

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2003 AND 2002

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Solucorp Industries Ltd. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Solucorp Industries, Ltd. and Subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' deficiency, 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 consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Solucorp Industries, Ltd. and Subsidiaries as of December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company is subject to a number of significant risks and uncertainties, including, among other things, net losses incurred of approximately \$3,889,000 in 2003 and \$1,630,000 in 2002, and working capital deficiency of \$3,460,000 and stockholders' deficiency of \$3,374,000 at December 31, 2003. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with regards to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of these risks and uncertainties.

Rachlin Cohen & Holtz LLP

Fort Lauderdale, Florida
November 20, 2004

Rachlin Cohen & Holtz LLP

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SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u>
Current Assets:		
Accounts receivable - trade	\$ 27,230	\$ 52,350
Advances receivable from stockholder/directors	157,396	175,464
Inventories, net	283,640	307,391
Prepaid expenses and other	<u>-</u>	<u>46,320</u>
Total current assets	468,266	581,525
Property and Equipment	3,064	9,562
Patents, Net	<u>83,599</u>	<u>67,819</u>
Total assets	<u>\$ 554,929</u>	<u>\$ 658,906</u>
<u>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</u>		
Current Liabilities:		
Bank overdraft	\$ 12,112	\$ 566
Accounts payable	1,772,664	1,536,303
Accounts payable - related parties	56,866	54,805
Payroll taxes payable	784,840	456,915
Accrued expenses	679,939	505,365
Deferred wages	394,275	554,045
Stockholder loans payable	228,018	331,083
Revolving line of credit - stockholder	<u>-</u>	<u>160,413</u>
Total current liabilities	<u>3,928,714</u>	<u>3,599,495</u>
Commitments, Contingencies and Other Matters	-	-
Stockholders' Deficiency:		
Common stock, no par value; 200,000,000 shares authorized, 29,471,485 and 25,923,960 shares issued and outstanding	24,467,996	20,800,310
Accumulated deficit	(29,026,857)	(25,137,389)
Accumulated comprehensive income	1,391,743	1,396,490
Unamortized stock-based compensation	<u>(206,667)</u>	<u>-</u>
Total stockholders' deficiency	<u>(3,373,785)</u>	<u>(2,940,589)</u>
Total liabilities and stockholders' deficiency	<u>\$ 554,929</u>	<u>\$ 658,906</u>

See notes to consolidated financial statements.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2003 AND 2002

	<u>2003</u>	<u>2002</u>
Revenue	\$ 60,529	\$ 178,622
Cost of Sales	<u>23,751</u>	<u>114,284</u>
Gross Profit	<u>36,778</u>	<u>64,338</u>
Operating Expenses:		
Selling, general and administrative (including stock-based compensation of \$1,857,600 and \$9,700, respectively)	2,810,167	1,426,843
Consulting fees - related parties	437,805	212,300
Depreciation and amortization	<u>10,893</u>	<u>13,742</u>
	<u>3,258,865</u>	<u>1,652,885</u>
Loss from Operations	<u>(3,222,087)</u>	<u>(1,588,547)</u>
Other Expenses:		
Interest expense	(666,968)	(46,258)
Other income (expense)	<u>(413)</u>	<u>5,218</u>
	<u>(667,381)</u>	<u>(41,040)</u>
Net Loss	<u>\$(3,889,468)</u>	<u>\$(1,629,587)</u>
Net Loss Per Common Share	<u>\$ (0.15)</u>	<u>\$ (0.06)</u>

See notes to consolidated financial statements.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

	Common Stock		Accumulated Deficit	Unamortized Stock-based Compensation	Accumulated Comprehensive Income	Total
	Shares	Amount				
Balance, December 31, 2001	25,923,690	\$20,774,601	\$(23,507,802)	-	\$ 1,396,699	\$ (1,336,502)
Year ended December 31, 2002:						
Net loss	-	-	(1,629,587)	-	-	(1,629,587)
Foreign currency translation adjustments	-	-	-	-	(209)	(209)
Total comprehensive loss	-	-	(1,629,587)	-	(209)	(1,629,796)
Stock-based compensation	-	9,716	-	-	-	9,716
Stock options issued in connection with stockholder loans	-	15,993	-	-	-	15,993
Balance, December 31, 2002	25,923,690	20,800,310	(25,137,389)	-	1,396,490	(2,940,589)
Year ended December 31, 2003:						
Net loss	-	-	(3,889,468)	-	-	(3,889,468)
Foreign currency translation adjustments	-	-	-	-	(4,747)	(4,747)
Total comprehensive loss	-	-	(3,889,468)	-	(4,747)	(3,894,215)
Exercise of stock options	355,000	35,500	-	-	-	35,500
Beneficial conversion feature of convertible debt	-	538,462	-	-	-	538,462
Conversion of convertible debt into common stock	2,925,795	1,000,000	-	-	-	1,000,000
Stock-based compensation	1,942,000	2,064,276	-	(206,667)	-	1,857,609
Stock options issued in connection with stockholder loans	-	29,448	-	-	-	29,448
Cancellation of shares held in trust	(1,675,000)	-	-	-	-	-
Balance, December 31, 2003	\$29,471,485	\$24,467,996	\$(29,026,857)	\$(206,667)	\$ 1,391,743	\$ (3,373,785)

See notes to consolidated financial statements.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2003 AND 2002

	<u>2003</u>	<u>2002</u>
Cash Flows from Operating Activities:		
Net loss	\$(3,889,468)	\$(1,629,587)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	44,729	13,742
Stock-based compensation	1,857,609	9,716
Amortization of beneficial conversion feature	538,462	-
Amortization of discount on stockholder loans	37,006	8,436
Settlement of related party notes receivable	89,920	155,685
Changes in operating assets and liabilities:		
Decrease (Increase) in:		
Accounts receivable	25,120	(2,350)
Inventories	23,751	101,734
Prepaid expenses and other assets	46,320	(46,614)
Increase in:		
Accounts payable and accrued expenses	579,163	844,688
Net cash used in operating activities	<u>(647,388)</u>	<u>(544,550)</u>
Cash Flows from Investing Activities:		
Patent expenditures	(54,011)	(13,977)
Proceeds from the sale of securities	-	27,345
Net cash provide by (used in) investing activities	<u>(54,011)</u>	<u>13,368</u>
Cash Flows from Financing Activities:		
Proceeds from issuance of convertible debenture	1,000,000	-
Proceeds from stockholder loans	37,500	320,000
Principal payments on stockholder loans	(217,987)	-
Net draws (payments) on line of credit	(160,413)	212,100
Proceeds from exercise of stock options	35,500	-
Increase (decrease) in bank overdraft	11,546	(709)
Net cash provided by financing activities	<u>706,146</u>	<u>531,391</u>
Effect of currency translation on cash and cash equivalents	<u>(4,747)</u>	<u>(209)</u>
Net Increase (Decrease) in Cash	-	-
Cash, Beginning	-	-
Cash, Ending	<u>\$ -</u>	<u>\$ -</u>
Supplemental Disclosure of Cash Flow Information:		
Interest paid	<u>\$ 52,750</u>	<u>\$ -</u>

See notes to consolidated financial statements.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Solucorp Industries, Ltd. ("the Company"), incorporated under the laws of the Territory of Yukon, Canada (formerly World Tec Industries, Inc.), was formed through a merger of Livingstone Energy Corp. and Intelicom Systems, Ltd. on June 30, 1987. On April 4, 1997, the Company changed its corporate domicile from British Columbia to the Yukon Territory.

On December 4, 1992, the Company acquired Environmental Training Institute, Inc. ("ETI"), a wholly owned subsidiary, incorporated under the laws of New Jersey. In February 2002, the Company changed the name of ETI to Integrated Fixation System Co. ("IFS").

On May 7, 1991, the Company formed EPS Environmental, Inc. ("EPS") d/b/a Solucorp Industries, a wholly owned subsidiary, incorporated under the laws of British Columbia.

Business

The Company is focused on the development, sales and marketing of technologies and services as solutions to problems within the environmental industry marketplace.

Principles of Consolidation

The consolidated financial statements include the accounts of Solucorp Industries, Ltd. and its wholly-owned subsidiaries, EPS and IFS. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition

Revenue from the sale of products, which contain the Company's patented solutions, is recognized when the product is shipped, all of the Company's obligations have been fulfilled, and collection is reasonably assured.

Revenue from the Company's licensing agreement is recognized at the time costs are incurred, sales are completed, or profits are realized related to the remediation and sale of sites owned by its exclusive licensee in accordance with the license agreement described in Note 13.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The financial statements and related disclosures are prepared in conformity with U.S. accounting principles. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses during the period reported. These estimates include assessing the estimated useful lives of tangible assets. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the financial statements in the period they are determined to be necessary. Although these estimates are based on management's knowledge of current events and actions it may undertake in the future, they may ultimately differ from actual results.

Inventory

Inventory is valued at the lower of cost or market. Cost is determined on a first-in, first-out basis, and market is determined on net realizable value.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed principally using the straight-line method for financial reporting purposes and accelerated methods for income tax purposes. Estimated useful lives for financial reporting purposes range from five to seven years. Expenditures which significantly extend useful asset lives are capitalized. Repairs and maintenance are charged to expense as incurred.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Research and Development

The cost of research and development is expensed as incurred. The Company incurred \$5,918 and \$0 in research and development costs during 2003 and 2002, respectively.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures About Fair Value of Financial Instruments", requires disclosure of the fair value information, whether or not recognized in the balance sheet, where it is practicable to estimate that value. The amounts reported for accounts receivable, prepaid expenses, loans payable, accounts payable and accrued expenses approximate their fair value because of their short maturities.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreign Currency Translation

The Company has selected the U.S. dollar as its consolidated reporting currency. The local currency of the countries where subsidiaries conduct operations is considered the functional currency for each entity. The Company's Canadian subsidiary translates its asset and liability accounts using the exchange rate in effect at the balance sheet date and results of operations using the average exchange rates prevailing during the year. Adjustments arising from these translations are included in accumulated comprehensive income, which is a separate component of consolidated stockholders' deficiency. Translation effects of this affiliate are accumulated as part of the consolidated balance sheets. Gains and losses for all affiliates from foreign currency transactions are included in general expenses in the accompanying combined statements of operations. The net effects on changes in cash are separately identified in the combined statements of cash flows.

Comprehensive Income

The Company accounts for comprehensive income in accordance with Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." Amounts are reported net of income taxes, if any, and include gains and losses on foreign currency translation adjustments.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and accounts receivable. The Company's investment policy is to invest in low risk, highly liquid investments. At various times during the year, the Company had cash balances in excess of federally insured limits. The Company maintains its cash balances with high quality financial institutions, which management believes reduces such risk.

A significant portion of the Company's revenues for the years ended December 31, 2003 and 2002 were generated from four customers as follows:

	<u>2003</u>	<u>2002</u>
Customer A	65%	73%
Customer B	20%	8%
Customer C	15%	-
Customer D	-	14%
Total	<u>100%</u>	<u>95%</u>

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations, in accounting for its employee and board of director stock options rather than the alternative fair value accounting allowed by SFAS No. 123, "Accounting for Stock-Based Compensation". APB No. 25 provides that the compensation expense relative to the Company's employee stock options is measured based on the intrinsic value of the stock option.

SFAS No. 123 requires companies that continue to follow APB No. 25 to provide a pro forma disclosure of the impact of applying the fair value method of SFAS No. 123. The Company follows SFAS No. 123 in accounting for stock options issued to non-employees.

Earnings (Loss) Per Share

The Company has adopted SFAS Statement No. 128, "Earnings per Share". The statement establishes standards for computing and presenting earnings per share (EPS). It requires dual presentation of basic and diluted EPS on the face of the income statement. There is no presentation of diluted loss per share in 2002 or 2003 as the effect of common stock options were antidilutive. The Company's weighted average shares outstanding were 25,219,784 and 25,923,690 for 2003 and 2002, respectively. The difference between weighted average shares outstanding and actual shares outstanding is entirely due to weighting. Note 11 discusses the issuance of options to stockholders in relation to the issuance of stockholder notes and to employees, board members, and non-employees of the Company.

Pro forma information regarding net income and earnings per share is required by SFAS No. 123, "Accounting for Stock-Based Compensation," and has been determined as if the Company had accounted for its stock options under the fair value method of that Statement. The fair value for these options was estimated at the grant date using a Black-Scholes option pricing model with the following weighted average assumptions for 2003 and 2002, respectively: risk-free interest rates of 1.56% and 2.20%, dividend yields of 0% and 0%, volatility factors of the expected market price of the Company's common stock of 377% and 462%; and weighted average expected lives of the options of 2.0 and 2.6 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options. For purposes of pro forma disclosures, the estimated fair value of the options is expensed at the time of issuance since the options are exercisable immediately upon issuance.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings (Loss) Per Share (Continued)

\$133,000 of stock-based employee compensation cost is reflected in the Company's net loss for 2003, as certain options granted to employees had an exercise price less than the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee and director compensation.

	<u>2003</u>	<u>2002</u>
Net loss	\$(3,856,018)	\$(1,629,587)
Deduct: total stock-based compensation expense under fair determined value based method for all awards, net of related tax effects	<u>(167,766)</u>	<u>-</u>
Pro forma net loss	<u>\$(4,023,784)</u>	<u>\$(1,629,587)</u>
Basic loss per share:		
As reported	<u>\$ (0.15)</u>	<u>\$ (0.06)</u>
Pro forma	<u>\$ (0.15)</u>	<u>\$ (0.06)</u>

Intangible Assets

The Company's intangible assets consist of patents and patent applications related to the Company's technologies and are amortized over the lives of the patents. There were no intangibles with indefinite lives as of December 31, 2003 or 2002.

Income Taxes

The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes". SFAS No. 109 requires an asset and liability approach for financial reporting for income taxes. Under SFAS No. 109, deferred taxes are provided for temporary differences between the carrying values of assets and liabilities for financial reporting and tax purposes at the enacted rates at which these differences are expected to reverse.

Segment Information

The Company has adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports issued to stockholders. The Company operates in one segment for management reporting purposes.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued SFAS Statement No. 123(R), "*Share-Based Payment*," a revision of SFAS Statement No. 123, that will significantly change the accounting for employee stock options and other equity-based compensation. The standard requires companies to expense the fair value of stock options on the grant date and is effective for interim or annual periods beginning after June 15, 2005. In accordance with the revised statement, the Company will be required to recognize the expense attributable to stock options granted or vested subsequent to July 1, 2005.

In 2002, the Company adopted the disclosure provisions of SFAS No. 148, "*Accounting for Stock-Based Compensation - Transition and Disclosure* (an amendment to FASB Statement No. 123)." SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

In January 2003, the FASB issued FASB Interpretation No. 46, "*Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51*." In December 2003, the FASB issued FIN No. 46R, which clarified certain issues identified in FIN 46. FIN 46R requires an entity to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the entity does not have a majority of voting interests. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risks and rewards of ownership. The provisions of this statement apply at inception for any entity created after January 31, 2003. For an entity created before February 1, 2003, the provisions of this interpretation must be applied at the beginning of the first interim or annual period beginning after March 1, 2004.

The Company does not have any interest in variable interest entities and therefore the adoption of this standard is not expected to have an impact on the Company's financial position and results of operations.

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, "*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*." SFAS No. 149 amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*." SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have any impact on the Company's financial position, results of operations or cash flows.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In May 2003, the FASB issued SFAS No. 150, "*Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*." SFAS No. 150 requires that certain financial instruments, which under previous guidance were recorded as equity, be recorded as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets, and certain obligations that can be settled with shares of stock. The Company adopted SFAS No. 150 on June 1, 2003. The adoption of this statement did not have any effect on the Company's financial position, results of operations or cash flows.

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, "*Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*," an interpretation of SFAS No. 5, 57, and 107 and rescission of FASB Interpretation No. 34. This statement addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. This interpretation also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. The adoption of this statement did not have a significant impact on the Company's financial position or results of operations.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, "*Accounting for Costs Associated with Exit or Disposal Activities*." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS 146 became effective in the second quarter of fiscal 2003 and did not have a significant impact on the results of operations or financial position of the Company.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets*". SFAS No. 144, which was adopted by the Company in the first quarter of fiscal 2003, requires testing for recoverability of long-lived assets whenever events or circumstances indicate that the carrying value may not be recoverable. An impairment loss shall be recognized when the carrying value of a long-lived asset exceeds its fair value. The adoption of SFAS No. 144 did not have a material effect on the consolidated financial statements.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "*Accounting for Asset Retirement Obligations*". The statement addresses accounting for and reporting obligations relating to the retirement of long lived assets by requiring that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The statement was effective for the Company's financial statements for the year ended December 31, 2003. The adoption of SFAS No. 143 did not have a material effect on the consolidated financial statements.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

Also in June 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 requires companies to account for goodwill and other intangibles in the following manner. Intangible assets which are acquired shall be recognized and measured based on fair value. Recognized intangible assets are to be amortized over their useful life. Goodwill and intangible assets determined to have an indefinite life are not amortized. Intangible assets that are not amortized and goodwill shall be tested for impairment annually. The provisions of SFAS No. 142 were applied by the Company in the year ended December 31, 2003. The adoption of SFAS No. 142 did not have a material effect on the consolidated financial statements.

NOTE 2. SUMMARY OF SIGNIFICANT RISKS AND UNCERTAINTIES

U.S. Securities and Exchange Commission Matters

In December 1999, the U.S. Securities and Exchange Commission ("SEC") filed a civil injunction against the Company alleging that six senior officers and directors of the Company, including the then president, chief financial officer, directors, and an outside consultant, engaged in a deliberate and systematic scheme to defraud investors over a four-year period. The complaint alleged that the Company's senior management publicly announced contracts that did not exist, and materially overstated revenues for existing contracts. In 2003, the Company reached an agreement with the SEC, resulting in permanent suspensions or prohibitions of all but one of the parties named in the action.

Consulting Agreement

In April 2003, the Company renewed a consulting agreement with an individual who is subject to permanent injunction as a result of the SEC actions described above. The terms of the renewed agreement are substantially the same as the original agreement. See Note 13 for the terms of the agreement.

Employment Agreement

In August 2003, the Company entered into an employment agreement with the former President of the Company who is subject to permanent consent decrees as a result of the SEC actions described above. Under the terms of the agreement, the individual serves as the President of one of the Company's wholly-owned subsidiaries and main operating entity. See Note 13 for the terms of the agreement.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2. SUMMARY OF SIGNIFICANT RISKS AND UNCERTAINTIES (Continued)

Board Members Subject to SEC Action

Two members of the Company's board of directors are subject to permanent consent decrees as a result of the SEC actions described above. They and the Company were permanently enjoined from violating certain antifraud, reporting and rules for insiders provisions of the Exchange Act.

Tax Liens

The Company is delinquent on substantial amounts of payroll taxes. As a result, the Internal Revenue Service holds blanket liens on all of the Company's assets. See Note 13.

Going Concern

As of December 31, 2003, the Company reflected a stockholders' deficiency of \$3,373,785 and a working capital deficiency (deficiency of current assets over current liabilities) of \$3,460,448. The Company had negative cash flows from operations of \$647,338 and \$544,550 for the years ended December 31, 2003 and 2002, respectively.

The Company has encountered severe financial hardship over the last several years resulting from SEC and other litigation, and, as a consequence, has lost its bonding capabilities and is unable to raise enough capital to secure its own operating projects. These circumstances raise substantial doubt regarding the Company's ability to continue as a going concern. Management's plans regarding these issues and the Company's future depend on the following:

- The ability to continue to secure license agreements with third parties on its patented technology,
- The ability to sell its reagents directly to contractors for the remediation projects, and
- The ability to act as the general contractor on "Brownsfield" projects generated by its exclusive licensee.

There is no assurance that the Company will be successful in implementing its plans regarding these issues, or be able to raise sufficient capital or generate sufficient cash flows from operations to be able to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

NOTE 3. INVENTORIES

	<u>2003</u>	<u>2002</u>
Chemicals	\$ 435,440	\$ 459,191
Allowance for obsolete inventories	<u>(151,800)</u>	<u>(151,800)</u>
	<u>\$ 283,640</u>	<u>\$ 307,391</u>

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4. PROPERTY AND EQUIPMENT

	Estimated Useful Lives (Years)	<u>2003</u>	<u>2002</u>
Furniture and fixtures	5-7	\$ 67,005	\$ 67,005
Less: accumulated depreciation		<u>(63,941)</u>	<u>(57,443)</u>
		<u>\$ 3,064</u>	<u>\$ 9,562</u>

Depreciation expense was \$6,498 and \$9,345 for the years ended December 31, 2003 and 2002, respectively.

NOTE 5. PATENTS

	<u>2003</u>	<u>2002</u>
Issued patents	\$ 65,929	\$ 65,929
Patents pending	34,152	13,977
Accumulated amortization	<u>(16,482)</u>	<u>(12,087)</u>
	<u>\$ 83,599</u>	<u>\$ 67,819</u>

Amortization expense for patents was \$4,395 for each of the years ended December 31, 2003 and 2002.

Estimated amortization expense for the succeeding years ending December 31 is as follows:

2004	\$ 4,395
2005	6,672
2006	6,672
2007	6,672
2008	6,672
Thereafter	52,506

NOTE 6. REVOLVING LINE OF CREDIT – STOCKHOLDER

The Company has a revolving line of credit with a major stockholder in the amount of \$4,000,000. The outstanding balance on the line of credit bears interest at an annual rate of 8%. All monies drawn down on the line are due within one year. The line of credit is secured by the Company's patents. There was no outstanding balance on the line of credit as of December 31, 2003.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7. CONVERTIBLE DEBT

On various dates during 2003, the Company issued convertible debentures totaling \$1,000,000 to an unrelated party. The debentures accrued interest at 8% annually and had a maturity date in December 2005. The outstanding principal and interest on the debentures were convertible at any time into shares of the Company's common stock at a conversion rate equal to 65% of the closing price per share on the Over-the-Counter Bulletin Board on the date of conversion. On the dates of the issuances of the convertible debentures, the Company's common stock had closing prices per share on the Over-the-Counter Bulletin Board ranging from \$0.25 to \$1.29. Based on the terms of the beneficial conversion feature associated with the debentures, there was an intrinsic value associated with the beneficial conversion features estimated at \$538,462, which was charged to interest expense during 2003. During 2003, the holder of the debentures converted the principal amount of \$1,000,000 into 2,241,352 of the Company's common stock.

NOTE 8. NOTES PAYABLE – STOCKHOLDERS

	<u>2003</u>	<u>2002</u>
In November 2001, the Company issued a promissory note in the amount of \$10,000 to a stockholder. The note bears interest at 8% per annum and is due on demand.	\$ 11,800	\$ 10,900

In June 2002, the Company issued promissory notes totaling \$129,000 to various stockholders. The notes bear interest at a rate of 12% per annum and, for each \$1,000 of notes, granted the holders options to purchase up to 1,000 shares of the Company's common stock at an exercise price of \$.10 per share for a period of three years. The notes matured in October 2002, at which time the holders elected to extend the terms of the notes for an additional 180 days in exchange for additional options to purchase up to 1,000 shares of the Company's common stock at an exercise price of \$.10 per share for a period of three years for each \$1,000 of notes extended. The notes were extended for an additional six month period under the same terms and became due on demand in October 2003. The extensions of the maturity dates were accounted for as extinguishments of the original notes and the issuance of new notes in accordance with the requirements of EITF 96-19: Debtor's Accounting for a Modification or Exchange of Debt Instruments ("EITF 96-19"). On the dates of the original issues, extensions of the maturity dates, and the issuances of additional options, the Company's common stock had closing prices per share on the Over-the-Counter Bulletin Board of \$0.04, \$0.04, and \$0.11, respectively. Using the Black-Scholes valuation method, the Company estimated the value of the options on each respective date of grant and allocated a portion of the debt proceeds to the options. The value of the options has been accounted for as a discount on the notes and charged to interest expense over the terms of the notes. In 2004, certain stockholders utilized portions of their notes as payments on the exercise of their options.

	151,149	129,183
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SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8. NOTES PAYABLE – STOCKHOLDERS (Continued)

	<u>2003</u>	<u>2002</u>
<p>In January 2003, the Company issued a promissory note in the amount of \$50,000 to a stockholder. The note matured in 120 days and required an interest payment of \$5,000 on the date of maturity. The note remained unpaid as of December 31, 2003 and is secured by accounts receivables and inventory of the Company.</p>	50,643	-
<p>In October 2002, the Company issued promissory notes totaling \$200,000 to two stockholders. The notes bear interest at a rate of 12% per annum and, for each \$1,000 of notes, granted the holders options to purchase up to 1,000 shares of the Company's common stock at an exercise price of \$.50 per share for a period of three years. The notes matured in October 2003. On the date of issuance of the options, the Company's common stock had a closing price per share on the Over-the-Counter Bulletin Board of \$0.04. Using the Black-Scholes valuation method, the Company estimated the value of the options on the date of grant and allocated a portion of the debt proceeds to the options. The value of the options has been accounted for as a discount on the note and charged to interest expense over the terms of the notes.</p>	3,880	191,000
<p>In July 2003, the Company issued a promissory note in the amount of \$35,000 to a stockholder. The note bears interest at a rate of 12% per annum and granted the holder options to purchase up to 10,000 shares of the Company's common stock at an exercise price of \$.30 per share for a period of three years. The note matured in September 2003 and is due on demand. The note was cosigned by a related party consultant to the Company. On the date of issuance of the options, the Company's common stock had a closing price per share on the Over-the-Counter Bulletin Board of \$0.37. Using the Black-Scholes valuation method, the Company estimated the value of the options on the date of grant and allocated a portion of the debt proceeds to the options. The value of the options was charged to interest expense in 2003.</p>	<u>10,515</u> <u>\$228,018</u>	<u>-</u> <u>\$331,083</u>

NOTE 9. NON-CASH INVESTING AND FINANCING ACTIVITIES

During 2002, the Company issued options to purchase 461,080 shares of common stock at exercise prices ranging from \$0.10 to \$0.50 per share in connection with the issuance of debt to various stockholders. Using the Black-Scholes valuation method, the Company valued the options and allocated \$15,993 of the proceeds from the stockholder loans to the options, which is presented as a discount against the loans, and amortized over the terms of the loans.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9. NON-CASH INVESTING AND FINANCING ACTIVITIES (Continued)

During 2002, the Company issued options to purchase 255,000 shares of common stock at exercise prices ranging from \$0.10 to \$0.15 per share as consideration for consulting services. Using the Black-Scholes valuation method, the options were valued at \$9,716, which was charged to expense in 2002.

During 2003 and 2002, the Company settled \$89,920 and \$155,685, respectively, of notes receivable from related parties. The amounts were charged to expense as compensation.

In January 2003, a stockholder advanced \$50,000 to the holder of the Company's revolving line of credit. The transaction is presented as loan payable to the stockholder and loan receivable from the holder of the revolving line of credit, who is also a stockholder.

During 2003, the Company issued stock options to employees that had an intrinsic value of \$133,000 due to the exercise price of the options being less than the fair market value of the shares on the date of issuance. The total amount was charged to expense during 2003.

During 2003, the holder of the Company's convertible debt converted \$1,000,000 of principal into 2,925,795 shares of the Company's common stock.

During 2003, the Company issued options to purchase 3,875,908 shares of common stock at exercise prices ranging from \$0.10 to \$1.50 per share as consideration for consulting services. Using the Black-Scholes Option Pricing Model, the options were valued at \$481,776, which was charged to expense in 2003.

During 2003, the Company issued options to purchase 290,010 shares of common stock at exercise prices ranging from \$0.10 to \$0.30 per share in connection with the issuance of debt to various stockholders. The Company valued the options using the Black-Scholes valuation method, and allocated \$35,783 of the proceeds from the stockholder loans to the options, which is presented as a discount against the loans, and amortized over the terms of the loans.

During 2003, the Company issued 1,192,000 shares of common stock valued at \$1,217,000 to employees, consultants, and board members as consideration for services rendered. The total amount was charged to expense during 2003. The Company also issued 750,000 shares of common stock valued at \$232,500 pursuant to a three-year consulting agreement. The total value is being amortized over the three-year term of the agreement with the unamortized portion presented as a reduction of shareholders' equity (deficiency).

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10. INCOME TAXES

A reconciliation of income tax computed at the statutory federal rate to income tax expense (benefit) is as follows:

	<u>2003</u>	<u>2002</u>
Tax provision at the statutory rate of 35%	\$(1,349,606)	\$(570,356)
State income taxes, net of federal income tax	(185,745)	(78,491)
Change in valuation allowance	1,519,301	642,016
Permanent items	<u>16,050</u>	<u>6,831</u>
	<u>\$ -</u>	<u>\$ -</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets at December 31, 2003, and 2002 are presented below.

	<u>2003</u>	<u>2002</u>
Deferred tax assets:		
Net operating loss carryforward	\$ 7,560,528	\$ 6,041,227
Less valuation allowance	<u>(7,560,528)</u>	<u>(6,041,227)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Because of the historical losses incurred by the Company, the net deferred tax assets have been fully reduced by a 100% valuation allowance. The valuation allowance for the net deferred tax assets was approximately \$7.5 million and \$6 million as of December 31, 2003 and 2002, respectively.

At December 31, 2003, the Company had net operating loss carryforwards available for Federal tax purposes of approximately \$18,960,000. These carryforwards expire through 2023.

Under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), the utilization of net operating loss carryforwards is limited under the change in stock ownership rules of the Code. As a result of ownership changes, which occurred in June 2002, the Company's operating tax loss carryforwards are subject to these limitations. Future ownership changes could also further limit the utilization of any net operating loss carryforwards as of that date.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11. STOCK OPTIONS

The Company has issued common stock options to employees, consultants, stockholders and directors. A summary of the Company's stock options as of December 31, 2003 and 2002 is presented below:

	2003		2002	
	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at the beginning of the year	4,550,263		3,834,183	\$0.10
Granted	7,085,010	\$0.11	716,080	\$0.21
Exercised	<u>(355,000)</u>	\$0.10	-	-
Outstanding at the end of the year	<u>11,280,273</u>	\$0.11	<u>4,550,263</u>	\$0.11
Options exercisable at the end of the year	<u>11,280,273</u>	\$0.11	<u>4,550,263</u>	\$0.11
Weighted average fair value of options granted	<u>\$0.12</u>		<u>\$0.04</u>	

The following table summarizes information for stock options outstanding at December 31, 2003:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	<u>Number Outstanding at 12/31/03</u>	<u>Weighted- Average Remaining in years</u>	<u>Weighted- Average Exercise Price</u>	<u>Number Exercisable at 12/31/03</u>	<u>Weighted- Average Exercise Price</u>
0.10 – 0.15	10,530,273	2.87	\$0.10	10,530,273	\$0.10
0.16 – 0.20	500,000	1.55	0.20	500,000	0.20
0.21 – 0.30	10,000	2.52	0.30	10,000	0.30
0.50 – 0.75	220,000	1.78	0.52	220,000	0.52
1.00 – 1.50	20,000	1.95	1.50	20,000	1.50

NOTE 12. RELATED PARTY TRANSACTIONS

The Company entered into a consulting agreement with a member of a director's immediate family. See Note 13. Total expense related to this agreement amounted to \$374,490 and \$148,300 for the years ended December 31, 2003 and 2002, respectively.

The Company paid certain major stockholders and directors consulting fees, which amounted to \$63,315 and \$64,000 for the years ended December 31, 2003 and 2002, respectively.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12. RELATED PARTY TRANSACTIONS (Continued)

The Company has advanced amounts to stockholders and directors. The amounts advanced bear no interest and are due on demand. The outstanding balance of advances receivable from stockholders and directors amounted to \$157,396 and \$175,464 as of December 31, 2003 and 2002, respectively.

The Company's line of credit is provided by a significant stockholder of the Company.

NOTE 13. COMMITMENTS, CONTINGENCIES AND OTHER MATTERS

License Agreements

In June 1998, the Company entered into a license agreement, which was amended and restated in March 2000, with Geomar Holdings Ltd., LLC ("Geomar") granting Geomar exclusive worldwide marketing rights of the Company's soil remediation processes for the life of the Company's related patents, and granting the Company specific rights and compensation as general contractor for remediation projects secured by Geomar. The Company is compensated based upon a percentage of costs incurred in the soil remediation process, and proceeds and profits from the sale of remediated property. The Company earned revenues from the agreement of approximately \$12,000 and \$14,000 during the years ended December 31, 2003 and 2002, respectively.

On May 4, 2001, the Company entered into an agreement with BATG Environmental. The agreement gives exclusive rights to use and market the Solucorp Molecular Bonding System used in soil remediation. This agreement requires the licensee to purchase from the Company certain chemicals used in the Molecular Bonding System and sets specific volume requirements and prices on the purchases. The agreement expired on May 4, 2002 and was subject to automatic renewals if performance requirements in the agreement were met. The Company renewed the agreement until December 31, 2003.

On December 31, 1999 the Company signed an agreement with RAGN-Sells Avfallsbehandling AB, granting exclusive marketing and use rights to the Molecular Bonding System in specific European countries. The agreement requires the licensee to pay certain license fees as well as royalties to the Company for a period of two (2) years. The agreement was extended to December 31, 2002, and expired on that date.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13. COMMITMENTS, CONTINGENCIES AND OTHER MATTERS (Continued)

Legal Proceedings

SEC Lawsuit: On May 1, 1998, the SEC suspended trading and initiated an investigation into various matters concerning the Company. The SEC then proceeded to file a lawsuit against the Company and certain present and former directors, officers, and outside consultants. This lawsuit was followed by a number of class action suits, which were eventually consolidated into one class action suit and was subsequently dismissed. In March of 2003, the Company and three individual defendants reached a settlement with the SEC. The order in the civil injunctive action brought by the SEC found that certain officers and directors had violated the antifraud provision of the securities laws and permanently barred certain individuals from serving as an officer or director of any publicly traded company, as well as other injunctive relief.

EWT Lawsuit: The Company previously filed a lawsuit against Environmental Waste Technologies "EWT" for work successfully completed by the Company. In 2004, the Company received a default judgment of approximately \$960,000, inclusive of punitive damages, against EWT.

Other Lawsuit: On December 30, 2003, a judgment was entered in the Supreme Court, County of Rockland, against the Company in the amount of approximately \$130,000 for unpaid fees. The Company satisfied this judgment in full in 2004.

Tax Liens

The Company currently has liens filed against it for unpaid payroll taxes in the amount of \$449,782. The Company defaulted on a payment plan established with the Internal Revenue Service to liquidate this obligation and currently does not have an agreement in place.

Office Lease

In July 2001, the Company entered into a lease for office space in New York for a period of five years at an annual rent of \$60,000. In January 2003, the Company reached a settlement with the landlord regarding past due rent and other repairs, and based on this settlement stipulation, the Company has the following future minimum lease obligations:

2004	\$123,000
2005	33,000
2006	16,500

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13. COMMITMENTS, CONTINGENCIES AND OTHER MATTERS (Continued)

Consulting and Employment Agreements

In August 2003, the Company entered into an employment agreement with the President of a subsidiary for a ten (10) year term. The agreement calls for payment of \$150,000 per year with 10% increases per year for the entire term. In addition to the base salary, the Company is obligated to pay a bonus of \$100,000 to \$250,000 based on the profit of the Company, as well as granting options to purchase 140,000 shares of the Company's common stock at an exercise price of \$0.10 per share each year. Pursuant to the agreement, the Company issued to the President of the subsidiary options to purchase 700,000 shares of the Company's common stock at an exercise price of \$.10 per share, exercisable over two years. The President of the subsidiary was formerly the President of the parent company. The Board of Directors has authorized Richard Runco, the President of the Company, to renegotiate the employment agreement.

In April 2003, the Company entered into a consulting agreement with a related party (see below) in which the Company is obligated to pay \$150,000 per year, with 10% increases each year for a ten-year term. In addition, the Company is to pay an annual bonus of \$100,000 to \$250,000 based on the profit of the Company, as well as granting options to purchase 150,000 shares of the Company's common stock at an exercise price of \$0.10 per share each year. Pursuant to the agreement, the Company issued to the consultant options to purchase 800,000 shares of the Company's common stock at an exercise price of \$.10 per share, exercisable over two years. The consultant has been a consultant of the Company for several years and is a member of the immediate family of a director of the Company. The Board of Directors has authorized Richard Runco, the President of the Company, to renegotiate the consulting agreement.

NOTE 14. SUBSEQUENT EVENTS

Acquisition

On June 30, 2004, the Company entered into an acquisition agreement with a Florida company which owns or has licenses to certain industry patents. Under the agreement, the Company acquired all of the outstanding common stock of the Florida entity, as well as its patents and licenses, in exchange for 4,050,000 shares of restricted common stock of the Company. The Company, under a separate agreement, issued options to purchase 1,200,000 shares of the Company's common stock at an exercise price of \$1.75 per share to the management team of the acquired Florida company as an incentive to continue their services. The options expire at various times through 2008.

The Company plans to relocate its executive officers to the offices of the acquired Florida company.

SOLUCORP INDUSTRIES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14. SUBSEQUENT EVENTS (Continued)

Issuance of Convertible Debt

At various times from February 2004 through August 2004, the Company issued two-year 7% subordinated convertible debentures totaling approximately \$915,000. The debentures were converted into 687,590 shares of the Company's common stock in accordance with the terms of the debentures. The holders of the debentures also received warrants to purchase 687,590 shares of the Company's common stock at an exercise price of \$1.60 per share.