

SPARQ SYSTEMS INC. (FORMERLY SPARQ CORP.)
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021
(Expressed in Canadian dollars)

To the Shareholders of SPARQ Systems Inc. (formerly SPARQ Corp.):

Opinion

We have audited the consolidated financial statements of SPARQ Systems Inc. (formerly SPARQ Corp.) (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2022 and December 31, 2021, and the consolidated statements of loss and comprehensive loss, changes in shareholders' (deficiency) equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2022 and December 31, 2021, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audits in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audits of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 2 in the consolidated financial statements, which indicates that the Company had a deficit as at December 31, 2022 and, for the year then ended, incurred a net loss and negative cash flows from operating activities. As stated in Note 2, these events or conditions, along with other matters as set forth in Note 2, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In addition to the matter described in the Material Uncertainty Related to Going Concern section, we have determined the matter described below to be the key audit matter to be communicated in our report.

Inventory

Key Audit Matter Description

Inventory comprises raw materials and finished goods and is carried at the lower of cost and net realizable value. In estimating net realizable value, the Company gathers data related to fluctuations in inventory levels, planned sales, obsolescence, future selling prices and costs to sell. As a result of management's analysis, the Company has determined that a provision for inventory obsolescence is required. Due to the level of estimation involved in determining the inventory obsolescence, we have determined that inventory valuation is a key audit matter.

Audit Response

We responded to this matter by performing procedures in relation to inventory valuation. Our audit work in relation to this included, but was not restricted to, the following:

- Obtained an understanding of the Company's controls and tested the design and implementation of those controls, including those related to management's process for developing the estimates used in the determination of net realizable value and the inventory obsolescence provision.
- Obtained support for selling prices to assess the accuracy of the provision for inventory obsolescence and considered the nature of inventory items in relation to planned product versions.
- Performed analytical procedures for assessment of trends in the type of inventory being held.

Other Information

Management is responsible for the other information. The other information comprises Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audits of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audits or otherwise appears to be materially misstated. We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audits and significant audit findings, including any significant deficiencies in internal control that we identify during our audits.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Brad Frampton.

Calgary, Alberta

April 20, 2023

MNP LLP

Chartered Professional Accountants

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in Canadian dollars)

As at:	Note	December 31, 2022	December 31, 2021
		\$	\$
Assets			
Current Assets			
Cash and cash equivalents		4,587,527	9,297,999
Accounts and other amounts receivable		293,977	82,661
Investment tax credits recoverable	12(c)	330,000	330,000
Inventory	5	1,711,641	529,331
Prepaid expenses and deposits		323,615	6,840
Total current assets		7,246,760	10,246,831
Property and equipment	6	158,477	40,004
Total assets		7,405,237	10,286,835
Liabilities			
Current Liabilities			
Accounts payable and accrued liabilities		916,156	607,440
Total current liabilities		916,156	607,440
CEBA Term Loan	7	38,196	38,196
Total liabilities		954,352	645,636
Shareholders' Equity			
Share Capital	8	26,462,308	26,462,308
Contributed Surplus	9	2,298,658	1,560,658
Warrants	8	3,946,176	3,946,176
Deficit		(26,256,257)	(22,327,943)
Total shareholders' equity		6,450,885	9,641,199
Total liabilities and shareholders' equity		7,405,237	10,286,835

Going concern (Note 2(e))
 Commitments and contingencies (Note 13)
 Subsequent events (Note 16)

Approved on behalf of the Board of Directors:

"Praveen Jain", Director

"Nishith Goel", Director

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

	Note	2022	2021
Revenue		-	-
Cost of sales	5	374,929	45,104
Gross loss		(374,929)	(45,104)
Expenses			
Research and development		1,573,918	972,178
Sales and marketing		24,724	15,873
General and administration	8(ii)	1,208,345	6,328,167
Depreciation of property and equipment	6	32,642	18,112
Qualifying transaction costs	4	-	676,255
Stock-based compensation	9	738,000	402,885
Loss before the undernoted items		(3,952,558)	(8,458,574)
Other income (expense)			
Investment tax credits	12(c)	-	330,000
Government assistance - wage subsidy	12(a)	-	307,307
Forgivable portion of CEBA Term Loan	7	-	11,804
Interest income		58,652	2,381
Foreign exchange gain (loss)		(34,408)	1,005
		24,244	652,497
Net loss and comprehensive loss for the year		(3,928,314)	(7,806,077)
Basic and diluted loss per share		(0.05)	(0.19)
Weighted average shares outstanding	8	82,444,752	42,110,808

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' (DEFICIENCY) EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

	Note	Number of Shares	Common Shares \$	Contributed Surplus \$	Warrants \$	Deficit \$	Total \$
Balance, December 31, 2020		42,000,000	15,248,419	1,113,378	-	(14,521,866)	1,839,931
Issued pursuant to Qualifying Transaction		2,444,752	771,580	44,395	-	-	815,975
Units issued pursuant to the Offering	8	20,000,000	6,312,140	-	3,687,860	-	10,000,000
Share issue costs - cash	8	-	(1,292,441)	-	-	-	(1,292,441)
Share issue costs - compensation options	8	-	(258,316)	-	258,316	-	-
Stock-based compensation	9	-	-	402,885	-	-	402,885
Management share bonus		18,000,000	5,680,926	-	-	-	5,680,926
Net loss for the year		-	-	-	-	(7,806,077)	(7,806,077)
Balance, December 31, 2021		82,444,752	26,462,308	1,560,658	3,946,176	(22,327,943)	9,641,199
Balance, December 31, 2021		82,444,752	26,462,308	1,560,658	3,946,176	(22,327,943)	9,641,199
Stock-based compensation	9	-	-	738,000	-	-	738,000
Net loss for the year		-	-	-	-	(3,928,314)	(3,928,314)
Balance, December 31, 2022		82,444,752	26,462,308	2,298,658	3,946,176	(26,256,257)	6,450,885

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

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

	Note	2022	2021
		\$	\$
Operating activities:			
Net loss for the year		(3,928,314)	(7,806,077)
Items not involving cash			
Depreciation expense	6	32,642	18,112
Forgivable portion of CEBA Term Loan	7	-	(11,804)
Qualifying transaction costs	4	-	676,255
Management share bonus		-	5,680,926
Stock-based compensation	9	738,000	402,885
Changes in non-cash working capital:			
Accounts and other amounts receivable		(211,316)	(64,888)
Investment tax credits recoverable		-	3,232
Inventory		(1,182,310)	(351,733)
Prepaid expenses and deposits		(316,775)	-
Government assistance receivable		-	41,633
Accounts payable and accrued liabilities		308,716	505,314
Cash flow used in operating activities		(4,559,357)	(906,145)
Investing activities			
Cash acquired on the Qualifying Transaction	4	-	165,726
Acquisition of equipment	6	(151,115)	(36,045)
Cash flow from (used in) investing activities		(151,115)	129,681
Financing activities:			
Advances of CEBA Term Loan	7	-	20,000
Proceeds from issuance of units	8	-	10,000,000
Issuance costs	8	-	(1,292,441)
Cash flow from financing activities		-	8,727,559
Net (decrease) increase in cash and cash equivalents		(4,710,472)	7,951,095
Cash and cash equivalents at beginning of the year		9,297,999	1,346,904
Cash and cash equivalents at end of the year		4,587,527	9,297,999

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

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

1. Nature of business

SPARQ Systems Inc. (formerly SPARQ Corp.) (the “**Company**”) was incorporated under the *Business Corporations Act* (Ontario) on November 13, 2018. On December 31, 2021, the Company completed its qualifying transaction pursuant to the rules of the TSX Venture Exchange (the “**Qualifying Transaction**”), resulting in a reverse takeover of the Company by SPARQ Systems Inc. (“**SPARQ**”). The Qualifying Transaction was completed by way of a three-cornered amalgamation (the “**Amalgamation**”) pursuant to which, among other things, (i) SPARQ amalgamated with a wholly-owned subsidiary of the Company, incorporated for the purposes of the Amalgamation, pursuant to the provisions of the *Business Corporations Act* (Ontario), and (ii) all of the outstanding common shares in the capital of SPARQ (the “**SPARQ Shares**”) were cancelled and, in consideration therefor, the holders thereof received post-consolidation common shares in the capital of the Company on a 1:1 basis.

Prior to the completion of the Qualifying Transaction, the Company changed its name to “SPARQ Corp.” and consolidated its common shares on a 1.25:1 basis (the “**Consolidation**”). In addition, SPARQ completed a consolidation of the SPARQ Shares on a 10.8085146:1 basis.

In connection with the Qualifying Transaction, on December 22, 2021, SPARQ completed a brokered private placement of subscription receipts (each, a “**Subscription Receipt**”) at a price of \$0.50 per Subscription Receipt, pursuant to which SPARQ issued an aggregate of 20,000,000 Subscription Receipts for aggregate gross proceeds of \$10,000,000 (the “**Offering**”). Concurrent with closing of the Qualifying Transaction, each Subscription Receipt was converted into units of the Company (each, a “**Unit**”) consisting of one common share and one common share purchase warrant (the “**Warrants**”) with each such Warrant entitling the holder thereof to acquire one common share at an exercise price of \$0.75 per share for a period of 24 months from the date of issuance, pursuant to the provisions of a subscription receipt agreement entered into among the Company, SPARQ, Echelon Capital Markets (the “**Agent**”) and TSX Trust Company dated December 22, 2021. In connection with the Offering, 1,258,250 compensation options (the “**Compensation Options**”) were issued to members of the selling group, with each such Compensation Option being exercisable for one common share and one Warrant on the same terms as those issued pursuant to the Offering.

On January 1, 2023, the Company completed a short-form vertical amalgamation with SPARQ pursuant to the *Business Corporations Act* (Ontario) (the “**Vertical Amalgamation**”). Upon completion of the Vertical Amalgamation, the Company changed its name to “SPARQ Systems Inc.”

The Company designs and manufactures next generation single-phase microinverters for residential and commercial solar electric applications. The Company has developed a proprietary photovoltaic (“**PV**”) solution called the Quad; the Quad inverter optimizes four PV modules with a single microinverter, simplifying design and installation, and lowering cost for solar power installations when compared to existing market offerings.

The address of the Company’s registered and head office is 945 Princess Street, Box 212, Kingston, Ontario K7L 0E9. The common shares are listed for trading on the TSX Venture Exchange under the symbol “SPRQ” and the Warrants are listed for trading under the symbol “SPRQ.WT”.

The common shares are also quoted for trading on the OTCQX Best Market under the symbol “SPRQF”.

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

2. Basis of presentation, measurement, and consolidation

a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). These consolidated financial statements were authorized for issue by the Board of Directors of the Company on April 20, 2023.

b) Basis of presentation

These consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments and share-based compensation transactions which have been measured at fair value.

On December 31, 2021, the Company acquired all of the issued and outstanding securities of SPARQ, which resulted in the shareholders of SPARQ holding the majority of the issued and outstanding common shares. While the Company is the legal acquirer, SPARQ is the accounting acquirer since shareholders of SPARQ held and controlled the majority of the issued and outstanding common shares upon completion of the Qualifying Transaction. Accordingly, these consolidated financial statements are presented with SPARQ as the continuing entity.

c) Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, SPARQ and Sparq Systems (USA) Inc., the former of which was incorporated under the laws of the Province of Ontario and the latter of which was incorporated under the laws of the State of Delaware. Inter-company transactions and balances between the Company and its subsidiaries have been eliminated on consolidation. All subsidiaries have a reporting date of December 31. As previously disclosed, SPARQ amalgamated with the Company pursuant to the Vertical Amalgamation, resulting in the Company only having one wholly-owned subsidiary as of January 1, 2023.

Profit or loss and other comprehensive loss of subsidiaries acquired or disposed of during the year are recognized from the effective date of acquisition, or up to the effective date of disposal, as applicable

d) Functional and presentation currency

The functional currency of the Company and its subsidiaries is determined using the currency of the primary economic environment in which each entity operates. The functional and presentation currency of the Company and its subsidiaries is the Canadian dollar.

e) Going concern assumption

These consolidated financial statements have been prepared on a going concern basis in accordance with IFRS. The going concern basis of presentation assumes that 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. As at December 31, 2022, the Company had a deficit of \$26,256,257 (2021 - \$22,327,943) and, for the year then ended, incurred a net loss of \$3,928,314 (2021 - \$7,806,077) and negative cash flows from operating activities of \$4,559,357 (2021 - \$906,145). The Company has used debt and equity financing from both related and unrelated sources to supplement its operations and will continue to be reliant on additional debt and/or equity financing in order to fully develop its business plan.

Although the Company has been successful in raising funds to date, there can be no assurance that adequate or sufficient funding will be available in the future or available under terms acceptable to the Company, or that the Company will be able to generate sufficient returns from operations.

The ability of the Company to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities and commitments when due is dependent on the Company generating revenue and debt and/or equity financing sufficient to fund its cash flow needs.

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

3. Significant accounting policies

These circumstances indicate the existence of material uncertainty that casts significant doubt on the ability of the Company to meet its business plan and its obligations as they come due, and accordingly the appropriateness of the use of the accounting principles applicable to a going concern.

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 were not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported expenses and the classifications used in the consolidated statement of financial position. Such differences in amounts could be material.

a) Revenue recognition

The Company has adopted all of the requirements of IFRS 15 Revenue from Contracts with Customers (“**IFRS 15**”). IFRS 15 utilizes a methodical framework for entities to follow in order to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

The Company derives revenue from the sale of hardware, including microinverters and their associated peripherals. The Company recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Company’s activities as described below.

Revenue from hardware sales is recognized when the hardware is shipped, and when all significant contractual obligations have been satisfied. The customer has full discretion over the channel and price to sell the products, and there is no unfulfilled obligation that could affect the customer’s acceptance of the products. Once products are delivered to the Company’s customers, the risks of obsolescence and loss have been transferred to the customer, and either the customer has accepted the products in accordance with the sales order, the acceptance provisions have lapsed, or the Company has objective evidence that all criteria for acceptance have been satisfied.

Revenue from contracts with customers is recognized as earned, based on the Company’s performance obligation according to specific terms of the contract. Foreseeable losses, if any, are recognized in the year in which the loss is determined.

b) Warranty provision

The Company provides a warranty on its hardware devices against defects in material and workmanship for a period of 12 years from the date of purchase. The Company’s obligation during the warranty period is to either replace or repair a defective unit, at its sole option. Estimated costs associated with the repair or replacement are included in the Company’s direct cost of sales.

c) Inventory

Inventory is measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less any applicable variable selling costs. Cost is determined by the weighted average method and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventory to its present location and condition. The costs of conversion include direct material and labour costs, and a systematic allocation of fixed and variable overheads incurred in converting materials into finished goods.

Inventory is written down to its net realizable value when the cost of inventory is estimated to be unrecoverable due to obsolescence, damage, or declining selling prices. The Company makes estimates related to obsolescence, future selling prices, seasonality, customer behaviour, and fluctuations in inventory levels.

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(Expressed in Canadian dollars)

d) Property and equipment

Property and equipment are recorded at cost, net of accumulated depreciation and any accumulated impairment losses. Expenditures that materially increase the life of the assets are capitalized. Ordinary repairs and maintenance are expensed as incurred. Depreciation is calculated on a straight-line basis over the estimated useful life of the depreciable asset using the following terms and methods:

Computer software	-	straight line basis over 1 year
Computer equipment	-	straight line basis over 3 years
Furniture and fixtures	-	straight line basis over 5 years
Equipment	-	straight line basis over 5 years
Leasehold improvements	-	straight line basis over the life of the lease

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial year-end and adjusted prospectively, if appropriate. An item of equipment is de-recognized upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in net loss and comprehensive loss in the year the asset is derecognized.

e) Financial instruments

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provision of the financial instrument. Financial assets are de-recognized when the contractual rights to receive cash flows from the financial asset expire and financial liabilities are de-recognized when obligations under the contract expire, are discharged or cancelled. The Company's financial assets, which include cash and cash equivalents, accounts and other amounts receivable, investment tax credits recoverable, and government assistance receivable are classified as amortized cost. The Company's financial liabilities, which include accounts payable and accrued liabilities, advances from shareholders and term loan, are classified as amortized cost.

Financial assets are initially measured at fair value and subsequently measured at amortized cost using the effective interest method if both of the following conditions are met and they are not designated as FVTPL:

- i. the financial asset is held within a business model whose objective is to hold financial assets to collect contractual cash flows; and
- ii. the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding. All financial assets not classified as amortized cost as described above are measured at FVTPL.

Financial liabilities are initially measured at fair value, less any directly attributable transaction costs, and subsequently measured at amortized cost using the effective interest method.

Financial assets and financial liabilities are measured at fair value using a valuation hierarchy for disclosure of fair value measurements. The determination of the applicable level within the hierarchy of a particular asset or liability depends on the inputs used in the valuation as of the measurement date, notably the extent to which the inputs are market-based (observable) or internally derived (unobservable). Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs are inputs based on a company's own assumptions about market participant assumptions using the best information available. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

- Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities that a company has the ability to access at the measurement date.

SPARQ SYSTEMS INC. (FORMERLY, SPARQ CORP.)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

(Expressed in Canadian dollars)

- Level 2 - Valuations based on quoted inputs other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data.
- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

f) Impairment of non-financial assets

The carrying amount of the Company's non-financial assets is reviewed at each financial reporting date to determine whether there is any indication of impairment. If such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss. An impairment loss is recognized when the carrying amount of an asset or its cash-generating unit ("CGU") exceeds its recoverable amount. The recoverable amount of an asset or CGU is the greater of its fair value less cost to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is only reversed if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount, however, not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognized in previous years.

g) Foreign currency translation

Monetary assets and liabilities denominated in currencies other than functional currencies are translated into functional currencies at the rate of exchange in effect at the consolidated statement of financial position date. Non-monetary assets and liabilities are translated at the historical rates. Revenues and expenses are translated at the transaction date exchange rate. Foreign currency gains and losses resulting from translation are reflected in net loss and comprehensive loss for the year.

h) Taxes

Taxes are comprised of current and deferred tax. Income tax is recognized in the statements of loss and comprehensive loss except to the extent that it relates to items recognized directly in shareholders' (deficiency) equity, in which case the income tax is also recognized directly in shareholders' (deficiency) equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of 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 on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted at the consolidated statements of financial position dates and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable the assets can be recovered.

i) Stock-based compensation

The Company records stock-based compensation related to stock options granted using the estimated fair value of the options at the date of grant. The estimated fair value is expensed as benefits over the period in which the option holder unconditionally become entitled to the award.

The amount recognized as an expense is adjusted to reflect the number of awards for which the related service conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related services and non-market performance conditions at the vesting date. The corresponding charge is to contributed surplus. Any consideration paid on the exercise of stock options is credited to common shares.

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The Company estimates the fair value of Options using the Black-Scholes valuation model. This model requires the Company to make estimates and assumptions, including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of the price of the Company's common shares and the number of options that will be forfeited prior to vesting. Changes in these estimates and assumptions can materially affect the determination of the fair value of stock-based compensation and, consequently, the related amount recognized in the Company's consolidated statements of loss and comprehensive loss.

For equity-settled share-based payment transactions, the Company measures the goods and services received, and the corresponding increase in equity, directly, at the fair value of goods and services received, unless that fair value cannot be estimated reliably. If the Company cannot estimate reliably the fair value of the goods or services received, it measures their value by reference to the fair value of the equity instrument granted. Transactions measured by reference to the fair value of the equity instrument granted have their fair values re-measured each vesting and reporting date until fully vested.

j) Government assistance

The Company recognizes government assistance received, or estimated government assistance to be received, when there is reasonable assurance that the Company has complied and will continue to comply with all relevant conditions stipulated in funding arrangements. Assistance related to the acquisition of equipment is deducted from the cost of the related assets, while assistance related to current operations is recognized in the statement of loss and comprehensive loss.

k) Loss per share

The Company presents basic and diluted loss per share for its common shares, calculated by dividing the loss attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share is determined by adjusting the loss attributed to shareholders and the weighted average number of common shares outstanding for the effects of all options outstanding that may add to the total number of common shares to the extent that they are not anti-dilutive.

l) Research and development expenditures

Expenditures on research are expensed as incurred. Research activities include formulation, design, evaluation and final selection of possible alternatives, products, processes, systems or services. Development expenditures are expensed as incurred unless the Company can demonstrate all of the following: (i) the technical feasibility of completing the intangible asset so that it will be available for use or sale; (ii) its intention to complete the intangible asset and use or sell it; (iii) its ability to use or sell the intangible asset; and, (iv) how the intangible asset will generate probable future economic benefits. Among other things, the Company can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset; (v) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and, (vi) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

m) Leases

The Company assesses, at inception of a contract, whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset for a period of time, the Company assesses whether the customer has the following through the period of use:

- the right to obtain substantially all of the economic benefits from use of the identified asset; and
- the right to direct the use of the identified asset.

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Where the Company is a lessee in a contract that contains a lease component, the Company allocates the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

At the lease commencement date, the Company recognizes a right-of-use asset and a lease liability. The right-of-use asset is initially measured at cost. The cost of the right-of-use asset is comprised of the initial amount of the lease liability, any lease payments made at or before the commencement date less any lease incentives received, initial direct costs incurred by the Company, and an estimate of the costs to be incurred by the Company in dismantling and removing the underlying asset and restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.

After the commencement date, the Company measures all right-of-use assets by applying the cost model, whereby the right-of-use asset is measured at cost less accumulated depreciation and impairment losses and adjusted for any remeasurement of the lease liability. The right-of-use assets are depreciated using the straight-line method from the commencement date to the end of the lease term or the end of the useful life of the right-of-use asset.

The estimated useful life of the right-of-use assets are determined on the same basis as those of property and equipment. The determination of the depreciation period is dependent on whether the Company expects that the ownership of the underlying asset will transfer to the Company by the end of the lease term or if the cost of the right-of-use asset reflects that the Company will exercise a purchase option.

The lease liability is initially measured at the present value of the lease payments not paid at the lease commencement date, discounted using the interest rate implicit in the lease or the Company's incremental borrowing rate, if the interest rate implicit in the lease cannot be readily determined. The lease payments included in the measurement of the lease liability are comprised of fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or rate, amounts expected to be payable by the Company under a residual value guarantee, the exercise price of a purchase option that the Company is reasonably certain to exercise, and payment of penalties for terminating the lease if the lease term reflects the Company exercising an option to terminate the lease. After the commencement date, the Company measures the lease liability at amortized cost using the effective interest method.

The Company remeasures the lease liability when there is a change in the lease term, a change in the Company's assessment of an option to purchase the underlying asset, a change in the Company's estimate of amounts expected to be payable under a residual value guarantee, or a change in future lease payments resulting from a change in an index or a rate used to determine those payments. On re-measurement of the lease liability, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Company has elected not to recognise right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Company recognized the lease payments associated with these leases of \$5,225 (2021 - \$43,470) as an expense during the year ended December 31, 2022.

n) Share capital

Common shares are classified as equity. The share capital presents the amounts received upon issuance of shares. Incremental costs directly attributed to the issuance of shares are recognized as a deduction from the proceeds in equity in the year in which the transaction occurs.

o) Significant accounting judgments, estimates and assumptions

Estimated useful lives and depreciation of property and equipment

Depreciation of property and equipment is dependent upon estimates of useful lives which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

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Valuation of deferred tax assets

Deferred tax assets, including those arising from tax loss carryforwards, require management to assess the likelihood that the Company will generate sufficient taxable income in future periods in order to utilize recognized deferred tax assets. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows. In addition, future changes in tax laws could limit the ability of the Company to obtain tax deductions in future periods. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.

Going concern risk assessment

The assessment of the Company's ability to continue as a going concern and meet its liabilities for the ensuing year involves significant judgment based on expectation of future events that are believed to be reasonable under the circumstances.

Valuation of research and development costs and tax credits

The Company claims investment tax credits as a result of incurring scientific research and experimental development ("SR&ED") expenditures. Investment tax credits are recognized when the related expenditures are incurred, and there is reasonable assurance of their realization. Management has made a number of estimates and assumptions in determining the expenditures eligible for the investment tax credit claim. The Company's claim is subject to audit by Canada Revenue Agency who may allow more than the amount recorded or may disallow all or a portion of the amount recorded.

Fair value of stock options

Stock-based compensation expense is measured by reference to the fair value of the stock options at the date at which they are granted. Estimating fair value for granted stock options requires determining the most appropriate valuation model which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the option, volatility, dividend yield, interest rate, and rate of forfeitures and making assumptions about them. Expected volatility is estimated using price history of comparable companies that are publicly listed over the expected life of the options granted.

Expected credit losses

The Company's accounts receivables are typically short-term in nature, with the exception of holdbacks and the Company recognized an amount equal to the lifetime expected credit losses ("ECLs"). The Company measures ECLs based on historical experience and forecasted economic conditions. The amount of the ECLs is sensitive to changes in future circumstance and economic conditions.

Valuation of inventory

The Company's inventory is valued at the lower of average cost or net realizable value and management makes an estimate for any item that cannot be sold. If realization of inventory values differ from estimates, future earnings would be affected.

p) New accounting standards

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting periods commencing on or after January 1, 2022. Many are not applicable or do not have a significant impact to the Company and have been excluded. The adoption of the following did not have a significant impact.

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IAS 37, Provisions, Contingent Liabilities, and Contingent Assets IAS 37 – Provisions, Contingent Liabilities, and Contingent Assets was amended on May 14, 2020. The amendments clarify that when assessing if a contract is onerous, the cost of fulfilling the contract includes all costs that relate directly to the contract – i.e. a full-cost approach. Such costs include both the incremental costs of the contract (i.e. costs a company would avoid if it did not have the contract) and an allocation of other direct costs incurred on activities required to fulfill the contract – e.g. contract management and supervision, or depreciation of equipment used in fulfilling the contract. The amendments are effective for annual periods beginning on January 1, 2022.

IAS 16, Property, Plant and Equipment IAS 16 – Property, Plant and Equipment was amended on September 20, 2020. The amendments introduce new guidance, such that the proceeds from selling items before the related property, plant and equipment is available for its intended use can no longer be deducted from the cost. Instead, such proceeds are to be recognized in profit or loss, together with the costs of producing those items. The amendments are effective for annual periods beginning on January 1, 2022.

q) Standards, amendments and interpretations not yet effective

IFRS 10 – Consolidated Financial Statements (“**IFRS 10**”) and IAS 28 – Investments in Associates and Joint Ventures (“**IAS 28**”) were amended in September 2014 to address a conflict between the requirements of IAS 28 and IFRS 10 and clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business. The effective date of these amendments is yet to be determined; however early adoption is permitted.

IAS 1, Presentation of Financial Statements IAS 1 – Presentation of Financial Statements (“**IAS 1**”) was amended in January 2020 to provide a more general approach to the classification of liabilities under IAS 1 based on the contractual arrangements in place at the reporting date. The amendments clarify that the classification of liabilities as current or noncurrent is based solely on a company’s right to defer settlement at the reporting date. The right needs to be unconditional and must have substance. The amendments also clarify that the transfer of a company’s own equity instruments is regarded as settlement of a liability, unless it results from the exercise of a conversion option meeting the definition of an equity instrument. The amendments are effective for annual periods beginning on January 1, 2023.

4. Qualifying Transaction

On December 31, 2021, the Company completed the Qualifying Transaction, pursuant to which it acquired all of the issued and outstanding SPARQ Shares (Note 1). While the Company was the legal acquirer, SPARQ was the accounting acquirer since shareholders of SPARQ held and controlled the majority of the issued and outstanding common shares upon completion of the Qualifying Transaction. Accordingly, the consolidated financial statements are presented with SPARQ as the continuing entity.

The Qualifying Transaction was accounted for as an asset acquisition, as the assets acquired and liabilities assumed did not constitute a business, as defined in IFRS 3, Business Combinations. The total consideration was allocated to the fair value of the net assets acquired and liabilities assumed, as follows:

	Estimated fair value
Consideration Paid	\$
2,444,752 common shares at \$0.3156 per share	771,580
244,000 stock options at an exercise price of \$0.25	44,395
	<u>815,975</u>
Allocation	\$
Cash	165,726
Accounts payable	(26,006)
Net assets acquired	<u>139,720</u>

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In connection with the Qualifying Transaction, the Company recognized a listing expense in the amount of \$676,255 in the year ended December 31, 2021, such amount being equal to the consideration paid less the net assets acquired under the Qualifying Transaction.

5. Inventory

	2022	2021
Finished goods	\$ 153,262	\$ 155,932
Raw materials	1,805,317	388,802
	1,958,579	544,734
Provision	(246,938)	(15,403)
	\$ 1,711,641	\$ 529,331

Inventory expensed in cost of sales during the year ended December 31, 2022 was \$Nil (2021 - \$Nil). During the year ended December 31, 2022, inventory provision related to obsolescence of \$374,929 have been expensed within cost of sales (2021 - \$45,104).

6. Property and equipment

	Equipment \$	Furniture and fixtures \$	Computer equipment \$	Computer software \$	Leasehold improvements \$	Total \$
Cost						
Balance, December 31, 2020	376,243	24,826	58,278	-	-	459,347
Additions	29,695	-	-	6,350	-	36,045
Balance, December 31, 2021	405,938	24,826	58,278	6,350	-	495,392
Additions	110,504	2,201	12,756	2,500	23,154	151,115
Balance, December 31, 2022	516,442	27,027	71,034	8,850	23,154	646,507
Accumulated depreciation						
Balance, December 31, 2020	357,563	24,826	54,887	-	-	437,276
Depreciation	10,992	-	1,829	5,291	-	18,112
Balance, December 31, 2021	368,555	24,826	56,716	5,291	-	455,388
Depreciation	25,455	37	2,866	3,142	1,142	32,642
Balance, December 31, 2022	394,010	24,863	59,582	8,433	1,142	488,030
Net book value						
At December 31, 2021	37,383	-	1,562	1,059	-	40,004
At December 31, 2022	122,432	2,164	11,452	417	22,012	158,477

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7. Term loan

During the year ended December 31, 2020, the Company obtained an unsecured loan of \$40,000 in respect of the Canada Emergency Business Account (the “CEBA”). The loan bears interest at a rate of 0% per annum during the initial term. An additional, \$20,000 was received in 2021 under the same terms and conditions. No principal repayments are required during the initial term. If the Company has repaid 75% of the loans amount prior to December 31, 2023, the lender will forgive the remaining outstanding balance of the loans (on January 12, 2022, the Government of Canada announced an extension of the forgiveness repayment date for eligible CEBA loan holders in good standing from December 31, 2022 to December 31, 2023.). If a balance still exists at January 1, 2024, interest will commence at a rate of 5% per annum, payable monthly. Any balance remaining on the loans will be repayable in full on December 31, 2025. As at December 31, 2022, management had determined that it is likely that the non-forgivable portion of the loan will be repaid by December 31, 2023 and had recognized the \$10,000 forgivable portion of the arrangement in income during the year ended December 31, 2020.

8. Share capital

Authorized

An unlimited number of common shares

Issued

	Number of shares	Dollar Amount
	#	\$
Balance, December 31, 2020	42,000,000	15,248,419
Shares issued pursuant to Qualifying Transaction (note 4)	2,444,752	771,580
Management Bonus (ii)	18,000,000	5,680,926
Shares issued pursuant to Offering (i)	20,000,000	10,000,000
Valuation of warrants (i)	-	(3,687,860)
Share issue costs – cash (i)	-	(1,292,441)
Share issue costs - Compensation Options (i)	-	(258,316)
Balance, December 31, 2021 and December 31, 2022	82,444,752	26,462,308

- (i) On December 22, 2021, SPARQ completed a brokered private placement of Subscription Receipts, which converted into units of SPARQ (each, a “SPARQ Unit”) immediately prior to the completion of the Qualifying Transaction, with each SPARQ Unit consisting of one SPARQ Share and one common share purchase warrant (each, a “SPARQ Warrant”). Each SPARQ Warrant entitled the holder thereof to acquire one additional SPARQ Share at a price of \$0.75 per share for a period of 24 months. Upon completion of the Qualifying Transaction, the SPARQ Units were exchanged for Units on a one-for-one basis. The SPARQ Warrants were allocated an estimated fair value of \$3,687,860 using the Black-Scholes option pricing model using the weighted average assumptions of an expected forfeiture rate of 0%, a risk-free interest rate of 0.96%, an expected dividend yield of 0%, an expected stock price volatility of 152%, and an expected life of two years. In connection with the private placement, the Company paid commissions of \$856,072 and professional fees of \$436,369 which have been accounted for as share issuance costs.

In addition, the Company issued the Agent an aggregate of 1,258,250 Compensation Options. Each Compensation Option will be exercisable to acquire one Unit at \$0.50, consisting of one common share and one Warrant, for a period of 24 months. The Compensation Options issued were allocated an estimated fair value of \$258,316 using the Black-Scholes option pricing model using the same assumptions as the SPARQ Warrants above.

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- (ii) In accordance with the articles of SPARQ, upon completion of the Qualifying Transaction, the Company issued 18,000,000 common shares to certain eligible employees. 12,000,000 of such common shares were issued to Praveen Jain. As at December 31, 2022, an aggregate of 33,473,470 (2021 - 40,296,564) common shares were held in escrow. 33,045,470 of the shares are under a value escrow agreement dated December 31, 2021 and 428,000 common shares under the CPC escrow agreement dated July 12, 2019. In accordance with the value escrow agreement, 10% of the shares were released from escrow on the date of the final exchange bulletin, and then 15% released every 6 months. In accordance with the CPC escrow agreement, 25% of the shares were released from escrow on the date of the final exchange bulletin, and then 25% released every 6 months.

Loss per share

Loss per share is calculated by dividing loss by the weighted average number of common shares outstanding during the period. In computing diluted earnings per share, an adjustment is made for the dilutive effect of outstanding share options, warrants and other convertible instruments. In periods where a net loss is reported all outstanding options, warrants and other convertible instruments are excluded from the calculation of diluted loss per share, as they are all anti-dilutive.

9. Stock-based compensation

The Company has an omnibus equity incentive plan (the “**Omnibus Plan**”) which provides for a wide range of incentive awards, including Options, deferred share units (“**DSUs**”), restricted share units (“**RSUs**”), performance share units (“**PSUs**”) and other share-based awards (“**Other Share-Based Awards**”, and together with Options, DSUs, RSUs, PSUs, “**Awards**”) to attract, retain and motivate Employees, Directors, Officers and Consultants of the Company (as such terms are defined in the Omnibus Plan). The Omnibus Plan is a “rolling up to 10% and fixed up to 10%” Security Based Compensation Plan, as defined in Policy 4.4 - Security Based Compensation of the TSXV. The Omnibus Plan is a: (a) “rolling” plan pursuant to which the number of common shares that are issuable pursuant to the exercise of Options granted under the Omnibus Plan shall not exceed 10% of the issued and outstanding common shares as at the date of any Option grant; and (b) “fixed” plan under which the number of common shares that are issuable pursuant to all Awards other than Options granted under the Omnibus Plan and under any other security based compensation arrangement, in aggregate is a maximum of 8,244,475 common shares, in each case, subject to adjustment as provided in the Omnibus Plan and any subsequent amendment to the Omnibus Plan. Shareholders approved the adoption of the Omnibus Plan at the Company’s annual and special meeting held on June 1, 2022. The Omnibus Plan replaced the Company’s rolling stock option plan (the “**Legacy Plan**”).

The table below details all Options granted under the Omnibus Plan during the year ended December 31, 2022 and the year ended December 31, 2021. No DSUs, RSUs, PSUs or Other Share-Based Awards have been issued as of the date hereof.

	Number of Options	Weighted average exercise price
	#	\$
Balance, December 31, 2020	-	-
Granted pursuant to the initial public offering (i)	244,000	0.25
Granted (ii)	5,025,000	0.50
Balance, December 31, 2021	5,269,000	0.49
Expired	(132,000)	(0.25)
Granted (iii)	1,175,000	0.37
Balance, December 31, 2022	6,312,000	0.47

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- (i) In connection with the Company's CPC initial public offering completed on August 9, 2019, the Company granted Options to acquire up to an aggregate of 305,000 common shares at a price of \$0.20 per share to its directors and officers for a period of 10 years from the date of grant. Following the completion of the Consolidation and the Qualifying Transaction with SPARQ, the number of common shares issuable pursuant to the Options was reduced to 244,000 common shares and the exercise price per share was increased from \$0.20 to \$0.25 per share.
- (ii) On December 31, 2021, 5,025,000 options were granted to directors, officers and consultants, under the Legacy Plan with an exercise price of \$0.50 for a period of five years from the date of grant. Options issued were allocated an estimated fair value of \$1,263,994 using the Black-Scholes option pricing model to estimate the fair value using the weighted average assumptions of an expected forfeiture rate of 0%, a risk-free interest rate of 1.25%, an expected dividend yield of 0%, an expected stock price volatility of 123%, and an expected life of five years.
- (iii) On February 24, 2022, 275,000 Options were granted to a director under the Legacy Plan with an exercise price of \$0.50 for five years. Options issued were allocated an estimated fair value of \$53,224 using the Black-Scholes option pricing model to estimate the fair value using the same weighted average assumptions in (ii) above.
- (iv) On November 22, 2022, 400,000 Options were granted to a VP with an exercise price of \$0.385 for a period of five years from the date of grant. Options issued were allocated an estimated fair value of \$133,889 using the Black-Scholes option pricing model to estimate the fair value using the weighted average assumptions of an expected forfeiture rate of 0%, a risk-free interest rate of 3.05%, an expected dividend yield of 0%, an expected stock price volatility of 132%, and an expected life of five years.
- (v) On December 1, 2022, 500,000 Options were granted to the Company's Country Manager of India with an exercise price of \$0.285 for a period of five years from the date of grant. Options issued were allocated an estimated fair value of \$123,891 using the Black-Scholes option pricing model to estimate the fair value using the weighted average assumptions of an expected forfeiture rate of 0%, a risk-free interest rate of 3.05%, an expected dividend yield of 0%, an expected stock price volatility of 132%, and an expected life of five years.

The underlying expected stock price volatility for the calculation of the fair value of the Options is based on historical data of similar companies, as the Company has limited historical data itself on which it could be based. The risk-free interest rate is based on the yield of a Government of Canada benchmark bond in effect at the time of grant with an expiry commensurate with the expected life of the options.

The Options have various vesting terms. In total, \$738,000 (2021 – \$402,885) of stock-based compensation expense relating to Options was included in the consolidated statements of loss and comprehensive loss for the year ended December 31, 2022 and credited to contributed surplus.

As at December 31, 2022 the Company had the following Options outstanding:

Number of Options Outstanding	Exercise Price (\$'s)	Expiry Date	Number of Options Exercisable	Weighted Average Remaining Life (years)
112,000	0.25	8/9/2029	112,000	6.61
5,025,000	0.50	12/31/2026	3,533,335	4.00
275,000	0.50	02/24/2027	220,000	4.15
400,000	0.385	11/22/2027	-	4.90
500,000	0.285	12/01/2027	-	4.92
6,312,000			3,865,335	4.18

The weighted average exercise of the Options is \$0.47 (2021 - \$0.49).

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10. Related party transactions

- (a) As at December 31, 2022, accounts payable and accrued liabilities included \$37,601 (2021 - \$181,620) payable to certain shareholders of the Company, which are non-interest bearing, unsecured and due on demand.
- (b) During the year ended December 31, 2021, the Company converted \$2,989,700 of unsecured advances from shareholders (Note 8) into common shares of the Company. These advances were non-interest bearing and due on demand.
- (c) During the year ended December 31, 2022, the Company was charged \$300,000 (2021 - \$140,000) for consulting services provided by PE Consultants Inc., an entity which is controlled by Praveen Jain, the Chief Executive Officer of the Company. These expenses have been recorded in research and development and general and administrative expenses.
- (d) During the year ended December 31, 2022, the Company was charged \$38,500 (2021 - \$18,000) for consulting services provided by CFO Advantage Inc., an entity which is controlled by Kyle Appleby, the Chief Financial Officer of the Company. These expenses have been recorded in general and administrative expenses.
- (e) On June 16, 2022, the Company signed a manufacturing agreement (the “**Manufacturing Agreement**”) with Ti-Lane Precision Electronic Company Limited (“**Ti-Lane**”) to manufacture turn-key Q1200 microinverters for the Company on a high volume basis at Ti-Lane’s facility based in Guangdong Province, China. The Manufacturing Agreement has an initial term of three years and will automatically renew for additional one year terms after expiration of the initial term unless terminated earlier by either the Company or Ti-Lane. Ti-Lane is a shareholder in the Company and is controlled by Baojun (Robbie) Luo, one of the Company’s directors. During the year ended December 31, 2022, the Company was charged \$268,552 by Ti-Lane.
- (f) Transactions with related parties are incurred during the course of normal operations and initially recorded at fair value. Key management includes directors and officers of the Company. Compensation awarded to key management was comprised of the following for the years ended December 31, 2022 and 2021:

	2022	2021
Short-term compensation	\$ 338,500	\$ 140,000
Management share bonus	-	3,787,284
Share-based payments	727,727	402,885
Total	\$ 1,066,227	\$ 4,330,169

11. Taxes

The reconciliation of the combined Canadian federal and provincial statutory income tax rate of 26.5% (2021 - 26.5%) to the effective tax rate is as follows:

	2022	2021
Net Income (Loss) before recovery of income taxes	\$ (3,928,314)	\$ (7,806,077)
Expected income tax (recovery) expense	\$ (1,041,003)	\$ (2,068,610)
Non-deductible for tax purposes	889	210
Stock based compensation	195,570	1,612,210
True-up	234,812	(61,447)
Tax benefits not recognized	609,732	517,637
Income tax (recovery) expense	\$ -	\$ -

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

Current tax (recovery) expense	\$	-	\$	-
Deferred tax (recovery) expense		-		-
	\$	-	\$	-

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities. Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

At December 31, 2022 and 2021 the Company had unrecognised deductible temporary differences as follows:

	2022		2021	
Non-capital losses carried forward	\$	11,876,247	\$	8,784,780
Equipment		528,868		1,163,398
Share issuance costs		1,085,105		1,240,606
SRED and ITCs		4,697,152		4,682,770
	\$	18,187,372	\$	15,871,554

The Company's unused deductible SR&ED expenditures can be carried forward to reduce taxable income in future years. The Company's non-capital losses that may be used to reduce taxable income in future years with expiry between 2035-2042 and SR&ED tax credit will expire between 2030-2035 that may be used to reduce future provincial income tax payable. The Company's Canadian non-capital income tax losses expire as follows:

2035	2,838,423
2036	2,131,899
2037	403,622
2038	921,672
2039	599,309
2040	603,753
2041	1,286,102
2042	3,464,467
	\$ 12,249,247

12. Government assistance

- (a) During the year ended December 31, 2022, the Company submitted applications in the amount of \$Nil (2021 - \$307,307) under the Canada Emergency Wage Subsidy and Temporary Wage Subsidy program. Of the amount submitted, \$Nil (2021 - \$Nil) is included in government assistance receivable as at December 31, 2022.
- (b) During the year ended December 31, 2022, the Company submitted applications in the amount of \$Nil (2021 - \$39,761) under the Canada Emergency Rent subsidy program. The funds applied for under the program were recognized as a reduction of rent on the Company's consolidated financial statements.
- (c) During the year ended December 31, 2022, the Company accrued \$330,000 (2021 - \$330,000) of SR&ED tax credits on eligible expenditures incurred in 2021.

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13. Commitments and contingencies

Commitments

On July 31, 2013, the Company entered into a licensing agreement with PARTEQ Research and Development Innovations (“**PARTEQ Agreement**”) for commercial rights to certain power generation, conversion, and switching technologies used in its products. Pursuant to the terms of the PARTEQ Agreement, the Company is obligated to pay 1% of specified net sales generated from the sale of products using the licensed technology. During the year-ended December 31, 2022, the Company paid licensing fees of \$Nil (2021 - \$771).

Contingencies

From time to time, the Company may be involved in litigation relating to claims arising out of operations in the normal course of business. As at December 31, 2022 and 2021, there were no pending or threatened lawsuits that could reasonably be expected to have a material effect on the results of the Company’s operations. There are also no proceedings in which any of the Company’s directors, officers or affiliates is an adverse party or has a material interest adverse to the Company’s interest.

14. Financial risk management

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Company mitigates these risks by assessing, monitoring and approving the Company’s risk management processes:

a) Credit risk

Credit risk is the risk of a potential loss to the Company if one party of a financial instrument fails to meet its contractual obligations. The maximum credit exposure as at December 31, 2022 and 2021 relates to the carrying amount of cash and cash equivalents, accounts receivable, investment tax credit recoverable, and government assistance receivable. To reduce credit risk, all significant cash balances are placed with major financial institutions and accounts receivable, investment tax credit receivable and government assistance receivable is due from the Government of Canada and therefore credit risk is low.

The Company provides credit to its customers in the normal course of its operations. It carries out, on a continuing basis, credit checks on its clients and maintains provisions for contingent credit losses which, once they materialize, are consistent with management’s forecasts. The maximum exposure to credit risk is the carrying value of the accounts receivable. The Company does not normally require a guarantee. As at December 31, 2022, 0% of the Company’s accounts receivables were comprised of outstanding balances from customers (2021- 0%).

The Company’s expected credit loss allowance is estimated using historical loss information, current industry conditions and payment practices, as well as reasonable and supportable forecasts of future economic conditions. Credit risk is assessed based on days outstanding and utilizes both internal credit assessments and publicly available credit information. As a result, the allowance reflects anticipated effects caused by recent market deterioration. As at December 31, 2022, the current expected credit loss allowance was \$Nil (2021 - \$Nil).

b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with financial liabilities. The Company manages liquidity risk through the effective management of its capital structure. The Company’s approach to managing liquidity is to ensure that it will have sufficient liquidity at all times to settle obligations and liabilities when due. The Company has the following contractual obligations:

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	Less than 1 year \$	1 to 3 years \$	3 to 5 years \$	Greater than 5 years \$	Total \$
Accounts payable and accrued liabilities	916,156	-	-	-	916,156
CEBA Term Loan	-	38,196	-	-	38,196
December 31, 2022	916,156	38,196	-	-	954,352

	Less than 1 year \$	1 to 3 years \$	3 to 5 years \$	Greater than 5 years \$	Total \$
Accounts payable and accrued liabilities	607,440	-	-	-	607,440
CEBA Term Loan	-	38,196	-	-	38,196
December 31, 2021	607,440	38,196	-	-	645,636

Interest

c) Interest rate risk

Interest rate risk relates to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's financial liabilities are non-interest bearing at December 31, 2022 and 2021, and therefore the Company is not exposed to interest rate risk.

d) Foreign exchange risk

The Company is exposed to foreign exchange risk from various currencies, primarily the US dollar. Foreign exchange risk arises from sales and purchase transactions as well as recognized financial assets and liabilities that are denominated in a currency other than the Canadian dollar, which is the functional currency of the Company.

The Company's primary objective in managing its foreign exchange risk is to preserve sales values and cash flows and reduce variations in performance. Although management monitors exposure to such fluctuations, it does not employ any external hedging strategies to counteract the foreign currency fluctuations.

The following amounts were denominated in foreign currency:

	Currency	December 31, 2022	December 31, 2021
Cash	US Dollar	\$ 20,089	\$ 2,744
Accounts Receivable	US Dollar	\$ 5,685	\$ 5,685
Accounts Payable	US Dollar	\$ 516,824	\$ 121,834

On December 31, 2022, an increase of 1% in the value of US dollar will result in a gain of \$272 (2021 - \$35) in the value of cash, \$77 (2021 - \$72) in accounts receivable and loss of \$6,700 (2021 - \$1,545) in accounts payable. Similarly, a decrease of 1% in the value of US dollar will have similar effects but in opposite direction.

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15. Capital management

The Company's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can provide returns for shareholders. The Company considers the items included in shareholders' equity of \$6,450,885 as capital, as at December 31, 2022 (2021 - \$9,641,199). The Company manages the capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Company's primary objective with respect to its capital management is to ensure that it has sufficient cash resources to fund the Company's business. To secure the additional capital necessary to pursue these plans, the Company intends to raise additional funds through equity or debt financing. The Company is not subject to any capital requirements imposed by a regulator.

16. Subsequent events

On January 1, 2023 the Company completed the Vertical Amalgamation. Upon completion of the Vertical Amalgamation, the Company changed its name from "SPARQ Corp." to "SPARQ Systems Inc."