

QHR TECHNOLOGIES INC.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2004

(Unaudited – Prepared by Management)

QHR TECHNOLOGIES INC.
INTERIM CONSOLIDATED BALANCE SHEETS
June 30, 2004 and December 31, 2003
(Unaudited – Prepared by Management)

| | (Unaudited) June 30, <u>2004</u> | (Audited) December 31, <u>2003</u> |
|---|--|--|
| <u>ASSETS</u> | | |
| Current: | | |
| Cash | \$ 1,267,020 | \$ 422,072 |
| Accounts receivable | 684,676 | 798,589 |
| Prepaid expenses and deposits (Note 3(b)) | 141,828 | 43,570 |
| | <u>2,093,524</u> | <u>1,264,231</u> |
| Accounts receivable | 106,409 | 129,462 |
| Capital assets | 326,055 | 298,858 |
| Intangible assets (Note 3) | 306,167 | - |
| | <u>\$ 2,832,155</u> | <u>\$ 1,692,551</u> |
| <u>LIABILITIES</u> | | |
| Current: | | |
| Accounts payable and accrued liabilities | \$ 321,863 | \$ 282,696 |
| Current portion of long-term debt | 46,071 | 44,114 |
| | <u>367,934</u> | <u>326,810</u> |
| Deferred revenue | 1,567,560 | 1,101,547 |
| | <u>1,935,494</u> | <u>1,428,357</u> |
| Long-term debt | 206,174 | 211,585 |
| | <u>2,141,668</u> | <u>1,639,942</u> |
| <u>SHAREHOLDERS' EQUITY</u> | | |
| Share capital (Notes 2(b) and 4) | 4,809,939 | 3,924,645 |
| Deficit (Note 2(b)) | (4,119,452) | (3,872,036) |
| | <u>690,487</u> | <u>52,609</u> |
| | <u>\$ 2,832,155</u> | <u>\$ 1,692,551</u> |
| Subsequent events (Note 7) | | |

SEE ACCOMPANYING NOTES

QHR TECHNOLOGIES INC.
INTERIM CONSOLIDATED STATEMENTS OF EARNINGS AND DEFICIT
for the three months and six months ended June 30, 2004 and 2003
(Unaudited – Prepared by Management)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|--------------------|---------------------------|--------------------|
| | <u>2004</u> | <u>2003</u> | <u>2004</u> | <u>2003</u> |
| Revenue (Note 6): | | | | |
| Software license fees | \$ 296,586 | \$ 402,280 | \$ 481,568 | \$ 804,758 |
| Software services | 596,264 | 404,279 | 1,189,681 | 800,130 |
| Consulting services and other | 27,168 | 27,848 | 50,800 | 94,401 |
| | <u>920,018</u> | <u>834,407</u> | <u>1,722,049</u> | <u>1,699,289</u> |
| Expenses: | | | | |
| Sales and marketing (Schedule 1) | 229,991 | 119,991 | 376,340 | 236,588 |
| Service delivery (Schedule 2) | 278,982 | 233,395 | 519,290 | 408,120 |
| Administrative (Schedule 3) | 317,684 | 244,185 | 546,213 | 510,985 |
| Product management and development (Schedule 4) | 265,670 | 198,999 | 439,556 | 418,549 |
| | <u>1,092,327</u> | <u>796,570</u> | <u>1,881,399</u> | <u>1,574,242</u> |
| Earnings (loss) before minority interest: | (172,309) | 37,837 | (159,350) | 125,047 |
| Minority interest in earnings of subsidiary | - | (7,099) | - | (8,897) |
| Net earnings (loss) | (172,309) | 30,738 | (159,350) | 116,150 |
| Deficit, beginning of period | | | | |
| As reported | (3,947,143) | (4,213,731) | (3,872,036) | (4,299,143) |
| Change in accounting policy (Note 2(b)) | - | - | (88,066) | - |
| As restated | <u>(3,947,143)</u> | <u>(4,213,731)</u> | <u>(3,960,102)</u> | <u>(4,299,143)</u> |
| Deficit, end of period | \$ (4,119,452) | \$ (4,182,993) | \$(4,119,452) | \$ (4,182,993) |
| Basic and diluted earnings (loss) per share | \$ (0.01) | \$ 0.00 | \$ (0.01) | \$ 0.01 |
| Basic weighted average number of shares outstanding | 14,726,803 | 13,350,759 | 14,248,781 | 13,350,759 |
| Dilutive effect of stock options | 77,035 | 22,500 | 77,035 | 13,950 |
| Diluted weighted average number of shares outstanding | <u>14,803,838</u> | <u>13,373,259</u> | <u>14,325,816</u> | <u>13,364,709</u> |

SEE ACCOMPANYING NOTES

QHR TECHNOLOGIES INC.
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
for the three months and six months ended June 30, 2004 and 2003
(Unaudited – Prepared by Management)

| | Three months ended June, 30 | | Six months ended June 30, | |
|---|-----------------------------|------------------|---------------------------|-------------------|
| | <u>2004</u> | <u>2003</u> | <u>2004</u> | <u>2003</u> |
| Cash provided by (used in): | | | | |
| Operating Activities: | | | | |
| Cash received from customers | \$ 1,292,225 | \$ 641,836 | \$ 2,325,028 | \$ 1,491,356 |
| Cash paid to suppliers and employees | (998,649) | (821,968) | (1,809,351) | (1,472,841) |
| Interest paid | (4,405) | (1,263) | (9,046) | (1,263) |
| Income taxes paid | - | - | - | - |
| | <u>289,171</u> | <u>(181,395)</u> | <u>506,631</u> | <u>17,252</u> |
| Financing Activities: | | | | |
| Long-term debt proceeds | - | 118,687 | - | 118,687 |
| Decrease in due to related parties included in accounts payable and accrued liabilities | - | (10,000) | - | (20,000) |
| Long-term debt repayments | (11,142) | (3,085) | (23,468) | (3,085) |
| Proceeds from share subscriptions | - | - | 750,000 | - |
| | <u>(11,142)</u> | <u>105,602</u> | <u>726,532</u> | <u>95,602</u> |
| Investing Activities: | | | | |
| Acquisition of capital assets | (29,371) | (43,563) | (54,215) | (183,059) |
| Acquisition of intangible assets | - | - | (334,000) | - |
| | <u>(29,371)</u> | <u>(43,563)</u> | <u>(388,215)</u> | <u>(183,059)</u> |
| Minority interest in cash of subsidiary | - | 4,900 | - | 4,900 |
| Increase (decrease) in cash | 248,658 | (114,456) | 844,948 | 65,305 |
| Cash, beginning of period | 1,018,362 | 199,438 | 422,072 | 150,287 |
| Cash, end of period | <u>\$ 1,267,020</u> | <u>\$ 84,982</u> | <u>\$ 1,267,020</u> | <u>\$ 84,982</u> |
| Non-cash financing and investing Activities | | | | |
| Leasehold improvements financed by and landlord term loan | \$ 20,014 | \$ - | \$ 20,014 | \$ - |
| Share capital issued for share subscriptions | \$ 750,000 | \$ - | \$ 750,000 | \$ - |

SEE ACCOMPANYING NOTES

QHR TECHNOLOGIES INC.
INTERIM CONSOLIDATED OPERATING EXPENSES
for the three months and six months ended June 30, 2004 and 2003
(Unaudited – Prepared by Management)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|-------------------|---------------------------|-------------------|
| | <u>2004</u> | <u>2003</u> | <u>2004</u> | <u>2003</u> |
| Schedule 1 – SALES AND MARKETING | | | | |
| Amortization of intangible assets | \$ 27,833 | \$ - | \$ 27,833 | \$ - |
| Wages and benefits | 117,638 | 78,306 | 213,843 | 142,921 |
| Other | 84,520 | 41,685 | 134,664 | 93,667 |
| | <u>\$ 229,991</u> | <u>\$ 119,991</u> | <u>\$ 376,340</u> | <u>\$ 236,588</u> |
| Schedule 2 – SERVICE DELIVERY | | | | |
| Wages and benefits | \$ 229,675 | \$ 184,421 | \$ 436,189 | \$ 311,494 |
| Other | 49,307 | 48,974 | 83,101 | 96,626 |
| | <u>\$ 278,982</u> | <u>\$ 233,395</u> | <u>\$ 519,290</u> | <u>\$ 408,120</u> |
| Schedule 3 – ADMINISTRATIVE | | | | |
| Accounting and audit fees | \$ 15,000 | \$ 3,260 | \$ 23,500 | \$ 20,760 |
| Amortization | 24,191 | 14,168 | 47,032 | 25,827 |
| Consulting fees | 31,000 | 52,059 | 61,000 | 95,684 |
| Directors' fees | 7,250 | 3,000 | 9,750 | 3,000 |
| Foreign exchange | (1,147) | 5,174 | (952) | 5,174 |
| Interest and bank charges | 407 | 5,714 | (286) | 6,424 |
| Interest on long-term debt | 4,405 | 1,263 | 9,046 | 1,263 |
| Legal fees | 7,231 | 13,900 | 22,143 | 32,199 |
| Office and miscellaneous | 53,308 | 34,708 | 92,166 | 81,542 |
| Rent | 38,848 | 23,678 | 66,332 | 42,792 |
| Stock-based compensation | 47,228 | - | 47,228 | - |
| Transfer agent fees | 9,185 | 5,783 | 15,971 | 10,167 |
| Travel | 2,104 | 4,648 | 3,269 | 14,859 |
| Wages and benefits, including management fees | 78,674 | 76,830 | 150,014 | 171,294 |
| | <u>\$ 317,684</u> | <u>\$ 244,185</u> | <u>\$ 546,213</u> | <u>\$ 510,985</u> |
| Schedule 4 – PRODUCT MANAGEMENT AND DEVELOPMENT | | | | |
| Wages and benefits | \$ 261,224 | \$ 190,859 | \$ 429,560 | \$ 393,346 |
| Other | 4,446 | 8,140 | 9,996 | 25,203 |
| | <u>\$ 265,670</u> | <u>\$ 198,999</u> | <u>\$ 439,556</u> | <u>\$ 418,549</u> |

QHR TECHNOLOGIES INC.
NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2004
(Unaudited – Prepared by Management)

Note 1 Interim Reporting

The unaudited interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information and follow the same accounting policies and methods of their application as the Company's most recent annual financial statements. These interim financial statements do not include all of the disclosure included in the annual financial statements, and accordingly, they should be read in conjunction with the annual financial statements for the year ended December 31, 2003. In the opinion of management, all adjustments considered necessary for fair presentation have been included in these financial statements. The results of operations for the interim periods are not necessarily indicative of the results of operations for the entire year.

Note 2 Significant Accounting Policies

a) Principles of Consolidation

These consolidated financial statements include the accounts of QHR Technologies Inc. ("QHR" or "the Company"), and its wholly owned subsidiaries, QHR Software Group Inc., QHR Atlantic Software Group Inc., and Optimed Software Corporation, all incorporated under the laws of the Province of British Columbia. All significant inter-company transactions and balances have been eliminated.

b) Adoption of New Accounting Standard

Effective January 1, 2004, Canadian GAAP requires the Company to estimate the fair value of stock-based compensation to employees and directors and to expense the fair value over the estimated vesting period of the stock options. In accordance with the transition rules, the fair value of stock options granted to employees and directors since January 1, 2002 has been estimated using the Black-Scholes Options Pricing Model, and an adjustment to opening retained earnings in the amount of \$88,066 representing the expense for the 2002 and 2003 fiscal years has been recorded. The offset to retained earnings is an increase in our share capital.

For the three months and six months ended June 30, 2004, \$47,228 was expensed with respect to stock-based compensation as 75,000 options vested on June 10, 2004, on their re-election as directors. Compensation cost, being the fair market value of the options, has been estimated using the Black Scholes Option Pricing Model using the estimated lives of the options, a volatility factor of 144%, a risk free rate of 2.65% and an assumed dividend rate of nil%

c) Intangible Assets

Intangible assets with a determinable life are amortized on the straight-line basis over their economic life which has been estimated to be three years for the Company's customer list acquired (See Note 3(a)), as well as the marketing and licensing agreement (See Note 3(b)). Management reviews the estimated economic life of its intangible assets and makes adjustments prospectively when factors indicate the economic life has changed or there is impairment in value.

Note 3 Intangible Assets

a) QHR Atlantic: Customer List

On March 29, 2004, QHR purchased the remaining issued common shares of QHR Atlantic from the minority shareholders of QHR Atlantic for \$84,000. The entire purchase price was allocated to the intangible asset entitled customer lists and is being amortized based on the policy as described in note 2(c).

b) Optimed: Marketing and Licensing Agreement

On March 3, 2004, QHR formed a new wholly owned subsidiary called Optimed Software Corporation (“Optimed”). Optimed signed an exclusive marketing and licensing agreement with Optimedirect Corporation with respect to its proprietary Accuro™ software product for a period of three years for a cash payment of \$250,000 (“initial fee”). In addition Optimed is required to pay Optimedirect royalties equal to the greater of 10% of the revenues from the sale of Accuro™ software or \$25,000 per three month period, whichever is greater. In addition to the \$250,000 initial fee, the Company advanced Optimedirect an additional \$90,000 as a prepayment of royalties.

The \$250,000 initial fee has been included as an intangible asset on the balance sheet and is being amortized as disclosed in Note 2(c). The prepayment of royalties has been included in prepaid expenses. (See Note 7).

Note 4 Share Capital

a) Authorized:

Unlimited common shares without par value
Unlimited Class A Preference shares

b) Issued:

| | <u>Common Shares</u> | |
|--|----------------------|--------------------|
| | <u>Number</u> | <u>Amount</u> |
| Balance, December 31, 2003 | 13,770,759 | \$3,924,645 |
| Change in accounting policy (Note 2(b)) | | 88,066 |
| Stock-based compensation | | 47,228 |
| For cash – pursuant to private placement at \$0.75 per share | 1,000,000 | 750,000 |
| Balance, June 30, 2004 | <u>14,770,759</u> | <u>\$4,809,939</u> |

c) Escrow:

At June 30, 2004, the Company’s transfer agent holds 2,951,998 shares in escrow. These shares are released from escrow on the basis of 10% of the original escrow amount (7,380,000) semi-annually to June 28, 2006.

Note 4 Share Capital (cont'd)

d) Stock-based Compensation Plan

The Company has granted employees and directors common share purchase options. These options are granted with an exercise price equal to the market price of the Company's shares on the date of the grant.

A summary of the status of the stock option plan as of June 30, 2004 and June 30, 2003 and changes during the periods ending on those dates is presented below:

| | <u>June 30, 2004</u> | | <u>June 30, 2003</u> | |
|--|----------------------|--|----------------------|--|
| | <u>Shares</u> | <u>Weighted Average Exercise Price</u> | <u>Shares</u> | <u>Weighted Average Exercise Price</u> |
| Outstanding at beginning of period | 1,045,700 | \$0.93 | 946,900 | \$0.95 |
| Granted | - | - | - | - |
| Vested | 75,000 | \$0.70 | - | - |
| Expired | (150,000) | (\$1.00) | - | - |
| Cancelled | - | - | (1,200) | (\$1.00) |
| Options outstanding and exercisable at end of period | <u>970,700</u> | <u>\$0.90</u> | <u>945,700</u> | <u>\$0.95</u> |

At June 30, 2004, the Company had 970,700 share purchase options outstanding entitling the holders thereof the right to purchase one common share for each option held as follows:

| <u>Number</u> | <u>Exercise Price</u> | <u>Expiry Date</u> |
|----------------|-----------------------|--------------------|
| 25,000 | \$0.35 | September 9, 2004 |
| 25,000 | \$0.70 | September 9, 2004 |
| 720,700 | \$1.00 | June 28, 2005 |
| 25,000 | \$0.35 | June 4, 2007 |
| 25,000 | \$0.35 | November 28, 2007 |
| 150,000 | \$0.70 | August 27, 2008 |
| <u>970,700</u> | | |

Note 5 Related Party Transactions

During the six months ended June 30, 2004 and 2003, the Company incurred the following expenses charged by directors, officers and private companies with common directors with the Company and a significant shareholder:

| | <u>2004</u> | <u>2003</u> |
|--|-------------------|-------------------|
| Consulting fees | \$ 9,000 | \$ 9,000 |
| Directors' fees | 9,750 | 3,000 |
| Management fees | - | 39,000 |
| Travel | 935 | 3,000 |
| Wages and benefits – administrative expenses | 81,019 | 82,000 |
| | <u>\$ 100,704</u> | <u>\$ 136,000</u> |

These transactions were measured at the exchange amount, which is the amount agreed upon by the transacting parties.

Included in accounts payable and accrued liabilities at June 30, 2004 is \$25,054 (December 31, 2003: \$65,064) owing to directors, officers of the Company and its subsidiaries and companies with a common director.

The controlling shareholder of Optimedirect Corporation became a director of the Company on March 25, 2004 (refer to Note 3(b)).

Note 6 Segmented Information

The Company's revenue is derived from the following geographic segments:

| | <u>June 30,</u> <u>2004</u> | <u>June 30,</u> <u>2003</u> |
|---------------------------------|--------------------------------|--------------------------------|
| Canada | | |
| – Software License Fees | \$ 466,618 | \$ 647,283 |
| – Software Services | 1,062,962 | 627,657 |
| – Consulting Services and Other | 48,385 | 79,185 |
| | <u>1,577,965</u> | <u>1,354,125</u> |
| United States | | |
| – Software License Fees | 14,950 | 157,475 |
| – Software Services | 126,719 | 172,473 |
| - Consulting Services and Other | 2,415 | 15,216 |
| | <u>144,084</u> | <u>345,164</u> |
| Total Revenue | <u>\$ 1,722,049</u> | <u>\$ 1,699,289</u> |

Note 7 Subsequent Events

a) Optimed: Software Purchase Agreement

Pursuant to an agreement dated August 6, 2004, Optimed purchased from Optimedirect Corporation, a corporation controlled by a director of the Company, the Accuro™ software product referred to in Note 3(b). The purchase price of \$300,000 is payable as follows:

- \$200,000 cash on closing
- \$100,000 in 10 monthly instalments of \$10,000 each, without interest, commencing 60 days after closing

The closing date was August 17, 2004. The exclusive marketing and licensing rights agreement dated March 3, 2004 is terminated by this purchase agreement, and the obligation to pay royalties has ceased.

Prepaid royalties were repaid by Optimedirect at the time of closing.

b) Issuance of Stock Options

Effective July 22, 2004, the Company granted a total of 400,000 stock options to employees and directors. These options, vesting on issue, have an exercise price of \$1.00 and may be exercised to July 21, 2009.

QHR TECHNOLOGIES INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
for the six months ended June 30, 2004

1.1 Date of Report:

August 29, 2004

1.2 Overall Performance

QHR Technologies Inc. (the "Company" or "QHR") is a public company whose common shares are traded on the TSX Venture Exchange and incorporated in the Province of British Columbia.

During the period ended June 30, 2004, QHR continued to execute its business plan to develop and market its commercial line of software products.

For the past three and one-half years, the Company has steadily improved its financial health, grown its operations and enhanced its business reputation. QHR has become an innovative leader in the human resource ("HR") software market through the design, development, marketing and implementation of its primary product, *Quadrant HRä*, a proprietary suite of integrated HR software modules.

*Quadrant HR*TM software modules deliver the key functional tools for payroll administration, staff scheduling, HR management and Web-based applicant/employee tracking in a unique integrated system format. The proprietary rights of *Quadrant HRä* are protected by trademarks in both Canada and the United States.

The Company delivers *Quadrant HR*TM and related services through its wholly owned subsidiaries QHR Software Group Inc. ("QHR Group") and QHR Atlantic Software Group Inc. ("QHR Atlantic"). These operations are consolidated in the financial statements as at June 30, 2004.

Given the software development experience of the Company, QHR plans to expand its future business by attracting, acquiring and creating new software products that offer solutions tailored to the needs of the healthcare industry and other commercial applications.

In accordance with its business goals, QHR formed a new wholly owned subsidiary company called Optimed Software Corporation ("Optimed") in March 2004. Optimed secured the exclusive worldwide marketing and licensing rights to the *Accuroä* line of software products from Optimedirect Corporation.

Accuroä is a powerful commercial suite of medical software modules designed to improve the quality of the operational work environment of Physicians, Medical Specialists and Surgeons while delivering administrative productivity gains and cost savings through computer automation.

The business plan of Optimed is currently being implemented. The market development of *Accuro*TM will require further investment in new marketing initiatives and ongoing product improvements but is expected to contribute significantly to the overall profitability of the Company in future periods. The investment and the results of operations of Optimed are consolidated in the financial statements of the Company at June 30, 2004.

Effective management information systems for strategic markets such as healthcare applications remain the main emphasis of the Company's business efforts as the case remains that professional managers perform best when they are accurately and reliably informed. By designing accurate data collection systems and integrating them with powerful administration and reporting software, QHR products allow professional managers to access critical information that effectively assists their decision making in a more timely and efficient manner.

The information technology ("IT") business is highly competitive and driven by innovation. Only "best of breed" products can be introduced, implemented, maintained and supported with quality customer service. Customer demand is driven by the functionality and economies offered by the Company's products. Marketing success and profitability to date are directly related to the design strength of *Quadrant HRä* and the business practices of QHR. Customer service and reliable products are the keys to the favourable market position enjoyed by the Company and will continue to be vital to winning new business in the future.

Earnings are the key measure of overall performance and the determining factor for the ongoing financial health of the organization. During the past three years product and service revenues have grown steadily from \$1,351,050 during the year ended December 31, 2001; to \$2,565,417 for the year ended December 31, 2002; to \$3,751,711 for the year ended December 31, 2003. Profitability was achieved in 2002 when the Company recorded its earnings in the amount of \$279,634 or \$0.02 per share up from a loss of \$1,087,080 or \$0.09 per share in the prior year. Earnings continued to grow in 2003 when a profit of \$427,107 or \$0.03 per share was recorded.

For the first six months of 2004, revenues reached \$1,722,049 compared to \$1,699,289 in the first six months of 2003. Operating results for the six months ended June 30, 2004 produced a loss of \$159,350 or \$0.01 per share compared to earnings of \$116,150 or \$0.01 per share during the six months ended June 30, 2003. This decrease in profitability can be attributed to expenses of \$164,348 for the start up of Optimed and the development of *Accuro*TM software, the recognition of \$47,228 for stock-based compensation with respect to the vesting of directors' stock options and an increase in amortization of \$49,038 attributable to the amortization of intangibles acquired in the first quarter and recent upgrades in equipment and leaseholds in the new office premises. When meaningful revenue streams have been created from an initial *Accuro*TM customer base, management believes that overall Company profitability will be returned to past performance levels.

At June 30, 2004, the Company had current assets of \$2,093,524 comprised of cash on hand of \$1,267,020, an increase of \$844,948 from December 31, 2003, accounts receivable of \$684,676 down \$113,913 from December 31, 2003 and prepaid expenses and deposits of \$141,828 up \$98,258 from the year ended December 31, 2003. Cash reserves have grown due to a private placement of \$750,000 and cash flows from operations during the period.

Total assets have grown to \$2,832,155 at June 30, 2004 up from \$1,692,551 at December 31, 2003. Generally Accepted Accounting Principles, as currently applicable to the Company, require that all product development costs be expensed as they are incurred. Hence, there is no value of the Company's software carried on the balance sheet as an asset. All investment in software development has been charged against shareholders' equity in the period in which the investment has been made.

Current financial obligations including accounts payable and deferred revenue were \$1,935,494 at June 30, 2004. Deferred revenue in the amount of \$1,567,560 is included in current liabilities. Deferred revenue is defined as cash received from customers for contractual arrangements in advance of services and products being delivered. This increase was due to the continuing success of ongoing marketing initiatives. All deferred revenue obligations will be serviced from current corporate resources.

Long term debt was reduced to \$206,174 at quarter end from \$211,585 at December 31, 2003. Shareholder's equity improved to \$690,487 at June 30, 2004 from \$52,609 at December 31, 2003.

1.3 *Selected Annual Information*

The following financial data is selected information for the Company for the three most recently completed financial years:

| <u>Year ended December 31</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---|--------------|--------------|----------------|
| Total Revenue | \$ 3,751,711 | \$ 2,565,417 | \$ 1,351,050 |
| Earnings (loss) before other items | \$ 422,207 | \$ 344,249 | \$ (935,285) |
| Net earnings (loss) | \$ 427,107 | \$ 279,634 | \$ (1,087,080) |
| Basic and diluted earnings (loss) per share | \$ 0.03 | \$ 0.02 | \$ (0.09) |
| Total Assets | \$ 1,692,551 | \$ 528,113 | \$ 315,974 |
| Long term debt | \$ 211,585 | \$ - | \$ - |
| Cash dividends declared per-share | Nil | Nil | Nil |

Business volume and financial results have improved over the past three years because significant investment has been made in product improvements and marketing initiatives to introduce and sell the Company's products and services in the marketplace. Marketing operations continue to provide steady revenue growth and reliable cash flows. Operational funding needs can be reasonably predicted and managed to profitable levels.

The product line of the Company was significantly strengthened with the introduction of a commercial Version 2.0 of *Quadrant HR*TM which was released in September 2003. This more powerful product release, which included a staff scheduling module, was a contributing factor to the increased profit performance of the Company in 2003. Development continues with Version 2.1, including additional HR modules, which is scheduled for release this summer.

1.4 *Results of Operations*

QHR and its wholly owned subsidiaries, QHR Group, QHR Atlantic and Optimed consolidate their operations for the purpose of financial reporting. The Company's year-end is December 31.

Results from operations are not necessarily indicative of results to be expected in future periods. QHR is a developing corporation where various trends and factors in the marketplace and product enhancements must be carefully managed to achieve revenue growth and profitability.

The Company recognized revenue in the amount of \$1,722,049 for the six months ended June 30, 2004 compared to \$1,699,289 in the comparative six-month period of 2003. Software license revenues declined \$323,190 from \$804,758 to \$481,568. The Company recognizes revenue from the majority of its licensing arrangements within 30-90 days of the customer

signing a contract. The reduction in revenue reflects the effect of more contracts being concluded in the comparative period.

Software services revenue increased \$389,551 from \$800,130 for the six months ended June 30, 2003 to \$1,189,681 for the three months ended June 30, 2004. These revenues include the provision of support and maintenance which are generally fixed annual amounts required to be paid by the customer to maintain the use of the original license purchased as well as implementation and consulting fees for services rendered. As the number of employees using QHR software increased from 85,000 as at June 30, 2003 to over 90,000 as at June 30, 2004, support and maintenance revenues increased. In addition, due to the number of contracts signed in the previous six months, the Company enjoyed an increase in implementation and consulting fees as the majority of these revenues tend to be earned within 6 to 9 months of the execution of the contract.

The Company's annual software service contracts billed in March 2004 reached approximately \$1,000,000 compared to \$750,000 in 2003.

Cash received from customers increased \$833,672 from \$1,491,356 in 2003 to \$2,325,028 despite the decrease in revenue due to the application of the Company's revenue recognition policy in which cash flow and revenue do not necessarily correlate in a given period. Overall, cash produced from operations increased \$489,379 from \$17,252 in 2003 to \$506,631 in 2004.

The loss from operations for the six months ended June 30, 2004 was \$159,350 or \$0.01 per share compared to earnings of \$116,150 or \$0.01 per share for the same period in 2003. Contributing to the decrease in earnings of \$275,500 were expenses of \$164,348 for the start up of Optimed and the development of *Accuro*TM software, the recognition of \$47,228 for stock-based compensation with respect to the vesting of directors' stock options and an increase in amortization of \$49,038 attributable to the amortization of intangibles acquired in the first quarter and recent upgrades in equipment and leaseholds in the new office premises.

The Company invested \$376,340 in sales and marketing activities during the six months ended June 30, 2004 compared to \$236,588 in 2003, an increase of \$139,752. These increased expenditures included additions to sales and marketing staff and amortization of intangibles of \$27,833.

Service delivery expenses for the six months ended June 30, 2004 increased to \$519,290 compared to \$408,120 for 2003. This was due primarily to additional or reallocated personnel acquired for the growth in new sales contracts.

Administrative expenses for the six months ended June 30, 2004 increased to \$546,213 compared to \$510,985 for 2003. The increase over 2003 relates to the fair value of non-cash directors options vesting during the three months ended June 30, 2004 of \$47,228. Excluding the stock-based compensation other administrative expenses decreased by \$12,000 during the six month period.

Product development expenditures increased to \$439,556 compared to \$418,549 for 2003. These expenditures were for ongoing improvements and additional functions for *Quadrant HR*TM and *Accuro*TM.

1.5 Summary of Quarterly Results

The following is a summary of the Company's financial results for its eight most recently completed quarters:

| | 2 nd Quarter 30 June 2004 | 1 st Quarter 31 March 2004 | 4 th Quarter 31 Dec. 2003 | 3 rd Quarter 30 Sept 2003 |
|---|---|---|---|---|
| Total Revenue | \$920,018 | \$802,031 | \$1,227,445 | \$824,977 |
| Earnings (loss) before other items | \$(172,309) | \$12,959 | \$169,430 | \$127,730 |
| Basic and diluted earnings (loss) per share | \$(0.01) | \$0.00 | \$0.01 | \$0.01 |
| Net earnings (loss) for period | \$(172,309) | \$12,959 | \$169,430 | \$141,527 |
| Basic and diluted earnings (loss) per share | \$(0.01) | \$0.00 | \$0.01 | \$0.01 |

| | 2 nd Quarter 30 June 2003 | 1 st Quarter 31 March 2003 | 4 th Quarter 31 Dec. 2002 | 3 rd Quarter 30 Sept.2002 |
|---|---|---|---|---|
| Total Revenue | \$834,407 | \$864,882 | \$538,926 | \$915,994 |
| Earnings (loss) before other items: | \$37,837 | \$87,210 | \$(113,582) | \$335,959 |
| Basic and diluted earnings (loss) per share | \$0.00 | \$0.01 | \$(0.01) | \$0.03 |
| Net earnings (loss) for period | \$30,738 | \$85,412 | \$(134,317) | \$367,073 |
| Basic and diluted earnings (loss) per share | \$0.00 | \$0.01 | \$(0.01) | \$0.03 |

Quarterly results over the most recent eight quarters are indicative of a developing junior software company that is using marketing initiatives to educate potential customers of the merits of the Company's products. The Company has not changed its marketing approach and must deal with its relative small size when dealing with larger competitors.

Several companies compete with QHR in the field of HR software management systems. Most are substantially larger and possess greater financial resources than the Company. The Company's software products have proven acceptable in the marketplace and can be sustained and the excellent service record and reputation of the Company is a definite strength. Future success, however, relies on achieving superior product capability and customer service in the market.

The Company currently experiences a lengthy marketing and sales cycle that requires considerable investment of Company resources to attract new customers. There are no assurances of success and approvals of contracts are often subject to delays that are beyond the control of QHR.

Contracts all vary in terms and conditions but usually involve a fixed price per employee for the various HR functions to be delivered. The implementation of software to the satisfaction of the customer involves various periods of time ranging from three months to eighteen months. This situation means that QHR must work closely and harmoniously with its clients to achieve success.

There are no assurances that any negative events in the implementation process for any customer will not have adverse effects on the business plans of QHR, the results of its operations and its financial health. Hence, customer service is a crucial focus of the Company.

The Company has noted no negative or unusual changes in customer opinion or barriers to the adoption of the Company's products or purchasing patterns during the six months ending June 30, 2004. There are no changes required to the current business model due to the introduction of new technologies or competitive products.

1.6 *Liquidity*

The Company has a cash balance of \$1,267,020 and accounts receivable of \$684,676 at June 30, 2004.

The ability of the Company to meet its financial obligations as they come due is largely dependent on its ability to generate profitable revenues as budgeted in its business plans, collect accounts receivable and to attract new equity capital from the investment community to cover product development expenditures and unexpected operational shortfalls. Management estimates that its current capital resources and anticipated cash flows from ongoing operations will be sufficient to meet its projected financial obligations for 2004.

1.7 *Capital Resources*

The Company had working capital of \$158,030 at June 30, 2004, an improvement of \$322,156 from December 31, 2003. Working capital at June 30, 2004 includes \$1,567,560 in deferred revenue that will be satisfied through the delivery of products and services in future periods. Deferred revenue will be recognized as revenue in the financial statements when the contractual obligations with the customer are met in accordance with the Company's disclosed accounting policy.

Current assets were \$2,093,524 at June 30, 2004, an increase of \$829,293 from December 31, 2003. Management calculates its adjusted working capital for internal purposes as current assets less current liabilities before deferred revenue. At June 30, 2004, this adjusted working capital amount was \$1,725,590. This is an improvement of \$788,169 from December 31, 2003.

The Company entered into two sales contracts during 2003 resulting in an amount of \$200,716 being recorded as a receivable over a period of five years, payable at \$4,288 monthly including interest at an average rate of 6.375%. The non-current portion of this receivable in the amount of \$106,409 is excluded from current assets at June 30, 2004.

Deferred revenue was \$1,567,560 at June 30, 2004 compared to \$1,101,547 at December 31, 2003, an increase of \$466,013. Deferred revenue is defined as cash received from customers for contractual arrangements in advance of services and products being delivered. This increase was due to the continuing success of ongoing marketing initiatives. All deferred revenue obligations are anticipated to be serviced from current corporate resources.

In February 2003, the Company entered into an arrangement with its landlord to finance a portion of the leaseholds for the Company's new Kelowna office. An additional \$20,014 was financed in May 2004 for an office expansion. Accordingly, a term loan was recorded for \$124,509 which is repayable at \$1,513 per month including interest at 8% and is due March 2008 unless the lease on the Company's premises is renewed at comparable terms. As at June 30, 2004 the amount outstanding on this term loan was \$114,633.

On January 9, 2003 the Company obtained approval of a Small Business Improvement Loan for an amount of up to \$250,000 to finance the purchase of capital assets. The loan, which was drawn down in the amount of \$177,443, bears interest at prime plus 3%. It is repayable in equal monthly instalments over its 5-year term. Security includes a General Security Agreement over the assets of the Company, a Chattel Mortgage assigning specific assets financed under the loan and a personal guarantee of \$62,500 by a Director of the Company. At June 30, 2004 the amount outstanding on this loan was \$137,612.

On March 3, 2004, QHR formed a new wholly owned subsidiary called Optimed Software Corporation ("Optimed") (formerly 3QB Technologies Inc.). Optimed signed an exclusive marketing and licensing agreement with Optimedirect Corporation with respect to its proprietary Accuro™ software product for a period of three years for a cash payment of \$250,000 ("initial fee"). In addition Optimed is required to pay Optimedirect royalties equal to the greater of 10% of the revenues from the sale of Accuro™ software or \$25,000 per three month period, whichever is greater. Assuming the license is maintained for the three-year period, Optimed is committed to a minimum of \$100,000 per year for a total additional commitment of \$300,000. Should Optimed at any time choose to not maintain the exclusive license, no additional commitment exists under the terms of the agreement.

At June 30, 2004, in addition to the \$250,000 initial fee, the Company advanced Optimedirect an additional \$90,000 as a prepayment of royalties referred to above. Optimed commenced operations on March 15, 2004.

The \$250,000 initial fee has been included as an intangible asset on the balance sheet and is being amortized as disclosed in the financial statements. The prepayment of royalties has been included in prepaid expenses.

Subsequent to June 30, 2004 Optimed purchased the Accuro™ software. (See 1.11 "Proposed Transactions").

On March 29, 2004, QHR purchased the remaining issued common shares of QHR Atlantic from the minority shareholders of QHR Atlantic for \$84,000. This has been included as an intangible asset on the balance sheet and is being amortized as disclosed in the financial statements.

1.8 *Off Balance Sheet Arrangements*

There are no off-balance sheet arrangements to which the Company is committed.

1.9 *Transactions with Related Parties*

Al Hildebrandt, President, CEO and Director, is paid a salary of \$10,000 per month. A performance bonus accrued during the year ended December 31, 2003 in the amount of \$30,000 was also paid during the period. An outstanding incentive stock option for 450,000

common shares exercisable at \$1.00 per common share is also in place. These options expire on June 28, 2005.

Effective March 25, 2004, David Goertz resigned as a director of the Company. His wholly owned company had an outstanding stock option for 150,000 common shares exercisable at \$1.00 per common share. This option expired on June 23, 2004 in accordance with the terms of the option agreement.

Dr. Tom Kinahan, founder, control shareholder and President of Optimedirect Corporation, consented to act as a director of the Company and was appointed by the Board of Directors to replace Mr. Goertz effective March 25, 2004. During March 2004, the Company through its wholly owned subsidiary, Optimed, acquired the exclusive marketing and licensing rights to Accuro™ software product from Optimedirect Corporation as described above under 1.7.

The Corporate Secretary of the Company was paid \$9,000 during the six months ended June 30, 2004 for administration services. This officer has an outstanding stock option for 5,000 common shares exercisable at \$1.00 per common share. These options expire on June 28, 2005.

Roger Whidden, a director of QHR Atlantic was paid \$18,229 during the six months ended June 30, 2004 for management services, travel allowances and commissions. He ceased to be a director effective April 1, 2004.

1.10 *Critical Accounting Estimates*

Management's discussion and analysis of operating results and liquidity and capital resources is made with reference to the Company's consolidated financial statements and notes thereto which have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. These estimates are based on management's historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about the reported amounts of revenues, expenses, carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

The Company has identified accounting policies outlined below as necessary to an understanding of its business operations and an understanding of its results of operations.

The Audit Committee reviews our accounting policies and all quarterly and annual filings, and recommends adoption of our annual financial statements to our Board of Directors. For a detailed discussion on the application of these and other accounting policies, see note 2 to the December 31, 2003 annual consolidated financial statements.

Revenue Recognition

The Company recognizes revenue from software licensing generally once delivery has occurred, evidence of an arrangement exists, the fee is fixed or determinable, collection of the fee is probable and there are no significant vendor obligations remaining.

Most of the company's contracts are multiple element arrangements where vendor specific objective evidence ("VSOE") is not available for all of the elements at the time of entering into the contract. Accordingly, the Company generally applies the residual method and does not recognize any revenue until VSOE exists for all undelivered elements.

In applying the residual method to the majority of the Company's contracts, the following recognition results:

- a) Software license revenue is recognized after completion of the initial support and maintenance period ("the initial period"), which is generally 30 to 90 days from the start of the contract.
- b) Software support and maintenance revenue derived from the sale of support and maintenance contracts which are required for the customer to continue to use the software are deferred until after completion of the initial period and then are recognized on a straight-line basis over the remaining term of the contract.
- c) Implementation and consulting revenue derived from services rendered during the initial period are deferred until completion of the initial period. The remaining implementation and consulting services are recognized as services are rendered.

For long term contracts where the customer pays its software license, support and maintenance and implementation and consulting revenue over a period extending beyond one year, the Company determines recognition of revenue to be the lesser of revenue recognition based on the above criteria and actual cash received under the arrangement as authoritative accounting literature suggests that the fee is not fixed or determinable in long term arrangements without adequate history of collecting such contracts to completion regardless of the assessment of the credit worthiness of the customer.

In all cases, cash received or billings made prior to the recognition of revenue results in the recording of deferred revenue.

Allowance for Doubtful Accounts

A significant portion of the Company's revenue is earned from selling to public and privately funded health care organizations as well as to a much lesser extent, individual business customers. Accounts receivable, as disclosed in the financial statements, is net of management's best estimate as to the required allowance for doubtful accounts. Management estimates its allowance for doubtful accounts by taking into account such factors as the Company's historical collection and write-off experience, the number of days an account is past due, and the status of a customer's account as to whether the customer is continuing to make use of the underlying software. As a result, changes in the above factors on a single customer account will directly impact the reported amount of bad debt expense.

Development Costs

Development costs related to software products developed for sale are expensed as incurred unless they meet the criteria for deferral under Canadian GAAP. Based on these criteria and the nature of the development activities undertaken by the Company to date, the Company has expensed approximately \$5,200,000 of its software development costs.

Amortization Policy and Useful Lives of Tangible and Intangible Assets

The Company amortizes the cost of capital assets and intangible assets with determinable lives over the estimated useful service life of the asset. These estimates of useful lives involve considerable judgement. In determining these estimates, the Company takes into account industry trends and company-specific factors, including changing technologies and expectations for the in-service periods of these assets as well as the contractual period of benefit for certain intangible assets. On an annual basis, the Company reassesses its existing estimates of useful lives to ensure they match the anticipated service life of the asset. If technological change occurs or the underlying market for the software which the Company has paid an upfront licensing fee for change or do not meet current expectations, the Company may have to reduce the estimated service life of certain tangible and intangible assets, which could result in higher depreciation and amortization expense in future periods or an impairment charge to write down the value of these assets.

Income Tax Valuation Allowances

The Company applies the asset and liability method for accounting for income taxes. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of existing assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes only if it is more likely than not that they can be realized. As at December 31, 2003, management has estimated the potential value of the losses carried forward for income tax purposes to be \$1,270,000 but has not recognized any amount as an asset in the financial statements of the Company based on management's assessment that insufficient evidence exists to support the assertion that it is more likely than not that the benefit of these losses can be realized.

Should management change its assessment as to the likelihood of realizing the benefit of all or a portion of these losses, the Company would recognize an amount as earnings in the period of determination with future earnings being reduced by the taxes otherwise payable on these earnings.

1.11 Proposed Transactions

On July 22, 2004, QHR granted 400,000 share options at an exercise price of \$1.00 per share divided amongst two recently appointed directors and 47 employees. The options expire July 21, 2009.

On August 6, 2004, Optimed signed an agreement to purchase the *Accuro*® software from Optimedirect Corporation, a corporation controlled by a director of the Company, for \$300,000. The agreement provided for consideration of \$200,000 upon closing and the balance to be paid in 10 monthly instalments of \$10,000. This agreement supersedes the Exclusive Marketing and Licensing Agreement of March 3, 2004 and all royalty calculations as per the original agreement have ceased. All prepaid royalties owed by Optimedirect Corporation, as previously disclosed, have been repaid to Optimed.

1.12 Changes in Accounting Policy

Effective January 1, 2004, Canadian GAAP requires the Company to estimate the fair value of stock-based compensation to employees and directors and to expense the fair value over the estimated vesting period of the stock options. In accordance with the transition rules, the fair value of stock options granted to employees and directors since January 1, 2002 has been

estimated using the Black-Scholes Options Pricing Model, and an adjustment to opening retained earnings in the amount of \$88,066 representing the expense for the 2002 and 2003 fiscal years has been recorded. The offset to retained earnings is an increase in share capital.

For the three months and six months ended June 30, 2004, \$47,228 was expensed with respect to stock-based compensation as 75,000 options vested on June 10, 2004, on their re-election as directors. Compensation cost, being the fair market value of the options, has been estimated using the Black Scholes Option Pricing Model using the estimated lives of the options, a volatility factor of 144%, a risk free rate of 2.65% and an assumed dividend rate of nil%

1.13 Financial Instruments

The carrying value of cash, accounts receivable (included in current assets) and accounts payable and accrued liabilities approximate their fair values due to the short maturity of those instruments. The carrying value of non-current accounts receivable and long-term debt approximate their market values as they bear market rates of interest. Unless otherwise noted, it is managements' opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

1.14 Other MD&A Requirements

Section 5.4 of National Instrument 51-102 - Disclosure of Outstanding Share Data

Authorized Shares:

Unlimited common shares without par value
Unlimited Class A preference shares

| <u>Issued Common Shares:</u> | <u>Number</u> | <u>\$</u> |
|------------------------------|---------------|-------------|
| Balance, June 30, 2004 | 14,770,759 | \$4,809,939 |

Transition to British Columbia Business Corporations Act

On June 10, 2004, the Company held its annual general meeting and voted to transition from the Company Act of British Columbia to the new Business Corporations Act ("BCBCA"), which came into force March 29, 2004. The Company, like all British Columbia pre-existing companies, was required to transition to the BCBCA within 2 years of March 29, 2004.

In addition to filing notice of transition with the BC Registrar of Companies, the Company approved and filed replacement Articles of Incorporation and increased its authorized capital to an unlimited number of common shares and an unlimited number of Class A Preference Shares, issuable in series with terms and conditions as may be set by the Company's directors.

The changes took effect June 10, 2004. The changes do not affect the number of common shares outstanding in the Company, nor have any Class A Preference Shares been issued.