

ESI Entertainment Systems Inc.
Consolidated Financial Statements

(expressed in Canadian dollars)

For the Years Ended February 28, 2010 and February 28, 2009

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Management's Responsibility

To the Shareholders of ESI Entertainment Systems Inc.

Management is responsible for the preparation and presentation of the accompanying financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is used.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors and the Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Audit Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Company's external auditors.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

June 4, 2010

"Tony Greening"
Tony Greening
Chief Executive Officer

"Ian Franks"
Ian Franks
Chief Financial Officer



MEYERS NORRIS PENNY LLP

Auditors' Report

To the Shareholders of ESI Entertainment Systems Inc.

We have audited the consolidated balance sheets of ESI Entertainment Systems Inc. as at February 28, 2010 and 2009 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at February 28, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in conformity with Canadian generally accepted accounting principles.

Meyers Norris Penny LLP

Surrey, Canada
June 4, 2010

Chartered Accountants



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ESI Entertainment Systems Inc.

Consolidated Balance Sheets

(expressed in Canadian dollars)

Years Ended	February 28, 2010	February 28, 2009
Assets		
Cash and cash equivalents	\$ 89,208	\$ 909,785
Accounts receivable	1,073,580	1,100,023
Prepays and other	65,658	106,513
Citadel processing accounts (Note 4)	4,937,401	2,958,565
	<u>6,165,847</u>	<u>5,074,886</u>
Property and equipment (Note 5)	170,499	280,725
Deferred contract costs	550,362	696,234
Capitalized development costs	47,532	-
	<u>6,934,240</u>	<u>6,051,845</u>
Liabilities		
Accounts payable and accrued liabilities (Note 6)	\$ 2,227,935	\$ 1,049,700
Loan Payable (Note 7)	2,174,733	2,564,704
Capital lease obligations (Note 8)	-	30,684
Deferred revenue	582,230	535,667
Citadel processing liabilities (Note 4)	5,649,239	2,958,565
	<u>10,634,137</u>	<u>7,139,320</u>
Deferred revenue	913,605	1,324,392
	<u>11,547,742</u>	<u>8,463,712</u>
Shareholders' Equity (Deficiency)		
Capital stock (Note 9)	9,957,969	9,957,959
Contributed surplus (Note 9)	4,467,539	4,328,885
Deficit	(19,039,010)	(16,698,711)
	<u>(4,613,502)</u>	<u>(2,411,867)</u>
	<u>\$ 6,934,240</u>	<u>\$ 6,051,845</u>

On behalf of the Board

"Tony Greening" Director
Tony Greening

"Michael Meeks" Director
Michael Meeks

ESI Entertainment Systems Inc.
Consolidated Statements of Operations and Comprehensive
Loss and Deficit
(expressed in Canadian dollars)

Years Ended	February 28, 2010	February 28, 2009
Revenues (Note 15)	\$ 3,581,478	\$ 3,954,820
Direct costs	<u>2,558,307</u>	<u>2,983,798</u>
Gross profit	<u>1,023,171</u>	<u>971,022</u>
Operating expenses		
Product development	175,463	604,070
Sales, marketing and customer service	135,043	741,212
General and administrative	2,797,099	3,761,514
Amortization of property and equipment	<u>187,298</u>	<u>453,205</u>
	<u>3,294,903</u>	<u>5,560,001</u>
Loss before under noted items	(2,271,732)	(4,588,979)
Other expenses (income)		
Foreign exchange (gain) loss	(109,597)	383,641
Interest income	(20,974)	(41,536)
Interest expense	175,170	128,913
Other	<u>23,968</u>	<u>-</u>
Loss before income taxes	<u>(2,340,299)</u>	<u>(5,059,997)</u>
Provision for income taxes	<u>-</u>	<u>8,529</u>
Net loss and comprehensive loss	<u>\$ (2,340,299)</u>	<u>\$ (5,068,526)</u>
Loss per share		
Basic and diluted	\$ (0.16)	\$ (0.36)
<hr/>		
Deficit, beginning of year	\$ (16,698,711)	\$ (11,630,185)
Net loss	<u>(2,340,299)</u>	<u>(5,068,526)</u>
Deficit and accumulated other comprehensive deficit, end of year	<u>\$ (19,039,010)</u>	<u>\$ (16,698,711)</u>
<hr/>		
Weighted average basic and diluted common shares outstanding	# 14,234,727	# 14,234,727

ESI Entertainment Systems Inc.

Consolidated Statements of Cash Flows

(expressed in Canadian dollars)

Years Ended	February 28, 2010	February 28, 2009
Cash flows provided by (used in)		
Operating activities		
Net loss	\$ (2,340,299)	\$ (5,068,526)
Items not affecting cash:		
Stock-based compensation (Note 10)	138,655	230,712
Amortization of property and equipment	187,298	453,205
Other	(13,395)	-
Net changes in non-cash operating items		
Accounts receivable	26,443	11,192
Prepays and other	40,855	338,062
Accounts payable and accrued liabilities	1,178,235	229,208
Allowance for bad debts	-	(311,500)
Deferred revenue	364,224	(770,186)
Deferred contract costs	145,872	420,227
	(272,112)	(4,467,606)
Investing activities		
Acquisition of property and equipment	(90,778)	(15,061)
Proceeds on disposal	10,500	-
Capitalized development costs	(47,532)	-
	(127,810)	(15,061)
Financing activities		
Capital lease payments	(30,684)	(214,715)
Loan payable	(389,971)	2,564,704
	(420,655)	2,349,989
Decrease in cash and cash equivalents	(820,577)	(2,132,678)
Cash and cash equivalents, beginning of year	909,785	3,042,463
Cash and cash equivalents, end of year	\$ 89,208	\$ 909,785
Supplemental information		
Interest received	\$ 20,929	\$ 41,536
Interest paid	\$ 175,168	\$ 128,913
Income taxes paid	\$ -	\$ 8,529

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

1. Nature and continuance of operations

ESI Entertainment Systems Inc. ("the Company") was incorporated as e-Success Inc. on December 9, 1999 under the *Canada Business Corporations Act*. On February 27, 2006, the Company was continued as a British Columbia corporation and changed its name to ESI Entertainment Systems Inc.

ESI Corporate

ESI Entertainment Systems Inc is a software development company with two main independently operated and controlled subsidiaries: ESI Integrity Inc. and Citadel Commerce Corp. The two active subsidiaries are located in separate physical locations and operated autonomously with completely separate management, personnel and infrastructure. ESI has 14 Citadel employees and 12 Integrity employees located in Burnaby, British Columbia, Canada, from where each company markets its products and services globally. The Company also has a number of other minor subsidiaries described in note 2.

ESI Integrity

ESI Integrity provides software solutions for real-time auditing, fraud control and risk management systems to businesses requiring high levels of security, integrity, and trust, including government lotteries and pari-mutuel (horse tracks) organizations. Integrity enters into long term customer license and support contracts where it charges a fixed license fee for the use of its audit and risk management software, as well as an annual support fee. The license contracts can be perpetual or renewable. The support contracts are renewable. Revenue is typically earned over a two to five year period, depending on the term of each contract. The growth in revenue is dependent on the number of contracts executed in a given year, which may vary substantially from year to year.

The cost of licensing revenue primarily consists of the cost of customizing the software and the cost of installing and testing the software. The cost of support revenues primarily relates to personnel support costs.

Citadel

Citadel's primary product is its Instant Bank Transfer service. It earns a fee on each payment processed to and from end-users and e-commerce merchants.

Citadel provides on-line payment processing services including electronic cheques and paper cheques but its main focus is its instant online banking services. Transactions are processed with concurrent transactional fraud detection services including full identity pre-authorization via in-house and third party databases and validation of previous transaction history. All of Citadel's services are based on a fee per transaction charged to its merchants. Its existing infrastructure and personnel have the capability to process substantially larger volumes.

The Instant Bank Transfer service uses a software product that assists the consumer to complete the details of an online bank transfer which simplifies the process and eliminates data entry errors. The software also detects when the customer initiated the transfer and the merchant is notified that the funds have been sent. Citadel uses proprietary back-office software to electronically scan Citadel bank accounts for received deposits and to notify merchants of changes in transaction states. Knowing that the funds have been sent by the customer allows the merchant to have a high level of confidence that the funds will soon be

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

1. Nature and continuance of operations (Continued)

received by Citadel. This allows the merchant to provide the customer with instant access to their funds.

These financial statements have been prepared on a going concern basis which includes the assumption that the Company will be able to realize its assets and settle its liabilities in the normal course of business. For the year ended February 28, 2010 the Company incurred a loss from operations of \$2,340,299 (2009: \$5,068,526) and a deficiency in operating cash flow of \$820,577 (2009: \$2,132,678). In addition, there is a working capital deficit of \$4,468,290 (2009: \$2,064,434).

The Company has made efforts to reduce costs incurred in its operations. The continued revenues from the Company's active businesses form the basis of management's opinion that the Company will meet its liabilities and commitments as they become due. The Company is currently monitoring all expenditures and implementing cash management strategies to ensure that it has adequate cash reserves to fund identified expenditure requirements.

Given the Company's operating losses and working capital deficit, there exists considerable uncertainty about the Company's ability to continue as a going concern. The Company will require continued financial support from its shareholders and creditors and/or new debt or equity financing until it is able to generate sufficient cash flow from operations on a sustained basis. There can be no guarantee that adequate funds will be available on acceptable terms as and when required by the Company. Failure to obtain ongoing support of its shareholders and creditors may make the going concern basis of accounting inappropriate, in which case the Company's assets and liabilities would need to be recognized at their liquidation values. These financial statements do not include any adjustment due to this going concern uncertainty.

2. Summary of significant accounting policies

Basis of consolidation and financial statement preparation

The Company has consolidated all the assets, liabilities, revenues and expenses of all subsidiaries after elimination of inter-company transactions and balances. These consolidated financial statements include the accounts of the Company and the following direct and indirect subsidiaries:

Active:

- ESI Integrity Inc. - wholly-owned subsidiary incorporated in Canada
- Citadel Commerce Corp - wholly-owned subsidiary incorporated in Canada
- Citadel Commerce UK Limited - wholly-owned subsidiary incorporated in United Kingdom
- Citadel Commerce Holdings (Malta) Limited - wholly-owned subsidiary incorporated in Malta
- Citadel Commerce (Malta) Limited - wholly-owned subsidiary incorporated in Malta
- CC Mexico Holdings, S. de R.L. de C.V. - wholly-owned subsidiary incorporated in Mexico

Inactive:

- Playline, Inc. - wholly-owned subsidiary incorporated in Canada
- Citadel Commerce Costa Rica Holdings S.R.L - wholly-owned subsidiary incorporated in Costa Rica
- Fortress Technologies Limited - wholly-owned subsidiary incorporated in Malta
- Playline Technologies Limited - wholly-owned subsidiary incorporated in Malta

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

2. Summary of significant accounting policies (Continued)

Cash and cash equivalents

All highly liquid investments with an original maturity date of three months or less at the date of purchase are classified as cash and cash equivalents.

Property and equipment

Property and equipment are recorded at cost less accumulated amortization. Amortization is calculated on a straight line basis at the following annual rates:

Computer hardware	3 years
Computer software	3 years
Equipment under capital leases	3 years
Leasehold improvements	5 years
Furniture and fixtures	10 years

Deferred contract costs

Contract costs incurred for the installation of software pursuant to license agreements with ESI Integrity are included in deferred contract costs. These expenditures generally relate to materials and direct labour costs and are charged to direct cost of revenues earned by ESI Integrity over the term of the related revenue contract. When it is determined that expenditures will not likely be recovered by future revenue, such expenditures are included in current year's net loss.

Leases

Leases that transfer substantially all the benefits and risk of ownership to the Company are recorded as capital leases. Assets under capital lease are included in property and equipment with offsetting long-term capital lease obligation being recorded as liabilities. All other leases are classified as operating leases under which lease costs are expensed in the period.

Financial instruments

In accordance with the CICA accounting standards 3855 and 3861, all financial instruments, including embedded derivatives, must initially be recognized at fair value on the balance sheet and classified into the following categories: financial assets and financial liabilities held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, and other financial liabilities. Subsequent measurements of the financial instruments are based on their classification. Unrealized gains and losses on held for trading financial instruments are recognized in earnings. Unrealized gains and losses on available-for-sale financial assets are recognized in other comprehensive income and are transferred to income when the instrument is settled. The other categories of financial instruments are recognized at amortized cost using the effective interest rate method. Investment transactions are made on the trade date and any transaction costs with respect to financial instruments are expensed in the period incurred.

The Company's financial instruments are listed as follows, according to their classification:

- a) Cash and cash equivalents and Citadel processing accounts are classified as held-for-trading and are measured at fair value;

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

2. Summary of significant accounting policies (Continued)

- b) Accounts receivable is classified as loans and receivables and are measured at amortized cost;
- c) Accounts payable, accrued liabilities and loan payable are classified as other financial liabilities and are measured at amortized cost. Also included in other financial liabilities are merchant processing liabilities, which due to their short term nature approximate their carrying value.

Comprehensive income

The components of other comprehensive income included unrealized gains and losses on financial assets classified as available-for-sale and the effective portion of cash flow hedges, if any. There were no such components to be recognized in comprehensive income upon transition or for the years ended February 28, 2010 and 2009. As the Company has no items of other comprehensive income or loss, the net earnings or loss for the periods are equivalent to comprehensive income.

Impairment of long-lived assets

Long-lived assets consist of property and equipment and deferred contract costs. Long-lived assets held for use are measured and amortized as described in the applicable accounting policies.

The Company performs impairment testing on long-lived assets held for use whenever events or changes in circumstances indicate that the carrying value of an asset, or group of assets, may not be recoverable. Impairment losses are recognized when undiscounted future cash flows from their use and disposal are less than the assets carrying amount.

Revenue recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured at the time of recognition.

For ESI Integrity contracts with multiple deliverables, such as software licenses and support services, these arrangements do not qualify for separate units of accounting as there is no vendor specific objective and reliable evidence of their fair value. Accordingly, the software license and the software support services revenue are recognized over the remaining term of the related support services contract, subject to the delivery and installation of the software and acceptance by the customer. Deferred revenue consists of unearned license fees received prior to delivery, installation and acceptance by the customer, unamortized license and support fees revenue and advance payments of annual support service.

Citadel's revenue from transaction processing services is recognized on execution of the underlying transactions. Revenue from consulting and support services is recognized as such services are provided.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

2. Summary of significant accounting policies (Continued)

Stock-based compensation plans

The Company has adopted the recommendations of CICA Handbook Section 3870, "*Stock-Based Compensation and Other Stock-Based Payments*", which requires the fair value based method of accounting for all stock-based compensation earned during the year. The fair value of options granted to employees is estimated on the date of grant and is recognized as compensation expense over the vesting period of the options with a corresponding credit to contributed surplus. The contributed surplus balance is reduced as options are exercised and the amount initially recorded for the options in contributed surplus is credited to share capital.

Income taxes

The Company follows the asset and liability method of tax allocation accounting whereby future tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as utilized losses carried forward. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of substantive enactment. The amount of future income tax assets recognized is limited to the amount that is estimated as more likely than not to be realized.

Translation of foreign currencies

The Company's functional currency is the Canadian dollar. The operations of the Company's subsidiaries are considered integrated and are translated using the temporal method. Transactions in foreign currencies are translated into Canadian dollars at the previous month's average exchange rate. Monetary assets and liabilities expressed in foreign currencies are translated to Canadian dollars at the exchange rates in effect at the balance sheet date. The resulting exchange gains and losses are recognized in income.

Loss per share

Basic loss per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted loss per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on loss per share. The diluted effect of outstanding options and warrants and their equivalents is reflected in diluted loss per share by the application of the treasury stock method. This method assumes the proceeds from the exercise of dilutive options and warrants are used to purchase common shares at the weighted average market price during the period.

Use of estimates and measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period reported. Items requiring significant estimates and subject to

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

2. Summary of significant accounting policies (Continued)

measurement uncertainty include amortization on property and equipment, deferred contract costs, bad debt allowance, impairment allowance, valuation allowance against future tax assets and stock based compensation expense. By their nature, these estimates are subject to measurement uncertainty. Actual results could differ, and such estimates may be subject to change in the future.

Capital disclosures

The Company is required to disclose of information that enables users of an entity's financial statements to evaluate its objectives, policies and processes for managing capital such as qualitative information about its objectives, policies and processes for managing capital, summary quantitative data about what the entity manages as capital, whether it has complied with any capital requirements and, if it has not complied, the consequences of non-compliance. Disclosures required by this standard are included in Note 14. The adoption of this standard did not have a material impact on the consolidated financial statements.

Deferred development costs

Deferred development costs represent material costs incurred by the Company related to the development of new ICS auditing software within its wholly owned subsidiary. These costs will be amortized over its estimated useful life once revenue is earned after implementation.

Recent pronouncements in accounting standards

a) International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board ("AcSB") announced that 2011 is the changeover date for publicly-listed companies to use International Financial Reporting Standards ("IFRS"), replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of March 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended February 28, 2011.

The Company is currently working to analyze the standards and while the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

b) Business combinations, Section 1582 / Consolidated financial statements, Section 1601 / Non-controlling interest, Section 1602

In January 2009, the CICA issued Handbook Sections 1582 "Business Combinations"; 1601 "Consolidated Financial Statements"; and 1602 "Non-controlling Interests", which replace CICA Handbook Sections 1581 "Business Combinations" and 1600 "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable for the Company's business combinations with acquisition dates on or after January 1, 2011. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning on January 1, 2011. Early adoption of these sections is permitted and all three sections must be adopted concurrently. The adoption of these standards is not expected to have an impact on the Company's financial statements.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

3. Changes in accounting policy

- a) Financial Instruments Disclosures, Section 3862 / Financial Instruments Presentation, Section 3863

In June 2009, the CICA issued amendments to CICA Section 3862, "Financial Instruments-Disclosures" and Section 3863 "Financial Instruments – Presentation". The amendments include disclosures around the liquidity risk associated with financial instruments and additional disclosures related to the fair value of the same. The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009. Disclosures required by this standard are included in Note 16. The adoption of these sections had no effect on the Company's financial statements.

- b) Goodwill and intangible assets, Section 3064

Effective January 1, 2009 the Company adopted Section 3064 "Goodwill and intangible assets" replacing Section 3062 "Goodwill and intangible assets" and Section 3450 "Research and development costs". Section 3064 establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The adoption of this section had no effect on the Corporation's financial statements.

- c) Credit risk and the fair value of the financial assets and liabilities, EIC – 173

Effective January 20, 2009, the Company adopted the Emerging Issues Committee ("EIC") Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Liabilities" which provides additional information on the fair value of financial assets and liabilities under Section 3855, "Financial Instruments- Recognition and Measurement". The adoption of this Abstract resulted in no change to the Company's financial statements.

4. Citadel processing

Citadel Processing Accounts represent the bank accounts maintained by the Company for the purpose of payment processing for Citadel merchants and clients. These accounts are recorded separately from the Company's operating bank accounts.

Citadel Processing Liabilities represent balances due to myCitadel clients, merchants and their clients from funds held in trust, pending transaction cancellation periods and processing times. These amounts consist of:

	<u>2010</u>	<u>2009</u>
Merchant processing funds	\$ 5,581,442	\$ 2,853,746
Merchant reserves	58,101	56,690
myCitadel consumer funds	<u>9,696</u>	<u>48,129</u>
	<u>\$ 5,649,239</u>	<u>\$ 2,958,565</u>

Merchant processing funds are funds held with Citadel for the merchants, these are available on demand.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

4. Citadel processing (Continued)

Merchant reserves represent 10% of certain processed transactions accumulated on a six month rolling period for certain merchants.

myCitadel consumer funds represent the funds held by clients to be used in e-commerce activities.

5. Property and equipment

2010	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Computer hardware	\$ 1,202,500	\$ 1,167,898	\$ 34,602
Computer software	507,643	487,377	20,266
Furniture and fixtures	246,702	166,447	80,255
Leasehold improvements	134,037	98,661	35,376
Capital Leases	<u>951,871</u>	<u>951,871</u>	<u>-</u>
	<u>\$ 3,042,753</u>	<u>\$ 2,872,254</u>	<u>\$ 170,499</u>

2009	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Computer hardware	\$ 1,252,146	\$ 1,189,556	\$ 62,590
Computer software	487,932	459,007	28,925
Furniture and fixtures	248,502	141,373	107,129
Leasehold improvements	346,457	292,429	54,028
Capital Leases	<u>1,006,271</u>	<u>978,218</u>	<u>28,053</u>
	<u>\$ 3,341,308</u>	<u>\$ 3,060,583</u>	<u>\$ 280,725</u>

6. Accounts payable and accrued liabilities

Included in accounts payable and accrued liabilities are deferred salaries totaling \$861,016 (2009: \$388,837). Outstanding deferred salaries accrue interest annually at 8.4%.

7. Loan payable

In June 2008, the Company secured a US \$2 million dollar loan bearing interest at the rate of 6% per annum. The loan is secured by first ranking fixed charges on the entire issued share capital of the Company's principal subsidiaries, ESI Integrity Inc., Citadel Commerce Corp and Citadel Commerce UK Limited. On January 28, 2010, the Company renegotiated the terms of the loan facility so that the loan is no longer repayable on a fixed date and is now repayable on demand. All other terms of the loan are unchanged.

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

8. Capital lease obligations

The company had equipment under capital lease obligations until September 2009. The monthly lease payments consist of principal repayment and interest and the imputed interest rates vary between 11.56% and 12.32%. All lease obligations were repaid prior to the year end.

9. Capital stock and contributed surplus

Authorized:

Unlimited voting common shares without par value

Issued and outstanding – common shares	Number of Shares	Share Capital	Contributed Surplus
Balance, February 29, 2008	# 14,234,727	\$ 9,957,959	\$ 4,092,246
Expiry of warrants	-	-	5,926
Stock-based compensation	-	-	230,712
Balance, February 28, 2009	# 14,234,727	\$ 9,957,959	\$ 4,328,884
Stock-based compensation	-	-	138,655
Balance, February 28, 2010	# 14,234,727	\$ 9,957,959	\$ 4,467,539

10. Stock-based compensation

Under the Company's stock option plan and at the discretion of the board of directors, the Company may grant options to purchase up to 2,850,000 common shares of the Company to its directors, officers, employees and consultants. No one person is to be granted options equal to more than 5% of the total issued and outstanding common shares of the Company on a non-diluted basis. The maximum term of the options under this plan is ten years and the exercise price and vesting period will be determined by the board of directors at the time of granting.

During the fiscal years ended shown below, common share incentive stock options were granted and exercised as follows:

	Number of Shares Issuable on Exercise	Weighted Average Exercise Price
Balance, February 29, 2008	1,924,750	0.78
Granted during the year	775,000	0.26
Expired during the year	(369,250)	0.54
Forfeited during the year	(380,250)	0.52
Balance, February 28, 2009	1,950,250	0.64
Granted during the year	195,000	0.07
Expired during the year	(87,750)	0.78
Forfeited during the year	(97,500)	0.36
Balance, February 28, 2010	1,960,000	0.60
Exercisable at February 28, 2010	1,272,875	0.78

ESI Entertainment Systems Inc.

Notes to the Consolidated Financial Statements

(expressed in Canadian dollars)

Years Ended February 28, 2010 and February 28, 2009

10. Stock-based compensation plans (Continued)

All options granted carried exercise prices equal to the current trading price of common shares at the date of grant. The Company recorded a stock based compensation expense in the statement of operations of \$138,655 for the year ended February 28, 2010 (2009: \$230,712). This amount is included in General and Administrative operating expenses.

The fair value of each option grant was estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	<u>2010</u>	<u>2009</u>
Risk-free interest rate	1.26% to 1.70%	2.83% to 3.35%
Dividend yield	-	-
Expected life	1 to 4	2
Volatility	388% to 401%	209% to 213%

The fair value of the options granted during fiscal 2010 was \$12,431 (2009: \$206,250).

Common share incentive stock options outstanding at February 28, 2010 are summarized as follows:

Exercise Price	Number of Shares Issuable on Exercise	Weighted Average Remaining Life (Years)	Number of Shares Issuable on Exercisable Options
\$0.05	145,000	9.62	36,250
0.11	50,000	9.25	6,250
0.25	8,000	3.93	8,000
0.26	525,000	8.30	196,875
0.42	25,000	8.26	12,500
0.45	25,000	8.26	12,500
0.50	731,000	7.04	548,250
0.71	235,000	5.00	235,000
0.80	25,000	6.67	18,750
2.36	191,000	6.19	191,000
	<u>1,960,000</u>		<u>1,265,375</u>

11. Income taxes

The Company has filed all Canadian corporate tax returns relating to Canadian operations, however is not compliant with foreign statutory requirements related to its subsidiaries. It is the Company's position that no foreign tax provisions are outstanding due to the accumulated foreign non-capital losses held by these subsidiaries.

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11. Income taxes (Continued)

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities are as follows:

	<u>2010</u>	<u>2009</u>
Future income tax asset (liability)		
Property and equipment – Canada	\$ 46,000	\$ 68,000
Cumulative eligible capital – Canada	11,000	12,312
Deferred share issuance cost – Canada	107,000	270,542
Deferred start up cost and contract cost – Canada	(138,000)	(181,021)
Deferred development costs – Canada	(12,000)	-
Capital lease obligation – Canada	-	7,978
Non-capital losses carried forward – Canada	3,320,000	3,578,872
Non-capital losses carried forward – Malta	1,727,000	638,639
	<u>5,061,000</u>	<u>4,395,322</u>
Total future income tax asset	5,061,000	4,395,322
Less valuation allowance	(5,061,000)	(4,395,322)
Net future income taxes	<u>\$ -</u>	<u>\$ -</u>

The Company has Canadian non-capital tax losses amounting to \$13,278,677 which are available to be carried forward to reduce taxable income in future years, and expire as follows:

2015	314,968
2026	1,712,936
2027	705,398
2028	5,312,157
2029	4,881,570
2030	<u>351,648</u>

\$ 13,278,677

The Company has Maltese non-capital losses amounting to \$4,933,850 which are available to be carried forward indefinitely to reduce taxable income in future years.

The provision for income taxes shown on the statements of operations differs from the amounts obtained by applying combined Canadian and British Columbia statutory rates to the earnings before taxes as follows:

	<u>2010</u>	<u>2009</u>
Loss before income taxes	\$ (2,340,304)	\$ (5,059,997)
Combined statutory rate	<u>29.8%</u>	<u>30.8%</u>
Expected income tax recovery based on the statutory rate	\$ (696,240)	\$ (1,558,479)
Stock – based compensation	41,250	71,060
Tax effect of non-capital losses expired during the year	27,864	-
Change in tax rates	123,067	331,071
Change in valuation allowance	665,678	1,134,869
Tax effect of income taxed in foreign jurisdictions	(163,231)	-
Tax effect of permanent and other differences	<u>1,612</u>	<u>30,008</u>
	<u>\$ -</u>	<u>\$ 8,529</u>

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12. Related party transactions

During the year ended February 28, 2010, the Company had no related party transactions.

13. Commitments and contingencies

- (a) The Company leases its office premises. The future minimum payments under these leases are as follows:

2011	\$	242,532
2012	\$	228,322
2013	\$	13,106

- (b) The Company is subject to anti-money laundering ("AML") legislation in jurisdictions in which it operates or has operated. Management has implemented controls and procedures that it believes put the Company in compliance with all applicable AML rules and regulations.

It is possible that regulatory authorities may audit the Company systems and processes and assess monetary penalties for non-compliance which could be material; however, the likelihood and magnitude of any such assessments cannot be determined at this time.

- (c) The Company filed separate tax returns for its Canadian subsidiaries that were not filed on an individual basis in years prior to fiscal 2006. Management has recorded their best estimate of the Company's income tax obligation in the consolidated financial statements. The ultimate liability however is subject to final approval by taxation authorities. It is possible that the tax authorities may reassess the Company's filing position which could result in a material increase in the Company's liability for current and prior financial periods, however any such adjustment is indeterminate at this time.

14. Capital management

The company manages the following as capital:

	2010	2009
Capital stock	9,957,959	9,957,959
Contributed Surplus	4,467,539	4,328,885
Deficit	(19,039,010)	(16,698,711)

The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, as well as to generate sufficient cash flow to manage its existing debt.

The Company sets the amount of capital in proportion to risk and manages the capital structure and makes adjustments to it in light of changes to economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new debt, issue new shares, or defer various expenses in order to conserve cash flow. Financing decisions are generally made on a specific transaction basis and depend on such things as the Company's needs, capital markets and economic conditions at the time of the transaction.

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14. Capital management (Continued)

Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable, given the size of the Company.

15. Segmented information

The Company operates two main operating segments – ESI Integrity and Citadel.

The ESI Integrity segment provides software solutions for real-time auditing of transaction processing systems to businesses requiring high levels of security, integrity and trust including government regulated lotteries and pari-mutuel betting. Citadel provides on-line payment processing services including internet bank transfers and electronic cheques, with concurrent transactional fraud detection services including pre-authorization via in-house and third party databases and validation of previous transaction history.

Corporate activities include the Company's indirect support costs for the two operating segments.

The segmented information for each business segment is as follows:

2010	ESI		Corporate	Consolidated
	Citadel	Integrity		
Revenue	1,128,171	2,453,307	-	3,581,478
Direct costs	(1,204,781)	(1,353,526)	-	(2,558,307)
Gross profit (loss)	(76,610)	1,099,781	-	1,023,171
Operating expenses	(1,263,627)	(753,692)	(1,090,286)	(3,107,605)
Amortization	(109,346)	(26,347)	(51,605)	(187,298)
Other	-	-	(23,968)	(23,968)
(Loss) earnings before other income, expenses, and income taxes	(1,449,583)	319,742	(1,165,859)	(2,295,700)
Interest income	2,913	12,744	5,317	20,974
Interest expense	(1,270)	(18)	(173,882)	(175,170)
Foreign exchange (loss) gain	(180,972)	(132,164)	422,733	109,597
Provision for income taxes	-	-	-	-
Net (loss) income	(1,628,912)	200,304	(911,691)	(2,340,299)
Property and equipment, net	61,784	72,596	36,119	170,499

2009	ESI		Corporate	Consolidated
	Citadel	Integrity		
Revenue	700,977	3,253,843	-	3,954,820
Direct costs	(858,987)	(2,124,811)	-	(2,983,798)
Gross profit (loss)	(158,010)	1,129,032	-	971,022
Operating expenses	(2,459,745)	(1,069,619)	(1,577,432)	(5,106,796)
Amortization	(309,884)	(42,593)	(100,728)	(453,205)
(Loss) earnings before other income, expenses, and income taxes	(2,927,639)	16,820	(1,678,160)	(4,588,979)
Interest income	40,085	101	1,350	41,536
Interest expense	(12,780)	(912)	(115,221)	(128,913)
Foreign exchange (loss) gain	(242,015)	61,767	(203,393)	(383,641)
Provision for income taxes	-	(8,529)	-	(8,529)
Net (loss) income	(3,142,349)	69,247	(1,995,424)	(5,068,526)
Property and equipment, net	163,199	29,801	87,725	280,725

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15. Segmented information (Continued)

Geographic location

The company's operations are conducted in three geographic segments: Canada, the USA and International.

Revenues earned by geographic location are as follows:

	<u>2010</u>	<u>2009</u>
United States	\$ 905,829	\$ 1,571,782
Canada	328,685	565,968
International	<u>2,346,964</u>	<u>1,817,070</u>
	<u>\$ 3,581,478</u>	<u>\$ 3,954,820</u>

As at February 28, 2010, 72% of the Company's fixed assets were situated in Canada and 28% were located internationally.

Economic dependence

The Citadel business unit revenue consists of transaction processing. Customer dependency for Citadel revenue is as follows:

	<u>2010</u>	<u>2009</u>
Customer A	19%	20%
Customer B	15%	16%
Customer C	12%	14%
Customer D	8%	12%

16. Financial instruments and concentration of risk

Fair values

The carrying values of cash and cash equivalents, accounts receivable, Citadel processing accounts, accounts payable and accrued liabilities and Citadel processing liabilities approximated their fair values due to their short-term nature.

The carrying value of the loan payable approximates its fair value as it is payable on demand and bears market rate of interest.

Credit and chargeback risk

Financial instruments that potentially subject the Company to concentration of credit risk are primarily accounts receivable, Citadel processing accounts and Citadel processing liabilities. To minimize credit risk the Company maintains substantially all of its cash and cash equivalents with major financial institutions internationally. Management is of the opinion that any risk of loss is significantly reduced due to the financial strength of the Company's major customers.

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16. Financial instruments and concentration of risk (Continued)

The ageing of receivables at the reporting date was as follows (the ageing days relates to balances past due):

February 28, 2010	Total \$	Current and <30 days \$	30-60 days \$
Net trade receivables	188,730	111,304	76,726

Foreign currency risk

A significant component of the Company's transactions, particularly revenues, is undertaken in US Dollars, Euros and other foreign currencies. The Company maintains significant deposits in foreign currencies denominated accounts. Fluctuations in exchange rates between those foreign currencies could have a material effect on the business, results of operations and financial condition of the Company. The Company does not use hedging instruments to manage its exposure to foreign currency exchange risk.

At February 28, 2010, if the Canadian dollar had weakened 5% against other currencies, with all other variables held constant, after-tax net income for the year would have been \$103,874 lower. Conversely, if the Canadian dollar had strengthened 5% against other currencies, with all other variables held constant, after-tax net income would have been \$103,874 higher.

Liquidity risk

The Company is exposed to liquidity risk, which is the risk that the Company may be unable to generate or obtain sufficient cash to meet its commitments as they become due. The financial liabilities on the balance sheet consist of accounts payable and accrued liabilities, loan payable and capital lease obligations. This risk is mitigated through the management of cash and loans received and the Company may adjust capital spending, issue new shares or draw additional debt.

Forecasted cash flows and operating and capital outlays are updated frequently to ensure necessary liquidity remains available. All of the Company's financial obligations are either demand or are due within one year.