

DIGITAL GEM CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

McGovern, Hurley, Cunningham, LLP

2005 Sheppard Avenue East, Suite 503
Toronto, Ontario, Canada M2J 5B4

Chartered Accountants

Telephone: (416) 496-1234
Fax: (416) 496-0125
Gen.E-mail address: info@mhc-ca.com
Website: www.mhc-ca.com

AUDITORS' REPORT

To the Shareholders of
Digital Gem Corporation

We have audited the consolidated balance sheets of Digital Gem Corporation as at March 31, 2000 and 1999 and the consolidated statements of operations and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2000 and 1999 and the results of its operations and cash flows for the years then ended in accordance with generally accepted accounting principles.

McGOVERN, HURLEY, CUNNINGHAM, LLP

Signed "McGovern, Hurley, Cunningham, LLP"

Chartered Accountants

TORONTO, Canada
June 19, 2000

DIGITAL GEM CORPORATION
CONSOLIDATED BALANCE SHEETS
AS AT MARCH 31

	2000 \$	1999 \$
ASSETS		
CURRENT		
Cash and cash equivalents	5,643,058	55,811
Securities owned, at market value (Note 3)	621,650	-
Accounts receivable	802,351	290,366
Inventory (Note 4)	2,222,499	2,301,465
Prepaid expenses and other (Note 5)	299,802	-
Deposit with carrying broker	350,000	-
Due from clients	104,527	-
	<u>10,043,887</u>	<u>2,647,642</u>
MINING PROPERTIES (Note 6)	3,855,377	3,855,377
CAPITAL ASSETS (Note 7)	2,087,071	1,074,365
RECLAMATION BOND AND DEPOSITS	113,244	129,225
GOODWILL (Note 8)	7,345,564	-
	<u>23,445,143</u>	<u>7,706,609</u>

APPROVED ON BEHALF OF THE BOARD:

Signed "VICTOR P. ALBOINI" _____, Director

Signed "NADIR DESAI" _____, Director

DIGITAL GEM CORPORATION
CONSOLIDATED BALANCE SHEETS
AS AT MARCH 31

	2000 \$	1999 \$
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	1,809,988	544,224
Securities sold, at market value (Note 3)	43,350	-
Due to clients	102,098	-
Debentures payable (Note 9)	1,700,000	-
Current portion of lease inducement	48,000	-
Current portion of long-term debt (Note 10)	139,154	-
Income taxes payable	48,284	-
Due to issuer	1,000,000	-
	<u>4,890,874</u>	<u>544,224</u>
LEASE INDUCEMENT	164,000	-
LONG-TERM DEBT (Note 10)	<u>442,983</u>	<u>-</u>
	<u>5,497,857</u>	<u>544,224</u>
SHAREHOLDERS= EQUITY		
CAPITAL STOCK (Note 11(a))	63,831,575	47,068,958
COMMON SHARES TO BE ISSUED	-	100,000
WARRANTS	5,749	-
DEFICIT	<u>(45,890,038)</u>	<u>(40,006,573)</u>
	<u>17,947,286</u>	<u>7,162,385</u>
	<u>23,445,143</u>	<u>7,706,609</u>

See Accompanying Notes to the Consolidated Financial Statements

DIGITAL GEM CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEARS ENDED MARCH 31

	2000 \$	1999 \$
REVENUES		
Sapphire, jewelry and sundry sales	713,396	834,648
Brokerage, revenue and commissions	<u>2,753,958</u>	<u>-</u>
	<u>3,467,354</u>	<u>834,648</u>
OPERATING EXPENSES		
Selling, general and administrative	3,696,208	1,553,292
Website development costs	1,483,673	-
Brokerage operations	2,380,743	-
Cost of goods sold	461,111	304,039
Interest (income) expense, net	(70,644)	(4,706)
Mine operations	-	329,259
Depreciation and amortization	<u>1,270,110</u>	<u>771,428</u>
	<u>9,221,201</u>	<u>2,953,312</u>
Loss before the undemoted	(5,753,847)	(2,118,664)
Loss on abandonment of mining properties	-	(347,822)
Gain on settlement of note receivable	-	75,435
Loss on disposal of assets	(80,569)	(324,269)
Settlement of lawsuit	-	(226,305)
Write-down of heat treatment technology	-	(100,581)
Forgiven debt	<u>-</u>	<u>532,057</u>
(Loss) before income taxes	(5,834,416)	(2,510,149)
Income taxes	<u>(49,049)</u>	<u>-</u>
NET (LOSS) FOR THE YEAR	(5,883,465)	(2,510,149)
(DEFICIT) , beginning of year	<u>(40,006,573)</u>	<u>(37,496,424)</u>
(DEFICIT) , end of year	<u>(45,890,038)</u>	<u>(40,006,573)</u>
(LOSS) PER SHARE – Basic	<u>(0.04)</u>	<u>(0.02)</u>

See Accompanying Notes to the Consolidated Financial Statements

DIGITAL GEM CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED MARCH 31

	2000 \$	1999 \$
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) for the year	(5,883,465)	(2,510,149)
Adjustments for:		
Depreciation and amortization	1,270,110	771,428
Loss on abandonment of mining properties	-	347,822
Loss on write-off of deposits	-	32,769
Write-down of heat treatment technology	-	100,581
Loss on disposal of assets	80,569	324,269
Gain on settlement of note receivable	-	(75,435)
Forgiven debt	-	(532,057)
Common shares issued for services	163,300	131,397
Common shares issued for debt	-	1,995
	<u>(4,369,486)</u>	<u>(1,407,380)</u>
Changes in non-cash working capital balances:		
Securities owned, at market value	(621,650)	-
Accounts receivable	(511,985)	272,372
Due from clients	(104,527)	-
Inventory	78,966	(38,415)
Prepaid expenses and other	(299,802)	-
Deposit with carrying broker	(350,000)	-
Accounts payable and accrued liabilities	1,265,766	459,740
Lease inducement	(28,000)	-
Due to clients	102,098	-
Debenture payable	1,700,000	-
Due to issuer	1,000,000	-
Income taxes payable	48,284	-
Securities sold, at market value	43,350	-
	<u>2,322,500</u>	<u>693,697</u>
Cash flows from (used in) operating activities	<u>(2,046,986)</u>	<u>(713,683)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds on note receivable	-	226,305
Acquisition of capital assets (net)	(401,903)	(7,334)
Decrease in reclamation bond and deposits	15,981	-
Proceeds from sale of capital assets	112,549	331,129
Acquisition of subsidiaries	(1,597,986)	-
Cash flows from (used in) investing activities	<u>(1,871,359)</u>	<u>550,100</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	7,327,250	-
Proceeds from exercising stock options	539,363	-
Proceeds from exercising stock warrants	2,237,810	-
Stock issuance costs	(499,350)	-
Principal repayments on long-term debt	(99,481)	(311,492)
Proceeds from common shares to be issued	-	100,000
Cash flows from (used in) financing activities	<u>9,505,592</u>	<u>(211,492)</u>
Increase (decrease) in cash and cash equivalents	5,587,247	(375,075)
Cash and cash equivalents, beginning of period	<u>55,811</u>	<u>430,886</u>
Cash and cash equivalents, end of period	<u>5,643,058</u>	<u>55,811</u>

See Accompanying Notes to the Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company are in accordance with generally accepted accounting principles and are consistent with that of the previous year. Outlined below are those policies considered particularly significant:

Organization and Nature of Business:

These consolidated financial statements include the accounts of the Company and all its subsidiaries. The Company's subsidiaries are American Gem Corporation (U.S.A.), Square One Corporation, American Gem Processing, Inc., American Gem Limited, Northern Securities Inc. and Digital Fluid Ltd.

The Company was engaged in the business of mining sapphire-bearing properties, acquiring sapphire rough and heat-treating, cutting and marketing sapphires. Since inception, the Company has had limited operating revenues from its intended sapphire operations and it has not been determined whether the Company's mining properties contain reserves that are economically recoverable. The recoverability of capitalized costs related to inventories, mining properties and mining plant and equipment is dependent upon the discovery of economically recoverable reserves, confirmation of the Company's interest in the mining properties, the ability of the Company to obtain the necessary financing to complete the development of the properties, and ultimate realization of profits through the production and sale of sapphires.

During the year, the Company acquired Northern Securities Inc. ("Northern") (see Note 2(a)). Northern entered into an agreement to act as a Type 2 introducing broker to National Bank Financial Corp. [formerly First Marathon Securities Limited] ["National Bank"] and the Correspondence Network ("CN"). Under the terms of the agreement, the Company has lodged a deposit of \$250,000 with National Bank and CN, which has been recorded as deposit with carrying broker.

Northern has entered into a temporary agreement to act as a Type 3 introducing broker to CT Securities Inc. ["CT"]. Under the terms of the agreement, the Company has lodged a deposit of \$100,000 with CT, which has been recorded as deposit with carrying broker.

The Company has expanded its operations to become an e-commerce company focusing on the company's sapphire e-commerce website, and the development of websites for online securities trading, online IPO's, online mergers and acquisitions and online private placements.

Cash and Cash Equivalents:

The Company considers all highly liquid debt instruments with an original maturity date of twelve months or less to be cash equivalents. The Company's cash and cash equivalents consist of cash held in banks in Ontario, Canada and Montana, U.S.A. Included in cash and cash equivalent are amounts on deposit with the carrying broker which are available for withdrawal on demand.

Inventory:

Historically, inventory, which is composed of sapphires, has been stated at the lower of average cost or net realizable value. The cost of sapphires includes mining, processing, heat treatment and cutting costs, including depreciation, depletion and amortization.

Goodwill:

Goodwill represents the excess of purchase price paid on acquisition over the value assigned to identifiable net assets acquired. Goodwill is amortized on a straight-line basis, over periods from 7 to 10 years, based on management's opinion of the future benefits from the acquisition.

Mining Properties:

Expenditures related to the acquisition of mining properties, deeded property and options on mineral properties are capitalized by project area. The capitalized costs associated with each such project area are assessed periodically for impairment. Any impairment identified, as well as all costs associated with abandoned projects or project areas, are charged against income in the year they are identified or abandoned. Capitalized costs, net of residual values, are depleted on the units of production method based on the property's measured and indicated sapphire resource. Exploration and administrative expenditures are expensed as incurred. Costs incurred to maintain mineral claims are expensed as incurred as a component of exploration expense.

The Company evaluates the recoverability of proved mining properties based on the expected undiscounted future net revenues from the property's measured and indicated sapphire resource. An impairment loss will be recorded if the unamortized costs exceed the expected undiscounted future net revenues from the related property. The impairment loss recognized will equal the excess of the unamortized costs over the expected undiscounted future net revenues.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Environmental Protection and Site Restoration:

Expenditures related to environmental protection and site restoration undertaken during mining development and operations are expensed as incurred.

Capital Assets:

Capital assets are recorded at cost and depreciated, net of residual value, using the straight-line method based on the estimated useful lives of the assets or the term of the capital lease. The estimated useful lives of the mining plant range from 5 to 10 years and for mine and office equipment from 3 to 7 years.

Repair and maintenance expenditures are charged to operations; major improvements and replacements which extend the useful life of an asset are capitalized and depreciated over the remaining estimated useful life of that asset. Upon the sale or retirement of capital assets, any gain or loss on disposition is reflected in the statement of operations and the related asset cost and accumulated depreciation are removed from the respective accounts.

Reclamation Bond Deposits:

Reclamation bond deposits are held in the Company's name in escrow until the related reclamation activities are completed.

Securities Transaction:

Securities transactions and related revenue are recorded on a trade-date basis.

Loss Per Share Calculation:

Loss per share is calculated by dividing the loss by the weighted average shares outstanding during each year. The existence of stock options and warrants may effect the calculation of loss per share on a fully diluted basis. As the effect of this dilution is to reduce the reported loss per share, fully diluted loss per share has not been disclosed.

Foreign Currency Translation:

The Company's focus has changed as described in Note 1 and, as such, commencing April 1, 1999, its functional and reporting currency is now the Canadian Dollar. To facilitate comparison, the 1999 financial information has been translated to Canadian Dollars using the exchange rate in effect on March 31, 1999 which was CDN.\$1.5087 = U.S.\$1.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the statement date. Capital assets are translated at the rates prevailing at the dates of acquisition. Long-term monetary assets and liabilities with a fixed or ascertainable life are translated at the statement date rate; any resulting gain or loss thereon is amortized over the life of the item. Revenue and expense items, other than amortization, are translated at the average rate of exchange for the year. An exchange gain or loss that arises on translation or settlement of a foreign currency denominated monetary item is included in the determination of net income for the period.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

Lease Inducements:

Lease inducements are taken into income on a straight-line basis over the term of the respective lease.

Future Income Taxes:

Future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount and their tax bases. Future income tax assets are recognized for the benefit of any deductions or losses available to be carried forward to future periods for tax purposes that are likely to be realized. These amounts are measured using enacted or substantively enacted tax rates and are re-measured annually for changes in these rates. Any future income tax assets are reassessed each year to determine if a valuation allowance is required. Any effect of the re-measurement or reassessment is recognized in the period of the change.

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

2. BUSINESS ACQUISITIONS

- (a) Pursuant to an agreement dated April 12, 1999 which closed June 4, 1999, the Company acquired Northern Securities Inc. (Northern) for cash proceeds of \$1,500,000 plus costs of acquisition of \$97,986 and the issuance of 6,000,000 common share purchase warrants with an exercise price of \$0.65 per share and 2,000,000 common share purchase warrants with an exercise price of \$1.00 per share. The warrants were valued at \$10,000. Each warrant gives the holder the right to purchase one common share of the Company. The warrants expire two years after the closing date. One of the selling shareholders who was the beneficial owner of 33.33% of Northern was a former director of the Company.

The Company recorded this acquisition using the purchase method of accounting with the Company identified as the acquirer.

The estimated fair value of the assets acquired is as follows:

Working capital	\$ 89,960
Capital assets	90,000
Restricted cash	<u>330,000</u>
Net assets	509,960
Total consideration	<u>1,607,986</u>
Excess of purchase price over fair value of net assets acquired allocated to goodwill	<u>\$ 1,098,026</u>

- (b) Pursuant to an agreement dated April 23, 1999 which closed on July 8, 1999, the Company acquired all of the common shares of Digital Fluid Ltd., and the related partnership interests of the Digital Fluid partnership, both e-commerce and technology companies, in exchange for an issuance, on closing, of 10,681,818 common shares valued at \$3,738,636 plus acquisition costs of \$60,186. An additional 9,318,162 common shares valued at \$3,261,357 were also issued to the vendors. The 9,318,162 common shares are being held in private escrow and will be released over 40 months. The acquisition was accounted for under the purchase method of accounting with the Company identified as the acquirer.

The estimated fair value of the assets to be acquired is as follows:

Working capital deficit	\$ (39,546)
Total consideration	<u>7,060,179</u>
Excess of purchase price over fair value of net assets acquired allocated to goodwill	<u>\$ 7,099,725</u>

- (c) The Company entered into employment agreements with 20 employees of St. James Securities Inc. (St. James). In addition to the hiring of personnel, the Company has acquired certain business and operating assets of St. James for \$72,000. See Note 14(d).

3. SECURITIES OWNED AND SECURITIES SOLD

Securities owned at market, consist of the following:

	<u>2000</u>	<u>1999</u>
	\$	\$
Equities	<u>621,650</u>	<u>-</u>

Securities sold at market, consist of the following:

	<u>2000</u>	<u>1999</u>
	\$	\$
Equities	<u>43,350</u>	<u>-</u>

4. INVENTORY

Inventory consists of the following:

	<u>2000</u>	<u>1999</u>
	\$	\$
Raw material	768,847	768,847
Finished sapphire stones	1,312,796	1,358,700
Finished jewelry	<u>140,856</u>	<u>173,918</u>
	<u>2,222,499</u>	<u>2,301,465</u>

The above inventory accounts have been adjusted to reflect the respective allowance for obsolete inventory recorded in prior years.

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

5. PREPAID EXPENSES AND OTHER

Included in prepaid expenses and other is \$129,000 of professional fees related to a financing. See Note 18.

6. MINING PROPERTIES

Mining properties consist of the following:

	<u>2000</u>	<u>1999</u>
	\$	\$
Gem Mountain	7,212,529	7,212,529
Other	14,334	14,334
	<u>7,226,863</u>	<u>7,226,863</u>
Less: Accumulated depletion	<u>(3,371,486)</u>	<u>(3,371,486)</u>
	<u><u>3,855,377</u></u>	<u><u>3,855,377</u></u>

During the year ended March 31, 1999, the Company substantially abandoned all remaining land holdings in the Eldorado Bar and Dry Cottonwood Creek areas of interest.

The Company has identified, measured and indicated sapphire resources on portions of the Gem Mountain property.

7. CAPITAL ASSETS

	<u>2000</u>	<u>1999</u>
	\$	\$
Mining plant and equipment	1,678,863	1,960,872
Office equipment	719,710	95,436
Equipment under capital lease	673,387	-
Leasehold improvements	293,889	-
	<u>3,365,849</u>	<u>2,056,308</u>
Less: Accumulated amortization	<u>(1,278,778)</u>	<u>(981,943)</u>
	<u><u>2,087,071</u></u>	<u><u>1,074,365</u></u>

8. GOODWILL

	<u>2000</u>	<u>1999</u>
	\$	\$
Opening balance	8,197,751	-
	-	-
Less: Accumulated amortization	<u>(852,187)</u>	<u>-</u>
	<u><u>7,345,564</u></u>	<u><u>-</u></u>

9. DEBENTURES PAYABLE

The debentures payable are unsecured interest-bearing at 9%, non-convertible and will mature on June 30, 2000 as to \$500,000 and August 29, 2000 as to the remaining \$1,200,000. (See Note 18).

10. LONG-TERM DEBT

Long-term debt, having a carrying amount which approximates fair value, consists of the following:

	<u>2000</u>	<u>1999</u>
	\$	\$
Obligation under capital leases (Note 14(f))	582,137	-
Less: Current portion	<u>(139,154)</u>	<u>-</u>
	<u><u>442,983</u></u>	<u><u>-</u></u>

The obligations under capital lease are secured by capital assets having a net book value of \$609,695.

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

11. **CAPITAL STOCK**

(a) **Share Capital:**

Authorized:

Unlimited number of common shares
2,000,000 voting, convertible, redeemable preference shares

Issued:

155,500,857 common shares

\$63,831,575

Transactions during the year are as follows:

	<u>Shares</u> #	<u>Amount</u> \$
Balance, March 31, 1999	105,447,977	47,068,958
Exercise of stock warrants	3,427,400	2,232,061
Exercise of stock options	8,115,000	539,363
Private placements	18,063,888	7,327,250
Issued on purchase of Digital Fluid (Note 2(b))	19,999,980	6,999,993
Issued for services	446,612	163,300
Share issue costs	<u>-</u>	<u>(499,350)</u>
Balance, March 31, 2000	<u>155,500,857</u>	<u>63,831,575</u>

(b) **Stock Options:**

As at March 31, 2000, the Board of Directors has granted stock options to certain directors, officers, employees and consultants of the Company as follows:

<u>Date of Grant</u>	<u>Date of Expiry</u>	<u>Options</u> <u>Granted</u>	<u>Exercise</u> <u>Price</u> \$
Directors and executive officers			
January 14, 2000	January 14, 2010	125,000	0.65
November 17, 1999	November 17, 2009	150,000	0.36
July 27, 1999	July 27, 2009	150,000	0.58
July 7, 1999	July 7, 2009	3,250,000	0.55
July 7, 1999	July 7, 2009	1,290,000	0.64
July 7, 1999	July 7, 2009	11,860,000	0.55
June 14, 1999	June 14, 2009	150,000	0.63
May 3, 1999	May 3, 2009	200,000	0.64
February 12, 1999	February 12, 2009	5,000	0.65
Directors who are not executive officers			
October 6, 1999	October 6, 2009	250,000	0.49
Employees			
March 9, 2000	March 9, 2010	141,200	0.70
November 17, 1999	November 17, 2009	906,000	0.36
September 8, 1999	September 8, 2009	50,000	0.48
August 27, 1999	August 27, 2009	192,000	0.50
August 17, 1999	August 17, 2009	51,500	0.50
August 3, 1999	August 3, 2009	100,000	0.45
July 12, 1999	July 12, 2009	50,000	0.65
July 9, 1999	July 9, 2009	189,000	0.63
February 22, 1999	February 22, 2009	150,000	0.035
February 12, 1998	February 12, 2008	20,000	0.065
Consultants			
March 9, 2000	March 9, 2010	30,000	0.70
September 9, 1999	September 9, 2009	10,460	0.51
September 9, 1999	September 9, 2009	41,480	0.51
April 8, 1999	April 8, 2004	<u>250,000</u>	0.65
Total		<u>19,611,640</u>	

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

11. **CAPITAL STOCK** (Continued)

(c) **Stock Warrants:**

As at March 31, 2000, the following stock warrants are outstanding:

<u>Date of Grant</u>	<u>Date of Expiry</u>	<u>Stock Warrants Granted</u>	<u>Exercise Price</u> \$
June 4, 1999	June 4, 2001	2,000,000	1.00
June 4, 1999	June 4, 2001	2,572,600	0.65
June 4, 1999	June 4, 2001	250,000	0.85
December 30, 1999	December 30, 2001	500,000	0.60
February 28, 2000	February 28, 2003	1,200,000	0.60
		<u>6,522,600</u>	

12. **SUPPLEMENTAL INFORMATION – STATEMENT OF CASH FLOWS**

- (a) During the year, Digital Fluid Ltd. (see Note 2(b)) was acquired for total consideration of \$7,099,725. The purchase price was satisfied by the issuance of 19,999,980 common shares valued at 6,999,993 and the assumption of \$39,546 of net liabilities.
- (b) During the year, certain capital assets were acquired at an aggregate cost of \$967,276 of which \$598,178 were acquired by the assumption of capital leases and \$240,000 by receipt of lease inducement payments.
- (c) During the year, 446,612 common shares were issued for services valued at \$163,300.

13. **INCOME TAXES**

The Company has loss carry-forwards in the U.S. of approximately \$15,400,000 (1999 - \$15,200,000) which under certain circumstances may be utilized to offset future U.S. taxable income. These losses begin to expire in 2010. The Company has loss carry-forwards in Canada of approximately \$4,560,000 (1999 - \$985,000) which under certain circumstances may be utilized to offset future taxable income. These losses begin to expire in 2006. The benefit of these losses has not been recognized in the accounts.

14. **COMMITMENTS AND CONTINGENCIES**

- (a) Pursuant to an agreement dated as of November 26, 1993, the Company sold a royalty interest for \$396,034. The net proceeds of \$337,455 (after payment of legal and other fees of \$58,589) were reflected as a reduction in the carrying value of mining properties held as of November 26, 1993. The royalty is applicable to (a) sales of all minerals that are produced from any properties held at the date of the agreement by the Company or its affiliates, (b) sales of minerals that are produced from properties acquired after the date of the agreement by the Company or its affiliates, where sapphires are the primary mineral that is, has been or will be mined from the particular property, and (c) sales of all other sapphires by the Company or its affiliates. The royalty is at a rate of 3% of the aggregate of all such sales, until such time as the cumulative royalty paid equals \$396,034, at which time the rate is reduced to 1.5%.
- (b) A former employee asserted a claim against the Company and related entities in April 1999 for damages for failing to allow him to exercise certain stock options at an exercise price of \$0.065 for 50,000 common shares and at an exercise price of \$0.07 for 500,000 common shares. The Company has disputed the jurisdiction of the Montana courts and deny the employee's entitlement to exercise any options by virtue of his alleged misconduct and failure to abide by the terms of the agreements. The employee has also asserted a claim for damages for three months severance. The Company denies liability and has asserted just cause for his termination.

In September 1999 the Company asserted claims against such former employee and other parties for damages in the amount of US\$5,000,000 for various breaches relating to the wrongful removal of gemstones and other assets from the Gem Mountain property, wrongfully misappropriating certain of the mining claims in the area and failing to renew certain mining claims, and rescission of the option agreement. Certain of the defendants are seeking to challenge the jurisdiction of the Ontario court and assert that the Montana court should deal with these claims.

- (c) In December, 1999, legal action was instituted against the Company for an amount of approximately U.S.\$128,000 relating to the alleged breach of a lease contract for premises in Montana, U.S.A. The Company will be filing a statement of defence and, at this time, no prediction of the outcome of this action can be determined. No provision has been made in these financial statements in respect of this action.

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

14. COMMITMENTS AND CONTINGENCIES (Continued)

- (d) On November 16, 1999, the Company acquired certain assets and assumed certain contracts and leases of St. James (Note 2(c)). In connection with this transaction certain client accounts (the "subject accounts") were transferred to the Company. The Company has not accepted ownership or responsibility for the subject accounts. Subsequent to March 31, 2000 substantially all of the subject accounts were transferred from the Company to other brokerage firms or have been closed. Accordingly, the Company terminated the introducing broker agreement with CT Securities Inc.

The Company has not included the subject accounts in these financial statements. The Investment Dealers Association of Canada (the "IDA") is reviewing and investigating the transfer of the subject accounts and following completion of such review and investigation the IDA could take the position that the subject accounts were the responsibility of the Company. The Company would vigorously disagree with any such position that could be taken by the IDA. If the subject accounts had been the responsibility of the Company as at March 31, 2000, the amount due to the Company's clients would have been \$388,553 instead of \$102,097, the amount due from the Company's clients would have been \$400,005 instead of \$104,527.

- (e) The Company is committed to minimum amount rentals under long-term leases for premises which expires at various dates to January 31, 2005.

Minimum rental commitments remaining under the lease approximates \$870,174 including \$152,278 due within one year. Minimum rental commitments for successive years approximate:

<u>Year</u>	<u>Amount</u>
	\$
2001	170,995
2002	182,995
2003	194,995
2004	162,195
2005	6,716

The Company is also responsible for certain common area costs under the terms of the leases.

- (f) The Company has entered into various leasing agreements for equipment. The following is a summary of future minimum lease payments under the capital leases expiring at various dates to December 2003, together with the present balance of the obligation:

<u>Year</u>	<u>Amount</u>
	\$
2002	624,326
2003	116,279
2004	<u>56,621</u>
	797,226
Less: Amount representing interest (Note 10)	<u>(215,089)</u>
	<u>582,137</u>

DIGITAL GEM CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000

15. SEGMENTED INFORMATION

<u>Data by business segment</u>	<u>Sapphire</u>	<u>Brokerage</u>	<u>E-Commerce</u>	<u>Consolidated</u>
	\$	\$	\$	\$
For the year ended March 31, 2000				
Revenue	713,396	2,753,958	-	3,467,354
Interest revenue	5,331	-	138,302	143,633
Interest expense	89	-	72,900	72,989
Income tax expense	-	49,049	-	49,049
Amortization	241,388	31,842	996,880	1,270,110
At March 31, 2000				
Segment assets	7,082,069	3,384,734	12,978,340	23,445,143

<u>Data by geographic segment</u>	<u>Canada</u>	<u>United States</u>	<u>Consolidated</u>
	\$	\$	\$
For the year ended March 31, 2000			
Revenue	2,753,958	713,396	3,467,354
Interest revenue	138,302	5,331	143,633
Interest expense	72,900	89	72,989
Income tax expense	49,049	-	49,049
Amortization	1,028,722	241,388	1,270,110
At March 31, 2000			
Segment assets	16,363,074	7,082,069	23,445,143

Prior to March 31, 1999, the Company was solely engaged in the business of mining sapphire-bearing properties and related operations. Consequently, the majority of the Company's assets and revenues were located in the United States and no segmented information has been provided.

16. FINANCIAL INSTRUMENTS

The carrying amounts for cash and cash equivalents, accounts receivable, deposit with carrying broker, due from clients, accounts payable and accrued liabilities, due to clients and debenture payable on the balance sheet approximate fair value because of the limited term of these instruments.

Fair value estimates are made at the balance sheet date, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

17. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 Issue that may affect the entity, including those related to customers, suppliers, or other third parties, have been fully resolved.

18. SUBSEQUENT EVENT

Financing

- a) Pursuant to a final prospectus dated May 8, 2000, the Company has issued rights to subscribe for 14,000,000 units. Each unit consists of one common share and one-half of one warrant and 1,700,000 qualified warrants. The net proceeds were \$6,357,000 after deducting estimated costs of the offering of \$643,000.
- b) In conjunction with the financing referred to above, \$500,000 of debentures due June 30, 2000 and \$863,000 of debentures due August 29, 2000 were retracted. (See Note 9).