual rates:

Asset	Basis	Rate
Computer equipment	Declining balance	50%
Leasehold improvements	Straight-line	20%
Computer software	Straight-line	20%
Furniture and fixtures	Declining balance	20%
Tools and equipment	Straight-line	10%

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

4. Significant accounting policies (continued):

(h) Research and development:

Research costs are expensed as incurred. Development costs are capitalized only if the expenditure can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Otherwise, such costs are expensed as incurred. Subsequent to initial recognition, development costs are measured at cost less accumulated amortization and any accumulated impairment losses. To date, no development costs have been capitalized.

(i) Financial instruments:

(i) Financial assets

The Company initially recognizes loans and receivables on the date that they originate. All other financial assets are recognized initially on trade date at which the Company becomes party to the contractual provision of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or the rights to receive the contractual cash flows on the financial asset are transferred.

The Company has the following non-derivative financial assets: loans and receivables and investments.

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 method, less any impairment losses.

Loans and receivables comprise cash and trade and other receivables.

Cash comprises cash on hand and balances on deposit with Tier 1 Canadian chartered banks.

Investments

The investments in equity instruments that do not have a quoted price in an active market and for which fair value cannot be reliably measured, are initially recorded at fair value at the date of acquisition and are subsequently recorded at cost.

Fair Value:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value.

Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts, volatility measurements used to value option contracts and observable credit default swap spreads to adjust for credit risk where appropriate), or inputs that are derived principally from or corroborated by observable market data or other means.

Level 3: Inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

4. Significant accounting policies (continued):

(i) Financial instruments: (continued)

(ii) Financial liabilities

The Company initially recognizes other financial liabilities on the trade date at which the Company becomes party to the contractual provisions of the instrument. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

The Company derecognizes financial liabilities when its contractual obligations are discharged or cancelled or expire.

The Company has the following non-derivative other financial liabilities: trade and other payables, and bank indebtedness.

(iii) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects. From time to time the Company issues warrants in conjunction with share capital. Proceeds are allocated between share capital and warrants based on the relative fair value of each instrument. The fair value of the warrants is estimated using an appropriate option pricing model, as outlined in note 14.

(j) Impairment:

(i) Financial assets (including receivables)

Financial assets, other than those recorded at fair value through profit or loss, are assessed for objective evidence of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been affected.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against accounts receivable. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-Financial assets

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indications exist, the asset's recoverable amount is estimated.

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 are grouped together into the smallest group of assets which generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or groups of assets (the "cash-generating-unit" or "CGU").

4. Significant accounting policies (continued):

(k) Earnings (loss) per share:

The Company presents basic and diluted earnings (loss) per share for its common shares. Basic earnings (loss) per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of shares outstanding adjusted for the effects of all dilutive potential common shares.

(l) Application of new or revised IFRS and interpretations:

The following standards and amendments to existing standards have been adopted by the Company effective January 1, 2016:

Transfer of assets between an investor and its associate or joint venture:

The Amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The adoption of these amendments did not have any impact on the consolidated financial statements.

Annual Improvements to IFRS (2012-2014) cycle:

In September 2014, the IASB issued narrow-scope amendments to a total of four standards as part of its annual improvements process. The adoption of the amendments did not have a material impact on the consolidated financial statements.

Disclosure Initiative (Amendments to IAS 1):

In December 2014, the IASB issued amendments to IAS 1 Presentation of Financial Statements as part of its major initiative to improve presentation and disclosure in financial reports. These amendments will not require any significant change to current practice, but should facilitate improved financial statement disclosure. The adoption of these amendments did not have any impact on the consolidated financial statements.

Business combination accounting for interest in a joint operation (Amendments to IFRS 11):

The amendments require business combination accounting to be applied to acquisitions of interest in a joint operation that constitute a business. The adoption of the amendments to IFRS 11 did not have a significant impact on the Company's consolidated financial statements.

(m) Future changes in accounting policies:

A number of new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these consolidated financial statements.

IFRS 15, Revenue from Contracts with Customers:

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimated and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

4. Significant accounting policies (continued):

(m) Future changes in accounting policies (continued):

IFRS 9, Financial Instruments:

IFRS 9, Financial Instruments, will replace IAS 39, Financial Instruments: Recognition and Measurement, and some of the requirements of IFRS 7, Financial Instruments: Disclosures. The Objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. The IASB has determined the revised effective date for IFRS 9 will be for annual periods beginning on or after January 1, 2018. The Company will evaluate the impact of the change to the consolidated financial statements based on the characteristics of financial instruments outstanding at the time of adoption.

IFRS 16, Leases:

In January 2016, the IASB issued IFRS 16 *Leases*. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The new standard is effective for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of this standard on the consolidated financial statements.

Amendments to IAS 7, Statement of Cash Flows:

In January 2016, the IAS issued amendments to IAS 7, Statement of Cash Flows. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. One way to meet this new disclosure requirement is to provide a reconciliation between the opening and closing balances for liabilities from financing activities. These amendments apply prospectively for annual periods beginning on or after January 1, 2017. The Company intends to adopt the amendments to IAS 7 in its financial statements for the annual period beginning on January 1, 2017. The extent of the impact of adoption of the amendments has not yet been determined.

Amendments to IAS 12, Income Taxes:

In January 2016, the IASB issued amendments to IAS 12, Income Taxes. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences. The amendments apply retrospectively for annual periods beginning on or after January 1, 2017. The Company intends to adopt the amendments to IAS 12 in its financial statements for the annual period beginning on January 1, 2017. The extent of the impact of adoption of the amendments has not yet been determined.

4. Significant accounting policies (continued):

(m) Future changes in accounting policies (continued):

Amendments to IFRS 2, Share-based Payments:

In June 2016, the IASB issued amendment to IFRS 2, Shares-based Payments, clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; b) share-based payment transactions with a net settlement feature for withholding tax obligations; and c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. The Company intends to adopt the amendments to IFRS 2 in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

5. Reverse Acquisition

On February 18, 2015, Kraken Sonar Systems Inc. and Anergy Capital Inc., a company classified as a Capital Pool Company as defined under Policy 2.4 of the TSX Venture Exchange, completed a reverse take-over transaction (“RTO”) through the closing of a Share Exchange Agreement (“SEA”) dated November 20, 2014, as amended January 29, 2015. The SEA constitutes Anergy Capital Inc.’s Qualifying Transaction.

Under the terms of the SEA, Anergy issued 51,500,000 post-consolidated (2.25:1) common shares in exchange for the same number of common shares of Kraken Sonar Systems Inc. In addition, at the time of the RTO the lenders of a $2,109,500 bridge loan to Kraken Sonar Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company and share purchase warrants convertible into the same number of shares. Anergy was subsequently renamed Kraken Sonar Inc. A finder’s fee of 1,500,000 common shares of the Company issued at a deemed price of $0.15 per share was paid in connection with the RTO for a total value of $225,000 which was expensed in the three months ended March 31, 2015. In the prior fiscal year, Kraken Sonar Systems Inc. expensed $304,967 in costs directly related to the transaction. Following completion of the transaction, the Company had an aggregate 70,957,103 common shares issued and outstanding.

For accounting purposes the transaction constitutes a reverse acquisition, as the shareholders of Kraken Sonar Systems Inc. acquired control of the consolidated entity. Kraken Sonar Systems Inc. is considered the acquiring and continuing entity, and Anergy was the acquired entity. The consolidated financial statements are in the name of Kraken Sonar Inc. (formerly Anergy); however, these are a continuation of the financial statements of Kraken Sonar Systems Inc. The results of operations of Anergy are included in the consolidated financial statements of Kraken from the date of the reverse acquisition on February 18, 2015.

The following summarizes the reverse acquisition of Anergy by Kraken Sonar Systems Inc. and the net assets acquired and liabilities assumed at February 18, 2015.

Fair value of consideration paid to former Anergy holders of:	
Common shares (3,893,777 common shares @ $0.15 per common share)	$ 584,067
Options (note 12(b))	4,460
Total consideration	$ 588,527
Identifiable assets acquired:	
Cash	61,832
RTO Listing expense	$ 526,695

5. Reverse Acquisition (continued)

The transaction allowed Kraken Sonar Systems Inc., a private company, to obtain a listing on the TSX Venture Exchange without having to complete an initial public offering. As the acquisition was not considered a business combination, a total of $526,695, being the excess of the fair value of the consideration paid to obtain the listing over the fair value of the net assets acquired, was recorded as a RTO listing expense in the condensed consolidated interim statement of loss and comprehensive loss.

6. Cash and cash equivalents

Cash and cash equivalents consists of the following:

	2016	2015
Cash	$ 85,650	$ 653,212
Demand deposit	-	118,728
	$ 85,650	$ 771,940

As at December 31, 2015, the Company's demand deposit consisted of an advance payment guarantee from the Royal Bank of Canada. The demand deposit was security against a letter of credit and had an expiry date of January 31, 2016.

7. Trade and other receivables:

Trade and other receivables consist of the following:

	2016	2015
Trade receivables	$ 248,386	$ 387,825
Unbilled accounts receivable	153,729	132,520
Allowance for doubtful accounts	-	(175,863)
Government assistance receivable and other	148,581	32,089
	$ 550,696	$ 376,571

8. Inventory

As at December 31, 2016, the Company held $1,116,429 (2015 - $507,042) in inventory, consisting of $1,116,429 (2015 - $507,042) in raw materials and $Nil (2015 - $Nil) in work-in-progress.

9. Investment

As at December 31, 2016, the Company had entered into an agreement with Square Robot, Inc., a private US-based company, in respect of the co-design of small robots for large above ground storage tanks. Pursuant to the agreement, as at December 31, 2016, the Company had invested US$120,000in the company.

	USD	CAD
Investment	$ 120,000	$ 157,320

Subsequent to December 31, 2016, the Company sold this non-core asset (see note 22(c)).

10. Financial instruments:

Credit Risk:

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	2016	2015
Cash and cash equivalents	$ 85,650	$ 771,940
Trade and other receivables	550,696	376,571
Share subscription receivable	76,833	76,833
Loans receivable from a director	-	194,317
	$ 713,179	$ 1,419,661

The Company manages credit risk by holding the majority of its cash with high quality financial institutions in Canada, where management believes the risk of loss to be low.

Revenues from the top 3 customers represented 85% of the Company's revenue in the year ended December 31, 2016 (2015 – top 3 customers represented 68% of revenue). At December 31, 2016, 66% of the trade receivables balance was owing from 1 customer (2015 – 66% of the trade receivables was owing from 1 customer). At December 31, 2016, an amount of $Nil (2015 - $175,863) was recorded as an allowance for doubtful accounts.

The share subscription receivables relate to the exercise price for options issued to employees and subsequently exercised, and are recorded as a reduction of share capital.

Liquidity Risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. As of December 31, 2016, the Company had a cash and cash equivalents balance of $85,650 (December 31, 2015 - $771,940) to settle current liabilities of $1,416,353 (December 31, 2015 - $1,074,373). Refer to notes 2 and 22 (b) for discussion of going concern risk and private placement financing subsequent to December 31, 2016.

Market Risk:

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

(a) Interest rate risk

At December 31, 2016, the Company has cash balances of $85,650 and has drawn $150,000 against its line of credit. Convertible debt was converted into common shares during fiscal 2015. The Company is not exposed to any significant interest rate risk.

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to US$ sales and certain purchases of inventory. The Company does not use any form of hedging against fluctuations in foreign exchange.

10. Financial instruments (continued):

Market Risk (continued):

The Company's exposure to foreign currency risk was as follows:

	2016	2015
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	$ 87,295	$ 14,681
Trade and other payables GBP	65,196	-
Trade and other payables EUR	1,247	-
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	378,856	-

For the year ended December 31, 2016, with other variables remaining constant, a 10% increase (decrease) in the US dollar to Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $74,000 (2015 - $2,000).

Fair Value:

During the year ended December 31, 2016, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities. The fair values of the Company's financial instruments are considered to approximate the carrying amounts. The following table provides the disclosures of the fair value and the level in the hierarchy:

December 31, 2016	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash and cash equivalents	$ 85,650	$ -	$ -
Trade and other receivables	-	550,696	-
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	150,000	-
Trade and other payables	-	1,266,353	-

December 31, 2015	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash	$ 771,940	$ -	$ -
Trade and other receivables	-	376,571	-
Share subscription receivables	-	76,833	-
Loans to director	-	194,317	-
Financial liabilities at amortized cost:			
Trade and other payables	-	872,509	-

11. Property and equipment:

(a) As at December 31, 2016 and 2015, there were no assets pledged as security.

(b) Reconciliation of property and equipment:

	Furniture and fixtures	Computer equipment	Computer software	Leasehold improvements	Total
Cost					
Balance, January 1, 2015	$ 30,648	$ 5,010	$ 28,985	$ 84,116	$ 148,759
Additions	30,448	18,494	35,042	9,880	93,864
Balance, December 31, 2015	61,096	23,504	64,027	93,996	242,623
Additions	31,085	32,855	57,119	10,892	131,951
Balance, December 31, 2016	**$ 92,181**	**$ 56,359**	**$ 121,146**	**$ 104,888**	**$ 374,574**
Accumulated Depreciation					
Balance, January 1, 2015	$ 3,736	$ 2,081	$ 9,291	$ 4,305	$ 19,413
Depreciation	7,047	6,449	8,585	16,186	38,267
Balance, December 31, 2015	10,783	8,530	17,876	20,491	57,680
Depreciation	8,964	11,958	20,084	16,528	57,534
Balance, December 31, 2016	**$ 19,747**	**$ 20,488**	**$ 37,960**	**$ 37,019**	**$ 115,214**
Carrying Amount					
As at December 31, 2015	$ 50,313	$ 14,974	$ 46,151	$ 73,505	$ 184,943
As at December 31, 2016	**$ 72,434**	**$ 35,871**	**$ 83,186**	**$ 67,869**	**$ 259,360**

12. Bank indebtedness:

At December 31, 2016, the Company had a $150,000 line of credit for general operating purposes (the “operating line”). The operating line bears interest at the bank’s prime rate plus 2%, payable monthly. As at December 31, 2016, a total of $150,000 (2015 - $Nil) was drawn against this facility.

13. Related party transactions:

(a) Loans receivable from a director are unsecured and bear interest at 5% per annum. The terms of the arrangement are as agreed to between the parties. The loans were repaid on April 22, 2016.

(b) For the year ended December 31, 2016, the Company expensed $9,500 in costs for a condominium unit that it rents from an individual related to a member of its management team (2015 - $Nil).

(c) Compensation of key management personnel:

	2016	2015
Share-based payments	$ 98,900	$ 102,359
Short-term employee benefits	11,644	133,726
Salaries and wages	403,750	250,001

Included in share subscription receivables at December 31, 2015 is $60,608 (December 31, 2015 - $60,608) owing from key management personnel.

14. Share capital:

Authorized: Unlimited number of common shares

On October 3, 2014, the Company completed a consolidation of its issued and outstanding common shares on 6.19:1 basis, reducing the issued and outstanding common shares to 40,416,667 from 250,000,000.

See the consolidated statements of changes in shareholders' equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the years ended December 31, 2016 and 2015.

(a) Private placement

On August 15, 2016, the Company closed a non-brokered private placement offering comprised of 7,159,534 units (the "Units") at a purchase price of $0.15 per Unit for aggregate proceeds of $1,073,930. Each Unit consisted of one common share and one-half of one common share purchase warrant (each whole common share purchase warrant, a "Warrant"), with each Warrant exercisable to acquire one common share of Kraken at $0.30 for a period of 24 months from the date of issuance. The Company paid share issue costs of $42,783, comprised of cash finder's fees of $18,375 and $24,408 legal and other costs, in connection with the offering.

(b) Share purchase warrants

On February 18, 2015, as part of the RTO (notes 1 & 5) the lenders of a $2,109,500 bridge loan to Kraken Sonar Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company. On conversion of the bridge loan, the lenders also received share purchase warrants convertible into the same number of shares exercisable at a price of $0.15 per warrant for a period of thirty-six (36) months from the date of issuance.

Two grants of warrants were issued pursuant to a private placement completed by Anergy in October 2014, prior to completion of the RTO:

i) Each full Warrant A warrant entitled the holder thereof to acquire one common share of the Company at a price of $0.15 after adjusting for the consolidation (or $0.0666666 prior to consolidation). During the year ended December 31, 2016, 58,333 (2015 – 111,111) warrants were exercised for proceeds of $8,750 (2015 - $16,666). The weighted average share price on the dates on which the warrants were exercised during the year was $0.20 (2015 - $0.17). On October 14, 2016, the remaining 275,000 warrants expired unexercised.

ii) Each full Warrant B warrant entitled the holder to acquire one common share at a price of $0.40 after adjusting for the consolidation (or $0.17777777 prior to consolidation). A total of 444,444 warrants expired unexercised on October 14, 2016.

A total of 3,579,767 share purchase warrants were issued in August 2016 upon closing the non-brokered private placement offering (see note 14(a) above).

A further 116,666 share purchase warrants were issued in August 2016 in respect of a debt settlement arrangement (see note 14(f) below).

14. Share capital:

Share purchase warrant transactions are summarized for the years ending December 31, 2016 and 2015:

	Year ended December 31, 2016		Year ended December 31, 2015	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening balance, January 1	14,841,103	$ 0.16	-	$ -
Anergy private placement 'A' warrants	-	-	444,444	0.15
Anergy private placement 'B' warrants	-	-	444,444	0.40
Issued on conversion of bridge loan	-	-	14,063,326	0.15
Issued for private placement	3,579,767	0.30	-	-
Issued for debt settlement	116,666	0.30	-	-
Warrants exercised	(58,333)	0.15	(111,111)	0.15
Warrants expired	(719,444)	0.30	-	-
Ending balance, December 31	17,759,759	$ 0.18	14,841,103	$ 0.16
Warrants exercisable	17,759,759	$ 0.18	14,841,103	$ 0.16

At December 31, 2016 and 2015, the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	December 31, 2016	December 31, 2015	Weighted Average Remaining Contractual Life
October 14, 2016	$0.15	-	333,333	-
October 14, 2016	$0.40	-	444,444	-
February 18, 2018	$0.15	14,063,326	14,063,326	1.13 years
August 12, 2018	$0.30	3,579,767	-	1.61 years
August 22, 2018	$0.30	116,666	-	1.64 years
	$0.16	**17,759,759**	**14,841,103**	**1.46 years**

(c) Share options

The Company has a share option plan, under which the Board of Directors is authorized to grant options to employees, directors, officers and consultants, enabling them to acquire up to 10% of the issued and outstanding share capital of the Company. The exercise price of each option is based on the market price of the Company's share as calculated on the date of grant. The options can be granted for a maximum term of five years. Options granted to investor relations consultants are subject to vesting provisions, as established by regulatory authorities, over a twelve month period, with no more than ¼ vesting during any three month period. Vesting provisions for other options are determined by the Company's Board of Directors.

Prior to the RTO, Anergy had outstanding a total of 470,000 share options with an exercise price of $0.10 per share. Post-completion of the RTO, the options were consolidated on a 2.25:1 basis, resulting in 208,888 share options exercisable at $0.225 per share which expired unexercised on August 26, 2015.

14. Share capital (continued):

(c) Share options (continued):

The following options were outstanding as at December 31, 2016 and 2015:

	December 31, 2016		December 31, 2015	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance, January 1, 2015	4,260,000	$ 0.23	-	$ -
Granted	900,000	0.15	4,918,888	0.22
Expired	(200,000)	0.15	(658,888)	0.24
Ending balance	4,960,000	$ 0.21	4,260,000	$ 0.23
Options exercisable	2,226,666	$ 0.22	1,018,333	$ 0.23

All share options had exercise prices that were higher or equal to market prices at the date of grant.

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
$ 0.25	March 17, 2018	1,710,000	1,076,666	1.21 years
0.20	May 13, 2018	250,000	250,000	1.36 years
0.21	June 1, 2020	2,000,000	500,000	3.42 years
0.21	July 1, 2018	100,000	100,000	1.50 years
0.15	October 12, 2019	600,000	200,000	2.78 years
0.15	December 1, 2019	300,000	100,000	2.92 years
$ 0.21		**4,960,000**	**2,226,666**	**2.20 years**

(d) Share-based compensation

During the year ended December 31, 2016, the Company recorded share-based compensation totaling $143,500 (2015 - $131,000), which was expensed in operations with a corresponding increase in contributed surplus.

The fair value of share options was estimated on the measurement date using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options.

The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	Year ended December 31, 2016	Year ended December 31, 2015
Risk-free interest rate	0.61 to 0.76%	0.49 to 0.90%
Expected life of options	3 years	3 years
Expected volatility	222.68 to 228.68%	98.96 to 106.93%
Weighted average fair value per option	$0.11 to $0.13	$0.10 to $0.13
Dividend yield	Nil	Nil

(e) Escrowed shares

At December 31, 2015, there are a total of 22,941,323 (2015 – 38,262,205) common shares subject to escrow restrictions. The escrow shares will be released in tranches every six months until February 18, 2018.

14. Share capital (continued):

(f) Debt settlement

On August 22, 2016 the Company settled debt of $35,000 by issuing 233,333 common shares and 116,666 share purchase warrants exercisable to acquire one common share of Kraken at $0.30 for a period of 24 months from the date of issuance. The share purchase warrants were valued at $5,700 and credited to contributed surplus. Fair value was determined using the Black-Scholes valuation model, based on a risk free interest rate of 0.57%, an expected life of two years, an expected volatility of 78.98% and a dividend yield rate of nil.

15. Capital management:

The Company's objectives when managing its capital are to maintain a financial position suitable for supporting its operations and growth strategies, to provide an adequate return to shareholders and to meet its current obligations.

The Company's capital structure consists of shareholders' equity (deficiency), advances from directors and convertible debt. The Company makes adjustments to the capital structure depending on economic conditions, its financial position and performance. In order to maintain or adjust the capital structure, the Company may issue new shares, buyback shares or pay dividends, issue new debt and sell assets to reduce debt.

16. Cost of sales:

Included in cost of sales is inventory of $510,687 (2015 - $507,000).

17. Government assistance:

During the year ended December 31, 2016, the Company received government assistance in the amount of $894,568 (2015 - $698,370) which has been recorded as a reduction of administrative expenses.

18. Income taxes:

The Company's provision for income taxes differs from the amount computed by applying the combined Canadian federal and provincial income tax rates to income (loss) before income taxes as a result of the following:

	For the year ended December 31,	
	2016	2015
Net loss	**$ (1,420,175)**	$ (1,992,410)
Statutory tax rates	**26.0%**	26.5%
Income taxes (recovery) computed at the statutory rates	**$ (369,000)**	$ (528,000)
Change in statutory rates and other	**117,000**	(323,000)
Permanent differences	**46,000**	289,000
Change in unrecognized deductible temporary differences	**206,000**	562,000
Provision for income taxes	**$ -**	$ -

The enacted tax rate of 26.0% (2015 – 26.5%) is applied in the tax provision calculation.

18. Income taxes (continued):

The tax effect of the following temporary differences and non-capital losses have not been recognized in the consolidated financial statements.

	2016	2015
Non-capital losses carried forward	**$ 761,000**	$ 666,000
Capital losses carried forward	**1,000**	-
Property, plant and equipment	**(14,000)**	6,000
Intangible assets	**93,000**	215,000
	$ 841,000	$ 887,000

The Company has approximately $2,583,000 of Canadian non-capital losses which may be applied to reduce taxable income in future years, and which if not utilized, will expire through to 2035. Future tax benefits which may arise as a result of future income tax assets have not been recognized in these consolidated financial statements as management believes that it is not probable that sufficient taxable income will be available to realize such assets.

19. Change in non-cash working capital:

	2016	2015
Decrease (increase) in trade and other receivables	**$ (174,125)**	$ 475,386
Decrease (increase) in investment tax credit receivables	**-**	244,462
Increase in inventory	**(609,387)**	(177,671)
Decrease (increase) in prepayments	**(11,260)**	37,137
Increase (decrease) in trade and other payables	**428,844**	128,143
Increase (decrease) in deferred revenue	**(201,864)**	89,364
Increase in line of credit payable	**150,000**	-
	$ (417,792)	$ 796,821

20. Commitments:

The following is a summary of the minimum contractual obligations and commitments as at December 31, 2016:

	2017	2018	2019	2020	2021	2022
Operating leases	$ 201,654	$ 167,640	$ 167,640	$ 167,640	$ 167,640	$ 13,970

The Company currently has three lease agreements, as follows:

(i) an office lease at a rate of $4,000 per month expires on January 31, 2017;

(ii) an office lease at a rate of $632 per month expires March 31, 2017;

(ii) a production facility lease at a rate of $5,417 per month expires on August 24, 2017; and,

(iii) an office lease at a rate of $13,790 per month expires on January 31, 2022.

21. Segmented information:

The Company operates in one reportable operating segment, being the design, manufacture and sale of underwater sonar and acoustic sensor equipment. The summarized financial information for revenue derived by geographic segment is as follows:

	2016	2015
Total revenues:		
Canada	**$ -**	$ 67,500
United States	**608,362**	932,469
France	**91,332**	346,435
Israel	**989,822**	242,217
Other	**555,802**	294,805
	$ 2,245,318	$ 1,883,426

22. Subsequent events:

Subsequent to December 31, 2016, the Company:

(a) was awarded non-refundable financial contributions, which will be used to support development of the Company's underwater robotics program, of up to $1,470,000 from the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP);

(b) completed a non-brokered private placement of 11,806,660 units at a price of $0.18 raising gross proceeds of $2,125,199. Each unit consists of one common share and one half of one common share purchase warrant. Each full warrant is exercisable at a price of $0.30 for a period of two years. The Company paid cash finder's fees of $12,600 and issued 191,333 finder's warrants exercisable at a price of $0.18 per warrant share for a period of two years in connection with the placement;

(c) disposed of its investment in Square Robot Inc., a non-core asset, for consideration of US$700,000, half of which was received on February 28, 2017 with the balance in the form of a note receivable due no later than June 27, 2017;

(d) issued 366,666 common shares upon the exercise of share purchase warrants for proceeds of $55,000;

(e) entered into an investor relations advisory agreement with at a monthly cost of $5,000; and

(f) granted 250,000 incentive stock options to a consultant at an exercise price of $0.17 for a period of three years and recorded the expiry of 200,000 incentive stock options priced at $0.25.