



IOU Financial Inc.

**Annual Report
2016**

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IOU FINANCIAL INC.

Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

The following management's discussion and analysis ("MD&A") of IOU Financial Inc. ("IOU Financial" or the "Company"), prepared as of April 27, 2017, should be read in conjunction with, and is qualified in its entirety by reference to, the audited consolidated financial statements as at and for the years ended December 31, 2016 and 2015 and related notes which have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and IFRIC interpretations.

All amounts are expressed in Canadian dollars unless otherwise indicated.

OVERVIEW

IOU Financial provides small businesses throughout the U.S. and Canada access to capital. Typical customers include medical and dental practices, grocery and retail stores, salons, gas stations, auto repair shops, and restaurants. IOU Financial allows these businesses to apply for six, nine, twelve, fifteen and eighteen-month term loans of up to US\$150,000 (\$100,000 in Canada), that are repaid daily or weekly over the term of the loan directly out of the business' bank account, and that are personally guaranteed by their owner(s). As at December 31, 2016, IOU Financial's customers had been in business an average 11.4 years (based on their incorporation date) at the time of application. These businesses borrowed on average US\$69,695 for a weighted average term of 12 months and generally used the funds to purchase new equipment, invest in an increased workforce, attend to repairs, expand their business, purchase more inventory or increase marketing efforts.

IOU Financial finances its lending activities in part by selling some of its commercial loans receivable to third party purchasers and one related party on a non-recourse basis and retaining the servicing rights for these loans in exchange for a service fee.

As a lender, IOU Financial earns revenue from fees it charges to its borrowers, interest payments it receives on loans it has funded, gains on the sale of loans it has sold as well as servicing fees it charges third-party purchasers for servicing the loans. A referral fee is earned on loans that are referred to and funded by other third-party lenders.

IOU Financial's common shares trade on the TSX Venture Exchange ("TSX-V") under the symbol "IOU". Since commencing commercial lending operations in December of 2009 until December 31, 2016, the Company has originated approximately US\$415.4 million. IOU Financial had 53 full-time employees as at December 31, 2016.

CORPORATE HISTORY

IOU Financial is the continuation of Matco Ravary Inc. ("Matco Ravary"), a Company founded in 1977, which specialized for over 40 years in the retailing of home improvement and building materials. On November 1, 2002, Matco Ravary sold its operating assets to a company involved in the same sector, thereby ceasing all operations in the home improvement and building materials retailing sector. On May 14, 2004, substantially all of its issued and paid-up capital was distributed to its shareholders.

On April 29, 2005, Matco Ravary changed its corporate name to MCO Capital Inc. ("MCO"). During the following fiscal years, the main business and objective of MCO was to identify and evaluate businesses and assets with a view to a potential acquisition.

On February 28, 2011, MCO completed a reverse acquisition and acquired all of the issued and outstanding shares of IOU Central Inc. ("IOU Central"), a Canadian corporation incorporated in August 2006. On the same day, MCO also acquired all of the issued and outstanding shares of IOU USA, other than the shares of IOU USA already held by IOU Central. IOU USA was incorporated in Delaware in August 2006. In connection with the completion of the reverse acquisition, MCO effected a share consolidation and changed its name from "MCO Capital Inc." to "IOU Financial Inc."

FORWARD-LOOKING STATEMENTS

Statements made in this MD&A that describe IOU Financial's or management's budgets, estimates, expectations, forecasts, objectives, predictions or projections of the future may be "forward-looking statements", which can be identified by the use of the conditional or forward-looking terminology such as "anticipates", "believes", "estimates", "expects", "may", "plans", "projects", "should", "will", or the negative thereof or other variations thereon. IOU Financial cautions that, by their nature, forward-looking statements involve risks and uncertainties, and that its actual actions and/or results could differ materially from those expressed or implied in such forward-looking statements, or could affect the extent to which a particular projection materializes.

Many factors and assumptions could have an impact on the materialization of IOU Financial's projections, including, but not limited to, risks inherent in growing a new business, dependence on third-party service providers, competition, regulatory risk, dependence on key personnel, risks related to rapid growth of the Company, security and confidentiality risk, risk related to inability to attract borrowers and lenders, technological development risk, IT disruptions, maintenance of client relationships, litigation risk, volatility of stock price, and other factors that are beyond its control. IOU Financial cautions that the foregoing list of factors is not exhaustive. For more information on risks and uncertainties and assumptions that would cause the company's actual results to differ from current expectations, please refer to the section "Risks and Uncertainties" of this MD&A. The forward-looking statements in this MD&A reflect IOU Financial's expectations as at the date of this MD&A. IOU Financial does not undertake any obligation to update publicly or to revise any such forward-looking statements, unless required by applicable legislation or regulation.

OVERALL PERFORMANCE AND SELECTED FINANCIAL INFORMATION

The following table summarizes key financial data for each of the respective periods. The financial information presented below has been presented in Canadian dollars (except where otherwise noted) and has been prepared in accordance with International Financial Reporting Standards (IFRS).

Summarized Financial Data (\$)

	For the Year Ended December 31, 2016	For the Year Ended December 31, 2015
	\$	\$
Loan originations (\$US)	107,584,320	146,409,471
Principal balance of loan portfolio	42,108,901	27,488,253
Principal balance of servicing portfolio	28,193,582	65,185,687
Total loans under management	70,302,483	92,673,940
Gross revenue	17,400,527	11,971,148
Net revenue	6,892,660	7,708,353
Net loss	(4,808,115)	(3,658,473)
Net loss per share ⁽¹⁾	(0.08)	(0.06)
Adjusted net loss	(3,172,064)	(1,695,156)
Total assets	47,894,491	34,041,090
Total liabilities	37,471,496	20,646,498

⁽¹⁾ The net loss per share has been calculated using the weighted average number of shares outstanding during each period. Diluted earnings per share were not presented as the effect would be anti-dilutive.

IOU Financial's innovative lending platform continues to emerge as a viable solution to the challenges small businesses face when trying to obtain financing. IOU Financial believes that a large opportunity exists to expand its presence in what it believes is a significantly underserved market.

During the year ended December 31, 2016, IOU Financial originated (funded) approximately US\$107.6 million in loans (2015: US\$146.4 million). Loan originations decreased due to changes made to the Company's lending policies in response to increased delinquency levels. We anticipate that these changes will have a positive impact on our loan portfolio over the course of 2017.

For the year ended December 31, 2016 loans originated through the retail channel, where borrowers are sourced directly, decreased 15%, year over year, to US\$7.4 million as a result of a decrease in marketing spend and changes to our lending policies. Loans originated through our wholesale channel, where borrowers are sourced via relationships with third-party business loan brokers, decreased 27% year over year to US\$100.2 million due to changes to our lending policies. On December 31, 2016, total loans under management amounted to approximately \$70.3 million (2015: \$92.7 million), representing a decrease of 24.1% over the same period in 2015.

On December 31, 2016, the principal balance of the loan portfolio amounted to \$42.1 million (2015: \$27.5 million), representing an increase of 53.2% over the previous year, consistent with the Company's strategy to retain more loans on its balance sheet. Through a series of debt assignment agreements concluded during the year ended December 31, 2016, IOU Financial sold some of its commercial loans receivable to third-party purchasers and one related party on a non-recourse basis for total proceeds of \$60.8 million (2015: \$137.3 million). IOU Financial retained the servicing rights (payment collections) for these loans in exchange for a servicing fee. As at December 31, 2016, the principal balance of IOU Financial's servicing portfolio (loans being serviced on behalf of third-parties and one related-party) amounted to approximately \$28.2 million (2015: \$65.2 million), representing a decrease of 56.7%.

Gross revenues, comprised of interest revenue, net gains recognized on loan sales as well as fees and servicing income, totalled \$17,400,527 for the year ended December 31, 2016 (2015: \$11,971,148), representing an increase of 45.4% over the previous year. The increase in gross revenues was primarily driven by an increase in interest income. Interest income increased to \$13,310,052 for the year ended December 31, 2016 (2015: \$6,755,070), representing an increase of 97.0% over the previous year, as a result of an increase in the size of the loan portfolio as well as an increase in pricing.

Net revenue totalled \$6,892,660 for the year ended December 31, 2016 (2015: \$7,708,353), representing a decrease of 7.3% over the previous year.

Interest expense during the year ended December 31, 2016 increased by 82.9% to \$3,177,124, up from \$1,739,838 over the previous year. The increase is attributable to an increase in borrowings under the credit facility partially offset by a reduction in the cost of funds borrowed versus the previous year.

Provision for loan losses (net of recoveries) increased to \$7,330,743 for the year ended December 31, 2016 (2015: \$2,522,957). This increase is attributable to a significant increase in the size of the loan portfolio as well as a build in the allowance for loan losses mostly for loans originated prior to the quarter ended September 30, 2016. During the year ended December 31, 2016, IOU Financial made changes to its lending policies and deployed its next generation proprietary IOU Risk Logic Score. These changes are expected to contribute to improved credit performance in 2017. In addition, the Company has implemented certain process changes to improve its servicing and collections.

Operating expenses were \$11.6 million for the year ended December 31, 2016 (2015: \$11.6 million). During the year ended December 31, 2016, the Company adopted a plan to reduce operating expenses. These cost-reduction efforts, once fully implemented are expected to lower quarterly operating expenses from \$3.0 million for the quarter ended September 30th, 2016 to \$2.0 million to \$2.2 million in 2017, on a normalized basis. For the quarter ending December 31, 2016 operating expenses were \$2.5 million, representing a \$0.5 million reduction from the quarter ended September 30th, 2016 when the plan was initiated.

For the year ended December 31, 2016, IOU Financial had a net loss of \$4,808,115 or \$0.08 per share (2015: \$3,658,473 or \$0.06 per share).

Adjusted net loss for the year ended December 31, 2016 was \$3,172,064 (2015: \$1,695,156).

Assuming the cost reduction plan was fully implemented on January 1, 2016, IOU's pro forma adjusted earnings for the year ended December 31, 2016 would have been break even.

RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2016

The following table presents IOU Financial's condensed consolidated statement of comprehensive income for the years ended December 31, 2016 and 2015. The financial information is presented in Canadian dollars (except where otherwise noted) and was prepared in accordance with International Financial Reporting Standards (IFRS).

Condensed Consolidated Statement of Comprehensive Loss

	For the year ended December 31, 2016	For the year ended December 31, 2015
	\$	\$
Gross revenue	17,400,527	11,971,148
Cost of revenue	10,507,867	4,262,795
Net revenue	6,892,660	7,708,353
Operating expenses	11,562,792	11,605,919
Loss before income taxes	(4,670,132)	(3,897,566)
Income tax (expense) recovery	(137,983)	239,093
Net loss	(4,808,115)	(3,658,473)
Currency translation differences	(725,133)	1,811,043
Total comprehensive loss	(5,533,248)	(1,847,430)
Total net loss	(4,808,115)	(3,658,473)
Net loss per share	(0.08)	(0.06)
Adjusted net loss	(3,172,064)	(1,695,156)

Gross Revenue

IOU Financial's gross revenue consists of interest revenue earned on loans it has funded and servicing fees on loans sold to loan purchasers. Gross revenue also includes net gains recognized on the sale of loans.

The following table summarizes revenues by category.

Total Revenue by Category

	For the year ended December 31, 2016	For the year ended December 31, 2015
	\$	\$
Gross Revenue		
Interest revenue	13,310,052	6,755,070
Other fees and servicing income	1,570,027	1,321,068
Net gain recognized on sale of loans	2,520,448	3,895,010
Gross Revenue	17,400,527	11,971,148

Gross revenue for the year ended December 31, 2016 was \$17,400,527 (2015: \$11,971,148). The increase of \$5,429,379 is attributable to the following: Interest revenue increased by \$6,554,982 from \$6,755,070 earned during the 2015 period to \$13,310,052 in 2016 due to an increase in the size of the loan portfolio as well due to an increase in pricing, while other fees and servicing income increased by \$248,959 from \$1,321,068 in 2015 to \$1,570,027 in 2016. Net gains recognized on loan sales decreased by \$1,374,562 during the 2016 period from \$3,895,010 to \$2,520,448. This decrease is due to a decrease in the number of loans sold during 2016.

Cost of revenue

IOU Financial's cost of revenue consist primarily of interest costs incurred in connection with the financing of its lending activities and provisions for loan losses (net of recoveries). The following table summarizes cost of revenue by category.

Cost of Revenue by Category

	For the year ended December 31, 2016	For the year ended December 31, 2015
	\$	\$
Cost of revenue		
Interest expense	3,177,124	1,739,838
Provision for loan losses – net of recoveries	7,330,743	2,522,957
Total cost of revenue	10,507,867	4,262,795

Cost of revenue for the year ended December 31, 2016, compared to the same period in 2015, increased by \$6,245,072, from \$4,262,795 in 2015 to \$10,507,867 in 2016. This increase is attributable to an increase of \$1,437,286 in interest expense, from \$1,739,838 in 2015 to \$3,177,124 and an increase in the provision for loan losses (net of recoveries) of \$4,807,786, from \$2,522,957 in 2015 to \$7,330,743 in 2016. The increase is attributable to an increase in borrowings under the credit facility partially offset by a reduction in the cost of funds borrowed versus the previous year.

The provision for loan losses (net of recoveries) increased primarily as a result of a significant increase in the size of the loan portfolio as well as a build in the allowance for loan losses mostly for loans originated prior to the quarter ended September 30, 2016. During the year ended December 31, 2016, IOU Financial made changes to its lending policies and deployed its next generation proprietary IOU Risk Logic Score. These changes are expected to contribute to improved credit performance in 2017. In addition, the Company has implemented certain process changes to improve its servicing and collections.

Operating Expenses:

IOU Financial's operating expenses consist primarily of compensation costs (excluding capitalized salaries and fees paid to employees and consultants directly involved with IOU Financial's software development efforts) and professional service fees, including consulting services, legal, audit and accounting fees as well as stock-based compensation and other operating costs.

Operating expenses decreased by \$43,127 to \$11,562,792 during the year ended December 31, 2016 compared to \$11,605,919 in the same period in 2015. This decrease can be attributed to the following:

- a decrease of \$567,081 in professional fees and in legal and accounting fees mostly due to non-recurring costs in 2015 for an unsolicited takeover bid for the company;
 - a decrease of \$371,668 in advertising and promotion due to a decrease in marketing efforts;
- offset by:
- an increase in restructuring costs of \$220,411;
 - an increase in the amortization of transaction costs of \$206,880 in 2016 related to the new credit facility; and
 - an overall increase caused by a higher average exchange rate on our US denominated expenses.

During the quarter ended September 30th, 2016, IOU adopted a plan to reduce operating expenses. These cost-reduction efforts, once fully implemented are expected to lower quarterly operating expenses from \$3.0 million for the quarter ended September 30th, 2016 to \$2.0 million to \$2.2 million, on a normalized basis. For the quarter ending December 31, 2016 operating expenses were \$2.5 million, representing a \$0.5 million reduction from the quarter ended September 30th, 2016 when the plan was initiated costs.

Adjusted Earnings (Net Loss) represents earnings (net loss) excluding certain non-cash items such as amortization and depreciation, stock-based compensation, net gain recognized on sale of loans, amortization of servicing asset, income tax recoveries and excluding certain non-recurring expenses such as costs related to the Company's unsolicited takeover bid. The Company uses Adjusted Earnings (Net Loss) as a measure of financial performance.

Adjusted Net Loss

	For the year ended December 31, 2016	For the year ended December 31, 2015
	\$	\$
Net loss	(4,808,115)	(3,658,473)
Depreciation and amortization	246,053	111,422
Amortization of transaction costs	206,880	-
Stock-based compensation	258,122	517,121
Gain on servicing asset	(2,122,371)	(3,672,423)
Amortization of servicing asset	2,668,973	4,029,006
Income tax expense (recovery)	137,983	(239,093)
Restructuring costs	220,411	-
Non-recurring costs related to the unsolicited takeover bid	-	1,217,284
Adjusted net loss	(3,172,064)	(1,695,156)

Adjusted net loss for the year ended December 31, 2016 was \$3,172,064 (2015: \$1,695,156). Assuming the cost reduction plan was fully implemented on January 1, 2016, IOU's pro forma adjusted earnings for the year ended December 31, 2016 would have been break even.

CONSOLIDATED FINANCIAL POSITION

The following table presents IOU Financial's condensed consolidated statement of financial position as at December 31, 2016 and December 31, 2015. The financial information is presented in Canadian dollars (except where noted) and was prepared in accordance with International Financial Reporting Standards (IFRS).

Condensed Consolidated Statement of Financial Position

	As at December 31, 2016	As at December 31, 2015
	\$	\$
Assets		
Commercial loans receivable	43,187,707	27,951,420
Allowance for loan losses	(3,767,490)	(996,462)
Commercial loans receivable – net	39,420,217	26,954,958
Non-portfolio assets	8,474,274	7,086,132
Total assets	47,894,491	34,041,090
Liabilities		
Credit facility	25,800,542	8,851,238
Convertible debentures – liability component	10,202,019	10,138,177
Other liabilities	1,468,935	1,657,083
Total liabilities	37,471,496	20,646,498
Shareholders' equity	10,422,995	13,394,592

Total Assets

Total assets increased by 40.7% from \$34,041,090 at December 31, 2015 to \$47,894,491 at December 31, 2016. This increase is attributable to an increase of \$12,465,259 in net commercial loans receivable and an increase of \$1,668,476 in cash reserves (see "flow of funds" section below for an explanation of the variance).

Total Liabilities

IOU Financial's total liabilities increased 81.5% from \$20,646,498 at December 31, 2015 to \$37,471,496 at December 31, 2016. The increase is due to an increase of \$16,949,304 in the financing credit facility to finance the increased amount of loans retained on the balance sheet.

Shareholders' Equity

Shareholders' Equity decreased 22.2% from \$13,394,592 at December 31, 2015 to \$10,422,995 at December 31, 2016.

This decrease is attributable to current year comprehensive loss.

LIQUIDITY AND CAPITAL RESOURCES

IOU Financial's primary sources of liquidity and capital resources are cash-on-hand, cash provided by operations and cash provided by financing through the issuance of equity and/or debt securities as well as the sale of loans.

The condensed interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Although IOU Financial has continued to report operating losses and used cash to fund its operations, it also has strengthened its financial position by raising additional equity financing.

In October and November 2016, the Company raised \$2.2 million, net of transaction costs, as part of two tranches of a private placement.

The Company continues to review the current terms of its credit facility in order to best meet its liquidity needs. At December 31, 2016, the Company had undrawn borrowing facilities of \$5,784,582 (2015: \$4,988,762). The credit facility has an original term of three years and is expandable to US\$50 million at IOU's request and the lender's acceptance.

During the year ended December 31, 2016, the Company sold \$60.8 million (2015: \$137.3 million) of commercial loans receivable. The loan sales program continues to provide the Company with additional liquidity to meet its growing loan demand and increase its presence in the marketplace.

Operating lease commitments

The group leases offices under non-cancellable operating lease agreements. The lease terms are between 3 and 12 years and are renewable at the end of the lease term.

The future aggregate minimum lease payments under the non-cancellable operating lease are as follows:

	December 31, 2016	December 31, 2015
No later than 1 year	545,798	543,112
Later than 1 year and no later than 4 years	948,110	1,075,947
Later than 5 years	401,170	628,789
Total	1,895,078	2,247,848

Flow of Funds

The following table presents a summary of cash flows for the year ended December 31, 2016 and 2015.

Condensed Interim Consolidated Statement of Cash Flows

	For the Year Ended December 31, 2016	For the Year Ended December 31, 2015
	\$	\$
Cash used in operating activities	(14,167,488)	(11,559,381)
Cash generated from financing activities	15,907,894	13,808,014
Cash used in investing activities	(182,589)	(642,020)
Increase in cash	1,557,817	1,606,613
Exchange rate difference on cash	110,659	529,465
Net increase in cash	1,668,476	2,136,078

Cash used in operating activities

The \$2,608,107 increase in cash used for operating activities for the year ended December 31, 2016, compared to the same period in 2015, was primarily related to a decrease of \$76,476,012 in the cash inflow from the sale of commercial loans (2016: \$60,827,481 compared to \$137,303,493 in 2015) offset by a decrease in cash outflow of \$73,939,519 resulting from a decrease in commercial loans receivable funded (2016: \$74,217,150 compared to 2015: \$148,156,669).

Cash generated from financing activities

The \$2,099,880 increase in cash generated by financing activities for the year ended December 31, 2016, compared to the same period in 2015, is primarily due to an increase in cash inflows of \$23,936,541 (\$1,864,001 in 2015 compared to \$25,800,542 in 2016) resulting from the drawdown of funds of the financing credit facility, as well as an increase in cash inflows due to the issuance of equity of \$2.2 million (net of transaction costs), offset by a decrease of \$10,878,841 in convertible debentures of \$10,878,841 (net of transaction costs) (\$0 in 2016 compared to \$10,878,841 in 2015), the refinancing of the 2012 credit facility of \$9,226,338 and an increase of \$1,246,432 in interest paid.

Cash used in investing activities

The \$459,431 decrease in cash used by investing activities for year ended December 31, 2016, compared to the same period in 2015, is due to a decrease in cash outflows for the purchase of equipment of \$181,170 (2016: \$67,906 compared to 2015: \$249,076) and the purchase of intangible assets of \$278,261 (2016: \$114,683 compared to 2015: \$392,944).

SUMMARY OF QUARTERLY RESULTS

Quarterly Results

For the quarters ended	Dec 31/16	Sept 30/16	Jun 30/16	Mar 31/16
	\$	\$	\$	\$
Gross revenue	4,917,746	5,665,437	3,504,489	3,312,855
Net revenue	789,983	2,615,150	1,628,700	1,858,827
Net loss	(1,669,856)	(350,033)	(1,479,997)	(1,308,229)
Net loss per share ⁽¹⁾	(0.03)	(0.01)	(0.02)	(0.02)

For the quarters ended	Dec 31/15	Sept 30/15	Jun 30/15	Mar 31/15
	\$	\$	\$	\$
Gross revenue	3,823,875	2,642,893	2,866,542	2,637,839
Net revenue	2,397,195	1,513,153	1,788,374	2,009,632
Net loss	(628,524)	(2,118,655)	(696,296)	(214,997)
Net loss per share ⁽¹⁾	(0.01)	(0.03)	(0.01)	(0.00)

(1) Net loss per share has been calculated using the weighted average number of shares outstanding during each year. Diluted earnings per share were not presented as the effect would be anti-dilutive.

OFF-BALANCE SHEET ARRANGEMENTS

IOU Financial does not engage in any off-balance sheet financing activities. IOU Financial does not have any interest in non-consolidated entities referred to as variable interest entities, which include special purpose entities and other structured finance entities.

PROPOSED TRANSACTIONS

There were no proposed transactions as at the date of the Company's financial statements.

TRANSACTIONS BETWEEN RELATED PARTIES

- a) The CEO and director of IOU Financial is a shareholder in a company that owns a significant stake in Palos Capital Corporation, the parent company of Palos Management Inc ("Palos"). During the year ended December 31, 2016, a fund managed by Palos purchased \$25,441,447 (2015: \$29,316,987) of commercial loans receivable from the Company for which the Company has retained the servicing rights. Servicing fees, amounting to \$1,454,773 have been earned by the Company on these loans during the year ended December 31, 2016 (2015: \$1,501,557). Palos also received agency fees of \$31,002 (2015: \$71,435) relating to loans sold to a third-party purchaser, of which \$nil (2015: \$13,047,516) have been sold during the year.
- b) In October 2014, IOU Financial entered into a new leasing agreement with Palos for its Canadian office space. The lease may be cancelled after 7 years upon the payment of a termination fee. The terms of this operating lease are similar to those that would have been present for an arm's length transaction. The amount expensed as rent for the period relating to this lease amounts to \$232,153 excluding applicable taxes (2015: \$200,331). Future non-cancellable lease commitments under this agreement amount to \$1,507,902.
- c) Key Management Compensation

Key management includes directors (executive and non-executive) and officers. The compensation paid or payable to key management for employee services for the years ended December 31, 2016 and 2015 is shown below:

	For the year ended December 31, 2016	For the year ended December 31,
	\$	2015
		\$
Salaries and other short-term employee benefits	960,351	756,453
Share-based payments	179,668	291,360
Other director compensation	-	65,000
	1,140,019	1,112,813

COMMERCIAL LOANS RECEIVABLE

IOU Financial's commercial loan receivable portfolio is composed of a large number of loans, and as such, no individual loan comprises a significant portion of the portfolio. As at December 31, 2016, the average loan balance in the portfolio was approximately US\$56,475. In addition to limiting its exposure to any single loan, IOU Financial maintains a geographically and industry diversified loan portfolio which reduces the risk of loss arising from adverse regional or industrial economic conditions.

The following tables present the portfolio by geography and industry as at December 31, 2016.

Industry Category	Portfolio %
Specialty trade contractors and home building renovation	15%
Automotive garage	5%
Other store or online retailers wholesalers	5%
Retail store	4%
Plumbing, heating and air conditioning contractors	4%
Casual dining restaurant	3%
Automotive parts, accessories and tire stores	3%
Dentists	2%
Landscaping services	2%
Medical services	2%
Trucking and Towing Services	2%
Other food related services	2%
Other medical professionals	2%
Other	49%
Total	100%

State	Portfolio %
Florida	14%
California	9%
Texas	9%
New York	8%
Pennsylvania	6%
Illinois	5%
Georgia	4%
New Jersey	4%
North Carolina	3%
Ohio	3%
Other	35%
Total	100%

OUTSTANDING SHARE DATA

The following table presents IOU Financial's outstanding share data as at April 27, 2017:

Outstanding Share data

Ordinary shares issued and outstanding:	Number of shares issued
31 December 2015	61,628,783
Shares issued during the period	8,824,126
Shares outstanding on April 27, 2017	70,452,909
Warrants issued and Outstanding:	Number of warrants issued
December 31, 2015	1,371,481
Warrants exercised	(316,361)
Warrants outstanding on April 27, 2017	1,055,120
Options issued and outstanding:	Number of Options issued
December 31, 2015	6,146,000
Options forfeited	(472,166)
Options outstanding on April 27, 2017	5,673,834

BUSINESS OUTLOOK

In 2017, IOU Financial will continue to focus on finding operational efficiencies, the performance of its loan portfolio, and achieving profitability.

IOU Financial will maintain its core strategy of identifying, recruiting, and partnering with business loan brokers throughout the United States while continuing to focus its efforts on building long-term partnerships with its existing broker base by investing time in offering great service through dedicated account executives.

IOU Financial also intends to grow loan originations by forming new strategic partnerships with entities such as banks and small business suppliers and leveraging their relationships with small businesses to add new customers; expanding its product offering to allow it to serve small businesses whose needs are not met by its current products; investing in direct marketing and sales; and continuing its expansion into Canada.

PRIVATE PLACEMENT

In October and November 2016, IOU Financial completed an offering of 8,507,765 common shares at a price of \$0.27 per common share for gross proceeds of \$2,297,082. Transaction costs have been offset against share capital for net proceeds of \$2,162,346.

CRITICAL ACCOUNTING ESTIMATES

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

1. Deferred Tax Estimation

Deferred tax assets and liabilities recognition involves making a series of assumptions. For instance, the Company must estimate the timing of the reversal of temporary differences or if it is probable that temporary differences will not reverse in the foreseeable future or the tax rates expected to apply to the period when the asset is realized or the liability is settled.

With respect to deferred tax assets, their realization ultimately depends on taxable profits being available in the future. Deferred tax assets should be recognized when it is probable that taxable profits will be available against which the deferred tax asset can be utilized and it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments. This involves the Company making assumptions within its overall tax-planning activities and periodically reassessing them in order to reflect changed circumstances as well as tax regulations. Moreover, the measurement of a deferred tax asset or liability reflects the manner in which the entity expects to recover the asset's carrying value or settle the liability.

2. Stock-based compensation

The Company measures the cost of equity-settled transactions with employees of the Company and share warrants by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option or share warrant, volatility and dividend yield and making assumptions about them.

3. Servicing assets

The initial recognition of servicing assets requires the Company to make estimates of the fair value of the service to be provided which is based on market expectations at the time of the loan sale and may vary from the actual cash flows serviced.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after January 1, 2017 and have not been applied in preparing these condensed interim consolidated financial statements. None of these is expected to have a significant effect on the condensed interim consolidated financial statements of the Company, except the following set out below:

New standards and interpretations not yet adopted

IFRS 15, Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers, which introduces a single, comprehensive revenue recognition model for all contracts with customers other than those within the scope of other standards, such as insurance contracts and financial instruments. IFRS 15 therefore supersedes the two main revenue recognition standards, IAS 18, Revenue, and IAS 11, Construction Contracts, as well as related interpretations. The core principle of this new standard is that revenue recognition should depict the transfer of goods or services in an amount that reflects the consideration received or expected to be received in exchange for these goods or services. The new standard also provides more guidance on certain types of transactions and will result in an increase in disclosures related to revenue.

The Company is currently assessing the impact of adopting IFRS 15, which is effective for annual periods beginning on or after January 1, 2018.

IFRS 9, Financial Instruments

In July 2014, the IASB issued the complete and final version of IFRS 9, Financial Instruments, which will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 covers requirements concerning the classification and measurement of financial assets and financial liabilities, impairment of financial assets and hedge accounting. IFRS 9 establishes a new classification and measurement model for financial assets to determine whether a financial asset must be classified as measured at amortized cost, at fair value through profit or loss or at fair value through other comprehensive income. This model is based on the characteristics of the contractual cash flows of the financial asset and on the business model under which it is held. For the classification and measurement of financial liabilities, the new standard essentially follows the current requirements under IAS 39.

The standard also introduces a single impairment model for financial assets that requires recognizing expected credit losses instead of incurred losses, which is the requirement under the current impairment model. The model provides for a multi-phase approach based on changes in credit quality since initial recognition.

Lastly, IFRS 9 includes a new hedge accounting model to align hedge accounting more closely with risk management activities.

IFRS 9 will be effective for annual periods beginning on or after January 1, 2018. The Company is currently assessing the impact of adopting this standard.

IFRS 16, Leases

In January 2016, the IASB released IFRS 16, which supersedes IAS 17, Leases and the related interpretations on leases: IFRS Interpretations Committee (IFRIC) 4, Determining Whether an Arrangement Contains a Lease; Standard Interpretations Committee (SIC) 15, Operating Leases – Incentives; and SIC 27, Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for companies that also apply IFRS 15. The Company is currently evaluating the impact of the standard on its financial statements.

IAS 7, Statement of Cash Flows

In January 2016, the IASB released amendments to IAS 7 Statement of Cash Flows. The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The Company is currently evaluating the impact of the standard on its financial statements.

IAS 12, Income Taxes

In January 2016, the IASB released amendments to IAS 12 Income Taxes. The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The Company is currently evaluating the impact of the standard on its financial statements.

IFRS 2, Share-Based Payment

In June 2016, the IASB released amendments to IFRS 2 Share-based Payment. The amendments provide guidance on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, share-based payment transactions with a net settlement feature for withholding tax obligations, and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company is currently evaluating the impact of the standard on its financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Under IFRS 7, Financial instruments: Disclosures, financial assets must be classified into one of four categories: financial assets at fair value through profit or loss, held to maturity investments, loans and receivables and available for sale. Financial liabilities must be classified into one of two categories: at fair value through profit or loss or amortized cost. Cash, restricted cash, commercial loans receivable, certain other assets and sales tax receivable have been classified as loans and receivables. Loans and receivables are accounted for at amortized cost using the effective interest rate method. Accounts payable and accrued liabilities, and financing credit facility are classified as financial liabilities and are accounted for at amortized cost using the effective interest rate method.

The carrying values of cash, accounts receivable, loans receivable, credit facility and accounts payable approximate their fair values due to the relatively short period to maturity of these items.

Loan investment receivables are due from customers in the United States. The maximum credit risk associated with the company's financial assets is the carrying value of those assets.

Foreign exchange risk

The Company operates internationally and is exposed to foreign exchange risk arising from currency exposure with respect to the US dollar. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities.

The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results.

Listed below are the relevant instruments and the amount of foreign currencies included in their balances (in US dollars) as at December 31, 2016:

Cash	USD \$3,446,220
Restricted cash	USD \$275,681
Certain other assets	USD \$938,787
Net loan investment receivable	USD \$29,360,300
Accounts payable and accrued liabilities	USD \$(624,106)
Credit facility	USD \$ (19,215,418)

The exchange rate applied as at December 31, 2016 was 1.3427 (2015: 1.3840).

Based on the Company's foreign currency exposure noted above, varying the above foreign exchange rates to reflect a one (1) percent strengthening of the Canadian dollar would have increased the net loss by approximately \$347,130 (December 31, 2014: \$202,668), assuming that all other variables remained constant. An assumed one (1) percent weakening of the Canadian dollar would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach in managing liquidity is to ensure, as much as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company manages liquidity risk through the management of its capital structure.

Credit risk

Credit risk is managed on a Company basis and results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. The Company regularly monitors the credit risk exposure and takes steps to mitigate the likelihood of these exposures from resulting in actual loss. Even though there has been substantial growth in financial instruments, particularly commercial loans receivable, there has been no change in credit risk in 2016 as there has been no significant change in average loan sizes and credit policies for approval of loan applications from the prior year. There have been no changes in the management of risks arising from financial instruments during the current period.

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit risk history of each customer. These policies cover the approval of credit applications, attribution of risk ratings, management of impaired loans, establishment of provisions and risk-based pricing. The Company does not believe it is exposed to an unusual level of customer credit risk. The Company's maximum credit risk is the carrying value of the cash, restricted cash and commercial loans receivable. The Company has had a history of few bad debts and the allowance for loan losses is maintained at a level considered sufficient to cover all potential losses.

In addition, financial instruments that potentially subject the Company to significant concentrations of credit risk consist of deposits in the form of cash and restricted cash. The Company invests with major North American financial institutions. The Company has investment policies that are designed to provide for the safety and preservation of principal, the Company's liquidity needs and appropriate yields. The Company has no exposure to any asset-backed securities.

Interest rate risk

The Company is subject to interest rate risk on its cash and restricted cash. Sensitivity to a 1% change in interest rates would not have a material effect on the Company's results.

None of the Company's current commercial lending is based on variable interest rates. The Company is also exposed to changes in the value of a loan when that loan's interest rate is at a rate other than current market rate. The Company mitigates this risk by lending for short terms, with terms at the inception of the loan generally varying from six months to one year.

The Company is exposed to cash flow interest rate risk on its credit facility issued at a variable rate. During 2015 and 2016, the borrowings at a variable rate were denominated in USD. The Company mitigates this risk by borrowing for a 12-month term and therefore the Company does not believe that its exposure to interest rate risk is significant.

Interest income presented in the consolidated statement of comprehensive loss represents interest income on financial assets that are classified as loans and receivables.

RISKS AND UNCERTAINTIES

In addition to the risks mentioned above, IOU Financial is subject to a number of risks and uncertainties in carrying out its activities.

IOU Financial is Subject to the Risks Inherent in Growing a New Business.

IOU Financial's operations are subject to the general risks inherent in growing a new business, including, among others, hiring and retaining experienced and qualified employees. If IOU Financial cannot hire or retain qualified employees, or cannot effectively implement its business planned strategy, it will be hampered in its ability to grow its current market and to develop new markets, which would in turn have an adverse effect on its financial performance. Even if IOU Financial successfully implements its planned strategy, it may not achieve the favourable impact on its operations that it anticipates.

Compliance with debt covenants

IOU Financial entered into a loan agreement with a new lender. The loan agreement imposes covenants and obligations on the part of the Company. In particular, the agreement contains certain covenants and representations, the breach of which could result in a default and the acceleration of the maturity of the term credit facility. IOU Financial plans to address the risk of default by endeavoring to meet the financial covenants and other obligations in the loan agreement. There is no assurance, however, that IOU Financial will be in compliance with covenants in the future due to unforeseen events or circumstances and if IOU Financial was to default there is no assurance that an amendment or waiver will be granted by the lender.

Dependence on Third Party Service Providers

IOU Financial's service to its clients depends, in part, on its ability to attract and retain the services that are provided to it, by third party service providers. If some or all of IOU Financial's current third party service providers were to interrupt or cancel their current services to IOU Financial, the company might be forced to curtail or cease its operations.

Competition

IOU Financial operates in an increasingly competitive environment. Both large and small competitors compete with IOU Financial. Some of these competitors may have longer operating histories, greater name recognition and greater financial and marketing resources than IOU Financial. IOU Financial believes that its ability to compete effectively is dependent upon the quality of its product and client service. There can be no assurance that IOU Financial will be able to compete effectively and retain its existing clients or attract and retain new clients. IOU Financial's current and potential competitors may develop and market new products or services that render IOU Financial's existing and future products and services less marketable or competitive.

Regulatory Risk

IOU Financial is subject to strict regulatory and licensing compliance standards, non-conformity with which may expose IOU Financial to adverse consequences. IOU Financial's business is dependent to a large extent on its ability to remain in good standing with all regulators. Some of these regulators impose minimum working capital or net equity requirements, amongst other, which in certain cases and under certain circumstances, IOU Financial may not be able to satisfy. Under such cases, the Company may not be able to operate its regular business until all such financial or regulatory requirements have been satisfied.

Dependence on Key Personnel

IOU Financial's future depends, in part, on its ability to attract and retain key personnel. IOU Financial's future also depends on the continued contributions of its executive officers and other key technical personnel, each of whom would be difficult to replace. The loss of the services of executive officers or key personnel, and the process to replace any of its key personnel could involve significant time and expense and may significantly delay or prevent the achievement of its business objectives.

IOU Financial's growth could strain its personnel, resources and infrastructure

IOU Financial's growth in headcount and operations may place a significant strain on its management and its administrative, operational and financial reporting infrastructure. Accordingly, IOU Financial's success will depend, in part, on the ability of its senior management to manage the growth it achieves effectively. To do so, it must continue to hire, train and manage new employees as needed. The addition of new employees and the system development that it anticipates will be necessary to manage its growth will increase its cost base, which will make it more difficult for it to offset any future revenue shortfalls by reducing expenses in the short term. If IOU Financial fails to successfully manage its growth, it will be unable to execute its business plan. If its new hires perform poorly, or if it is unsuccessful in hiring, training, managing and integrating these new employees, or if it is not successful in retaining its existing employees, IOU Financial's business may be harmed. To manage the growth of IOU Financial's operations and personnel, it will need to continue to improve its operational and financial controls and update its reporting procedures and systems. Given the complex nature of the accounting of the Company's operations and the limited number of staff resources, IOU Financial may not be able to address all accounting and reporting impacts of new transactions or agreements on a timely basis.

Security and Confidentiality Risk

IOU Financial stores users' bank information and other personally-identifiable sensitive data. Any accidental or willful security breaches or other unauthorized access could cause users' secure information to be stolen and used for criminal purposes. Security breaches or unauthorized access to secure information could also expose IOU Financial to liability related to the loss of the information, time-consuming and expensive litigation, and negative publicity. If security measures are breached because of third-party action, employee error, malfeasance or otherwise, or if design flaws in its software is exposed and exploited, and, as a result, a third party or disaffected employee obtains unauthorized access to any of its users' data, IOU Financial's relationships with its users will be severely damaged and it could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until they are launched against a target, IOU Financial and its third-party hosting facilities may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach are costly to implement and often lead to widespread negative publicity, which may cause IOU Financial's users to lose confidence in the effectiveness of its data security measures. Any security breach, whether actual or perceived, could harm IOU Financial's reputation and could result in the loss of users and future business.

If IOU Financial is unable to increase transaction volumes, its business and results of operations will be affected adversely.

To succeed, IOU Financial must increase transaction volumes on its lending platform by raising additional capital and attracting a large number of qualified borrowers in a cost-effective manner. The general tightening and other developments in the broader credit markets may impact IOU Financial's ability to attract capital to lend which, in turn, could limit its ability to increase transaction volumes. If IOU Financial is not able to attract qualified borrowers, IOU Financial will not be able to increase its transaction volumes. In addition, IOU Financial will rely on a variety of methods to drive traffic to its website and lending platform. If IOU Financial is unable to use any of its planned marketing initiatives or the cost of these initiatives was to significantly increase, IOU Financial may not be able to attract new qualified borrowers in a cost-effective manner. As a result, its revenue and results of operations could be affected adversely and could impair its ability to maintain its lending platform.

As an online company constantly involved in the development of its online lending platform, IOU Financial faces increased risks, uncertainties, expenses and difficulties.

If IOU Financial is successful, the volume of loans originated through its lending platform may increase beyond its current capacity, which will require IOU Financial to increase its facilities, personnel and infrastructure in order to accommodate the greater servicing requirements and demands of its lending platform. IOU Financial's lending platform is dependent upon its website.

IOU Financial will likely be required to constantly add new hardware and update its software and website, expand its customer support services and add new employees to maintain the operation of its lending platform, as well as satisfy its servicing requirements. If IOU Financial is unable to increase the capacity of its lending platform and maintain the necessary infrastructure, it might then suffer from a negatively impact on its revenue stream.

Any significant disruption in service on IOU Financial's website or in its computer systems could reduce the attractiveness of its lending platform and result in a loss of users.

If a catastrophic event resulted in a lending platform outage and physical data loss, IOU Financial's ability to service its loans would be materially and adversely affected. The satisfactory performance, reliability and availability of its technology and its underlying network infrastructure are critical to its operations, level of customer service, reputation and ability to attract and retain users. IOU Financial's system hardware is hosted in multiple hosting facilities. All of the data is stored in multiple geographic locations to ensure data availability in the event a particular data center fails. IOU Financial's service provider does not guarantee that access to IOU Financial's website will be uninterrupted, error-free or secure. IOU Financial's operations depend on its supplier's ability to protect their and its systems in their facilities against damage or interruption from natural disasters, power or telecommunications failures, air quality, temperature, humidity and other environmental concerns, computer viruses or other attempts to harm its systems, criminal acts and similar events. If its arrangement with this supplier is terminated, or there is a lapse of service or damage to the supplier's facilities, IOU Financial could experience interruptions in its service, as well as delays and additional expense in arranging new facilities. Any interruptions or delays in its service, whether as a result of its supplier or other third-party error, its own error, natural disasters or security breaches, whether accidental or willful, could harm its relationships with its users and its reputation. In addition, in the event of damage or interruption, IOU Financial's insurance policies may not adequately compensate it for any losses that it may incur. IOU Financial's disaster recovery plan has not been tested under actual disaster conditions, and it may not have sufficient capacity to recover all data and services in the event of an outage at a supplier facility. These factors could prevent it from processing or posting payments on the loans, damage its brand and reputation, divert its employees' attention, reduce its revenue, subject it to liability and cause users to abandon its lending platform, any of which could adversely affect its business, financial condition and results of operations.

IOU Financial's ability to service loans or maintain accurate accounts may be adversely affected by computer viruses, physical or electronic break-ins and similar disruptions.

The highly-automated nature of IOU Financial's lending platform may make it an attractive target and potentially vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. If a computer "hacker" were able to infiltrate IOU Financial's lending platform, users would be subject to an increased risk of fraud or identity theft, and IOU Financial may not receive the principal or interest payments that it expects to receive on any loans that it was fraudulently induced to make. Hackers might also disrupt the accurate processing and posting of payments to IOU Financial's accounts on its lending platform, or cause the destruction of data and thereby undermine IOU Financial's rights to repayment of the loans it has made. While IOU Financial has taken steps to prevent hackers from accessing its lending platform, if it is unable to prevent hacker access, its ability to receive the principal and interest payments that it expects to receive on loans it made and its ability to service its loans and to maintain its lending platform could be adversely affected.

Maintenance of Client Relationships

The ability of IOU Financial to attract and maintain clients requires that it provide a competitive offering of products and services that meet the needs and expectations of its clients. IOU Financial's ability to satisfy the needs or demands of its clients may be adversely affected by factors such as the inability or failure to identify changing client needs or expectations or the inability to adapt in a timely and cost-effective manner to innovative products and services offered by competitors.

Litigation Risk

IOU Financial's business may become susceptible from time to time to various legal claims, including class action claims, in the course of its operations or with respect to the interpretation of existing agreements. Any future claims or litigation could have a material adverse effect on IOU Financial's business and its profitability.

Possible Volatility of Stock Price

The market price of the common Shares could be subject to wide fluctuations in response to factors such as actual or anticipated variations in IOU Financial's results of operations, changes in financial estimates by securities analysts or by management, general market conditions and other factors. Market fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations may adversely affect the market price of the common shares.

GENERAL

The Company also discloses information related to its activities on SEDAR at www.sedar.com and on its website www.ioufinancial.com

CORPORATE INFORMATION

DIRECTORS AND OFFICERS

Philippe Marleau, Director, President & CEO

David Kennedy, Chief Financial Officer and Secretary

Jason Cawley – Director

Serguei Kouzmine – Director

Evan Price - Director

Yves Roy - Director

AUDITORS

PricewaterhouseCoopers LLP

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.

HEAD OFFICE

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H3B 2B6
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Fax: (514) 789-0542

SUPPLEMENTARY INFORMATION

Supplementary documents regarding the Company are available on SEDAR's website (www.sedar.com) or upon written request to the Company's principal business centre:
1 Place Ville-Marie, Suite 1670, Montreal, Quebec, H3B 2B6.

MANAGEMENT'S REPORT

Management is responsible for the integrity and fair representation of the financial statements and other information in this annual report. The financial statements have been prepared in accordance with International Financial Reporting Standards. Financial data and operating results elsewhere in the annual report are consistent with those contained in the financial statements.

The Company's policy is to maintain high-quality internal accounting and administrative control systems within the limits of reasonable cost. Such systems are designed to provide assurance that the financial information is accurate and reliable and that assets are adequately accounted for and safeguarded.

The financial statements have been reviewed by the Audit Committee and approved by the Board of Directors, as has the other information in this annual report. In addition, the financial statements have been audited by PricewaterhouseCoopers LLP.

In the opinion of management, these financial statements incorporate, within reasonable limits, all important elements and data available as at April 27, 2017.

(s) David Kennedy

David Kennedy
Chief Financial Officer

Montreal, Canada
April 27, 2017



IOU Financial Inc.

²⁹ IOU Financial Inc. | 2016 Annual Report
Consolidated Financial Statements

**For the Years Ended
December 31, 2016 and 2015**

IOU FINANCIAL INC.

Consolidated Financial Statements

For the Years Ended
December 31, 2016 and 2015

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April 27, 2017

Independent Auditor's Report

To the Shareholders of IOU Financial Inc.

We have audited the accompanying consolidated financial statements of IOU Financial Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015 and the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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"PwC" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership.



We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of IOU Financial Inc. and its subsidiaries as at December 31, 2016 and December 31, 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP¹

¹ CPA auditor, CA, public accountancy permit No. A116819

IOU FINANCIAL INC.

Consolidated Statements of Financial Position
As at December 31
(in Canadian dollars)

	Note	2016 \$	2015 \$
Assets			
Cash		5,673,288	3,861,105
Restricted cash		872,520	1,016,227
Sales taxes receivable		226,448	231,097
Commercial loans receivable, net	4	39,420,217	26,954,958
Servicing asset	4	891,652	938,015
Other receivables		154,574	369,671
Prepaid expenses and deposits		74,646	22,100
Equipment and leasehold improvements	5	261,905	287,265
Intangible assets	6	319,241	360,652
Total Assets		47,894,491	34,041,090
Liabilities			
Accounts payable and accrued liabilities	7	1,468,935	1,657,083
Financing credit facility	8	25,800,542	8,851,238
Convertible debentures	9	10,202,019	10,138,177
Total Liabilities		37,471,496	20,646,498
Shareholders' Equity			
Share capital	10	24,032,349	21,688,794
Contributed surplus		3,818,416	3,600,320
Accumulated other comprehensive income		2,044,834	2,769,967
Deficit		(19,472,604)	(14,664,489)
Total Shareholders' Equity		10,422,995	13,394,592
Total Liabilities and Shareholders' Equity		47,894,491	34,041,090

Commitments and Contingency (Note 19)

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

Approved by the Board on April 27, 2017:

Phil Marleau (*signed*), Director

Jason Cawley (*signed*), Director

IOU FINANCIAL INC.

Consolidated Statements of Comprehensive Loss
For the Years Ended December 31
(in Canadian dollars)

	Note	2016 \$	2015 \$
Revenue			
Interest revenue	13	13,310,052	6,755,070
Other fees and servicing income	13	1,570,027	1,321,068
Net gain recognized on sale of loans	4	2,520,448	3,895,010
Gross Revenue		17,400,527	11,971,148
Cost of Revenue			
Interest expense		3,177,124	1,739,838
Provision for loan losses, net of recoveries	4	7,330,743	2,522,957
Total Cost of Revenue		10,507,867	4,262,795
Net Revenue		6,892,660	7,708,353
Operating expenses	15	11,562,792	11,605,919
Loss Before Income Taxes		(4,670,132)	(3,897,566)
Income tax expense (recovery)	14	137,983	(239,093)
Net Loss for the Year		(4,808,115)	(3,658,473)
Other Comprehensive Loss:			
Items that May be Reclassified Subsequently to Net Loss:			
Currency translation differences, net of income tax of \$137,983 in 2016, \$(239,093) in 2015		(725,133)	1,811,043
Comprehensive Loss for the Year		(5,533,248)	(1,847,430)
Loss per Share:			
Basic and diluted loss per share	12	(0.08)	(0.06)

Net loss and comprehensive loss are entirely attributable to the shareholders of IOU Financial Inc.

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

IOU FINANCIAL INC.

Consolidated Statements of Changes in Shareholders' Equity For the Years Ended December 31 (in Canadian dollars, except as otherwise noted)

	Common Shares (#)	Share Capital (\$)	Contributed Surplus (\$)	Deficit (\$)	Accumulated OCI ¹ (\$)	Shareholders' equity (\$)
Balance as at December 31, 2014	53,678,292	18,886,654	2,339,665	(11,006,016)	958,924	11,179,227
Comprehensive loss	-	-	-	(3,658,473)	1,811,043	(1,847,430)
Private placement (Note 10)	7,795,000	2,711,744	-	-	-	2,711,744
Warrants exercised (Note 10)	155,491	90,396	(28,200)	-	-	62,196
Equity component of convertible debenture (Note 9)	-	-	771,734	-	-	771,734
Stock-based compensation (Note 10)	-	-	517,121	-	-	517,121
Balance as at December 31, 2015	61,628,783	21,688,794	3,600,320	(14,664,489)	2,769,967	13,394,592
Comprehensive loss	-	-	-	(4,808,115)	(725,133)	(5,533,248)
Private placement (Note 10)	8,507,765	2,162,346	-	-	-	2,162,346
Warrants exercised (Note 10)	316,361	181,209	(54,665)	-	-	126,544
Equity component of convertible debenture (Note 9)	-	-	14,639	-	-	14,639
Stock-based compensation (Note 10)	-	-	258,122	-	-	258,122
Balance as at December 31, 2016	70,452,909	24,032,349	3,818,416	(19,472,604)	2,044,834	10,422,995

¹ OCI: Other comprehensive income

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

IOU FINANCIAL INC.

Consolidated Statements of Cash Flows For the Years Ended December 31 (in Canadian dollars)

	Note	2016 \$	2015 \$
Operating Activities			
Net loss for the year		(4,808,115)	(3,658,473)
Non-cash items included in net loss	16	(12,214,008)	(6,313,197)
Net change in non-cash working capital items	16	(74,460,022)	(147,386,112)
Sale of commercial loans		60,827,481	137,303,493
Interest received		13,310,052	6,755,070
Interest expense		3,177,124	1,739,838
Cash used in operating activities		(14,167,488)	(11,559,381)
Financing Activities			
Interest paid		(2,955,200)	(1,708,768)
Issuance of equity, net of transaction costs		2,162,346	2,711,744
Warrants exercised		126,544	62,196
Issuance of convertible debentures, net of transaction costs		-	10,878,841
Reimbursement of credit facility		(9,226,338)	-
Issuance of financing credit facility		25,800,542	1,864,001
Cash generated from financing activities		15,907,894	13,808,014
Investing Activities			
Additions to intangible assets		(114,683)	(392,944)
Additions to equipment and leasehold improvements		(67,906)	(249,076)
Cash used in investing activities		(182,589)	(642,020)
Increase in Cash and Restricted Cash		1,557,817	1,606,613
Exchange rate difference on cash and restricted cash		110,659	529,465
Cash and Restricted Cash			
Beginning of year		4,877,332	2,741,254
End of year		6,545,808	4,877,332

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

IOU FINANCIAL INC.

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1. General Information

IOU Financial Inc. (“IOUF”, “IOU Financial”, the “Company”) was incorporated under Part 1A of the *Companies Act* (Quebec) and is governed by the *Business Corporations Act* (Quebec). The registered office of IOU Financial Inc. is located at 1 Place Ville-Marie, Suite 1670, Montréal, Quebec, Canada.

The Company’s wholly-owned subsidiary, IOU Central Inc. (“IOUC”, “IOU Central”) was incorporated under the *Canada Business Corporations Act* on August 10, 2006 and presently operates an internet-based commercial lending business in the United States of America, through its subsidiary, IOU Central Inc. (USA) (“IOU USA”, together with IOUC and IOUF, the “Group”), based in the state of Georgia in the United States of America (incorporated in Delaware on August 16, 2006).

The Company incorporated a new wholly-owned subsidiary, IOU Financial Canada Inc. (“IOUF Canada”), under the *Canada Business Corporations Act* on December 1, 2015. Currently, IOUF Canada does not have any significant operations.

IOU Central Inc. incorporated a new wholly-owned subsidiary, IOU Small Business Asset Fund, LLC (“IOU SBAF”) on December 9, 2015.

IOU Financial is a public company listed on the TSX Venture Exchange (TSX-V).

These consolidated financial statements were authorized for issuance by the Board of Directors of the Company on April 27, 2017.

2. Basis of Preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board. These consolidated financial statements have been prepared under the historical cost convention. Other measurement bases used are described in the applicable notes.

IOU FINANCIAL INC.

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3. Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Use of Estimates and Judgements

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are described below:

1. Critical accounting estimates and assumptions

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a significant adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

1.1 Deferred tax estimation

The recognition of deferred tax assets and liabilities involves making assumptions including estimating the timing of the reversal of temporary differences or if it is probable that temporary differences will not reverse in the foreseeable future.

The realization of deferred tax assets ultimately depends on taxable profits being available in the future. Deferred tax assets should be recognized when it is probable that taxable profits will be available against which the deferred tax asset can be utilized and it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments. This involves the Company making assumptions within its overall tax-planning activities and periodically reassessing them in order to reflect changed circumstances as well as tax regulations. Moreover, the measurement of a deferred tax asset or liability reflects the manner in which the Company expects to recover the asset's carrying value or settle the liability.

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1.2 Servicing assets

The initial recognition of servicing assets requires the Company to make estimates of the fair value of the service to be provided which is based on market expectations at the time of the sale of the loan and may vary from the actual cash flows received.

2. Critical judgements in applying the Company's accounting policies

2.1 Valuation of commercial loans

Management exercises judgement to determine whether indicators of loan impairment exist based on historical loss experience, and if so, management must estimate the timing and amount of future cash flows from loans receivable. Specifically, management must assess at which point a loan is deemed to be uncollectible in order to write it off. Further details on the estimates used to determine any allowance for impaired loans receivable are provided in the accounting policy "Impairment of commercial loans receivable".

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, which are the entities over which the Company has control. The Group controls an entity when the Group is exposed to, or has the rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

All inter-company transactions, balances, income and expenses are eliminated in full on consolidation.

Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer.

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Equipment and Leasehold Improvements

Equipment and leasehold improvements are stated at historical cost less residual value, accumulated depreciation and impairment losses. Historical cost includes expenditure that are directly attributable to the acquisition of the items. The depreciation rate, residual value and useful life of equipment are reviewed annually and adjusted if appropriate. Depreciation based on the estimated useful life of the asset is calculated as follows:

Office equipment	20% straight line method
Computer equipment	30% straight line method
Leasehold improvements	over remaining lease term

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Intangible Assets

The costs to develop software for the Company's website and online loan platform are capitalized when management has authorized and committed project funding, preliminary development efforts are successfully completed, and it is probable that the project will be completed and the software will be used as intended. Capitalized software development costs primarily include fees paid to outside consultants and salaries for employees directly involved in the development efforts. Costs incurred prior to meeting these criteria, together with costs incurred for training and maintenance, are expensed. Costs incurred for upgrades and enhancements that are considered to be probable to result in additional functionality are capitalized. The Company capitalizes expenditures for betterments and expenses amounts for maintenance, repairs and renewals as they are incurred.

Internal use software is stated at cost less accumulated amortization. Amortization and useful lives are reviewed annually. Capitalized costs are amortized using the straight-line method over their expected lives which presently approximate three years.

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Impairment of Tangible and Intangible Assets

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in the consolidated statement of comprehensive loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized immediately in the consolidated statement of comprehensive loss.

Financial Instruments

Classification

The Company classifies its financial assets and financial liabilities in the following categories: loans and receivables and other financial liabilities. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Management determines the classification of its financial instruments at initial recognition. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period.

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The classification of financial assets and financial liabilities is as follows:

	Classification	Measurement
Financial Assets:		
Commercial loans receivable	Loans and receivables	Amortized cost
Cash	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Other asset	Loans and receivables	Amortized cost
Financial Liabilities:		
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Financing credit facility	Other financial liabilities	Amortized cost
Liability component of convertible debenture	Other financial liabilities	Amortized cost

Recognition and measurement

All of the Company's financial assets and liabilities are recognized initially at fair value and subsequently measured at amortized cost, less impairment losses, using the effective interest rate method.

Fair value

The fair value of financial instruments on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, fair value is determined by management using available market information or other valuation methodologies.

Impairment of commercial loans receivable

The Company assesses on an ongoing basis whether a loan is impaired and an impairment loss is only incurred when objective evidence of impairment exists. Evidence of impairment may include indications that the debtor is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganization, and where observable data indicate that there is a measurable decrease in the estimated future cash flows. Individual impairment is identified at the end of each reporting period by making judgements about the probability of an account going into default based upon information known by management.

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If it is determined that no objective evidence of impairment exists for an individual loan, this loan will be included in a group of loans with similar credit risk characteristics and the group is then collectively assessed for impairment. Future cash flows for the group are estimated on the basis of their contractual cash flows and historical loss experience for loans with credit risk characteristics similar to the group. Any estimates of loss rates contained within the model used to calculate the impairment are reviewed regularly and compared to actual results and adjusted as required to accurately reflect the operations of the Company.

The payment performance of customers could be different from the assumptions used to determine the impairment and there can be no assurance that expected future cash flows will be realized. As such, the measurement of impairment of loans receivable is subject to a high level of uncertainty and changes in estimates, assumptions, or circumstances may cause future assessments to be significantly different than current assessments and may require an increase or decrease in the allowance. All assumptions are reviewed regularly.

Any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of the allowance for loan losses and the amount of the loss is recognized in the consolidated statement of comprehensive loss.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the reversal of the previously recognized impairment loss is recognized in the consolidated statement of comprehensive loss, or as a reversal to the allowance for loan losses.

Loan sales

In the normal course of business, the Company may sell its interests in commercial loans receivable. The Company derecognizes loans receivable sold only when it has transferred substantially all the risks and rewards of ownership of the assets, which occurs when the Company no longer considers itself to have any significant exposure to the variability in the present value of the future cash flows from the loans receivable. Outstanding proceeds of sold or discharged loans receivable are reported separately from other loans receivable, and measured at their realizable value, net of expected transaction costs.

Where the Company retains the servicing rights of loans sold, the benefits of servicing are assessed against market expectations. When the benefits of servicing are more than market expectations, a servicing asset is recognized. Servicing assets are carried at amortized cost. Amortization is calculated on a straight-line basis over the term of the servicing agreement which approximates one year. When the benefits of servicing are less than market expectations, a servicing liability is recognized.

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Transaction costs

Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of that transaction and deducted from equity, net of any related income tax benefit. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs for all financial instruments not at fair value through profit and loss are added to the carrying amount of the instrument.

Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Revenue Recognition

The Company's revenue comprises the fair value of the consideration received or receivable for services provided in the ordinary course of business.

The Company recognizes revenue when the amount of revenue can be reliably measured and when it is probable that future economic benefits will flow to the Company.

a) Interest revenue

Interest revenue is recognized in the statement of comprehensive loss for all financial assets measured at amortized cost using the effective interest rate method. The effective interest rate is the rate that discounts estimated future cash flows through the expected life of the financial asset back to the net carrying amount. This calculation takes into account all contractual terms of the financial instrument including fee income charged to the borrower on the origination of the financial asset ("loan origination fees"), net of any transaction costs that are directly attributable to the financial asset but not future credit losses. Under the effective interest method, the interest realized is not necessarily the same as the stated interest rate on the loan. The application of this method has the effect of recognizing revenue on the

IOU FINANCIAL INC.

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financial asset evenly in proportion to the amount outstanding over the period of repayment.

When a loan is classified as impaired, the original expected timing and amount of future cash flows may be revised to reflect new loan circumstances. Interest revenue continues to be recognized using the effective interest rate used to discount the future cash flows for the purpose of measuring the impairment loss. This is offset by a corresponding adjustment to the loan loss provision charge to reflect the fact that this additional revenue may not be collectible.

Interest income and guarantee fee income is thereafter recognized on this impaired carrying value using the effective interest rate. Additional changes to the amount or timing of future cash flows could result in further loan losses, or the reversal of prior loan losses, which would also impact the amount of subsequent income recognized.

b) Other fees and servicing income

Fee income that is integral to the effective yield of a financial asset is recognized as an adjustment to the effective interest rate calculation and is included in financing revenue.

Fee and servicing revenue comprises service fees, non-sufficient funds fees and referral fees.

Service fees are charged on loans sold to third parties where the Company retains the servicing rights on the loans.

Non-sufficient funds fee revenue is charged and collected on all missed payments and recognized as it is earned.

Referral fee revenue is collected upon the successful referral and funding of unfunded loan applications to third parties. This revenue is recognized when it is earned.

All fee and servicing revenue is recognized as services are provided and when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of revenue can be reliably measured.

Cash and Restricted Cash

Cash and restricted cash include cash in hand, deposits held at call with banks and restricted cash. Restricted cash comprises funds held on behalf of third party loan purchaser, bonding insurance collateral and cash held as security for lending activities.

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Convertible Debentures

Convertible debentures are separated into their liability and equity components. The fair value of the liability component at the time of issue is determined based on an estimated interest rate of the debenture without the conversion feature. The amount attributed to the equity component is determined as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component.

Subsequent to initial recognition, the liability component is measured at amortized cost using the effective interest method. The equity component is not re-measured subsequent to initial recognition, except on conversion or expiry.

Leases

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

Interest Expense

Interest expense comprises interest expense on debt borrowings and is recognized in profit or loss in the period in which it is incurred, under the effective interest method.

Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares are shown in equity as a deduction, net of tax, from the proceeds.

Contributed Surplus

Contributed surplus is used to record the accumulated fair value of stock options recognized as share-based payments and warrants issued. Contributed surplus is increased by the compensation charge over the vesting period and is reduced by corresponding amounts when the options and warrants are exercised, cancelled or expire.

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Foreign Exchange

a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars. The functional currency of IOU USA and IOU SBAF is the U.S. dollar, while the rest of the Group has the Canadian dollar as functional currency.

b) Group companies

The assets and liabilities of the subsidiaries with a U.S. dollar functional currency are translated at the exchange rate prevailing on the reporting date, and revenues and expenses at the average rates during the reporting period. Foreign currency gains or losses resulting from the translation of these subsidiary is recorded in other comprehensive income (loss) with a corresponding increase or decrease to the foreign currency translation reserve component of accumulated other comprehensive income (loss), which is a component of the shareholders' equity.

Share-Based Compensation

The Company operates an equity-settled share-based compensation plan, under which the entity receives services from employees as consideration for equity instruments (options) of the Company. The fair value of the employee and others providing similar services received in exchange for the grant of options is recognized as an expense with a corresponding increase to contributed surplus. The total amount to be expensed is determined by reference to the fair value of the options granted at the grant date.

Each tranche of a share-based compensation award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is amortized over the vesting period of the respective tranches, based on the Company's estimate of equity instruments that will eventually vest. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognized in the consolidated statement of comprehensive loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to contributed surplus.

When the options are exercised, the Company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital. Any amounts previously credited to contributed surplus relating to the original stock-based compensation is also allocated to share capital.

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Taxation

Income tax expense or recovery represents the sum of the tax currently payable and deferred tax.

a) Current tax

The tax currently payable is based on taxable income for the year. Taxable income differs from net income as reported in the consolidated statement of comprehensive loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

b) Deferred tax

Deferred tax is recognized, using the balance sheet method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated statement of financial position. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the end of the reporting period, and which apply when the related deferred income tax asset is expected to be realized or the deferred income tax liability is expected to be settled.

i) Deferred tax liabilities:

- are generally recognized for all taxable temporary differences; and
- are not recognized on temporary differences that arise from goodwill which is not deductible for tax purposes or the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting nor taxable profit (loss).

ii) Deferred tax assets:

- are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilized; and
- are reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

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c) Current and deferred tax for the period

Current and deferred tax are recognized as an expense or income in the net loss, except when they relate to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the tax is also recognized outside profit or loss, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is included in the accounting for the business combination.

Basic and Diluted Earnings (Loss) per Share

Earnings (loss) per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings (loss) per share is computed using the treasury stock method, giving effect to the exercise of all stock options, warrants and convertible debentures. The diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of these elements.

Current and Future Changes in Accounting Policies

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2016. These changes were made in accordance with the applicable transitional provisions.

a) New standards adopted during the period

IAS 1 Presentation of Financial Statements

The Company has adopted the amendments to IAS 1 Presentation of Financial Statements issued by the IASB in December 2014. The amendments clarify the existing presentation and disclosure requirements in IAS 1, including the presentation of line items, subtotals and notes, and provide guidance to assist entities to apply judgment in determining what information to disclose, and how that information is presented in their financial statements. The effect of these amendments was not significant on the Company's financial statements.

b) New standards and interpretations relevant to the Company not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after January 1, 2017 and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Company, except the following set out below.

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IFRS 15, Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers, which introduces a single, comprehensive revenue recognition model for all contracts with customers other than those within the scope of other standards, such as insurance contracts and financial instruments. IFRS 15 therefore supersedes the two main revenue recognition standards, IAS 18, Revenue, and IAS 11, Construction Contracts, as well as related interpretations. The core principle of this new standard is that revenue recognition should depict the transfer of goods or services in an amount that reflects the consideration received or expected to be received in exchange for these goods or services. The new standard also provides more guidance on certain types of transactions and will result in an increase in disclosures related to revenue.

The Company is currently assessing the impact of adopting IFRS 15, which is effective for annual periods beginning on or after January 1, 2018.

IFRS 9, Financial Instruments

In July 2014, the IASB issued the complete and final version of IFRS 9, Financial Instruments, which will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 covers requirements concerning the classification and measurement of financial assets and financial liabilities, impairment of financial assets and hedge accounting. IFRS 9 establishes a new classification and measurement model for financial assets to determine whether a financial asset must be classified as measured at amortized cost, at fair value through profit or loss or at fair value through other comprehensive income. This model is based on the characteristics of the contractual cash flows of the financial asset and on the business model under which it is held. For the classification and measurement of financial liabilities, the new standard essentially follows the current requirements under IAS 39.

The standard also introduces a single impairment model for financial assets that requires recognizing expected credit losses instead of incurred losses, which is the requirement under the current impairment model. The model provides for a multi-phase approach based on changes in credit quality since initial recognition.

Lastly, IFRS 9 includes a new hedge accounting model to align hedge accounting more closely with risk management activities.

IFRS 9 will be effective for annual periods beginning on or after January 1, 2018. The Company is currently assessing the impact of adopting this standard.

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IFRS 16, Leases

In January 2016, the IASB released IFRS 16, which supersedes IAS 17, Leases and the related interpretations on leases: IFRS Interpretations Committee (IFRIC) 4, Determining Whether an Arrangement Contains a Lease; Standard Interpretations Committee (SIC) 15, *Operating Leases – Incentives*; and SIC 27, Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for companies that also apply IFRS 15. The Company is currently evaluating the impact of the standard on its financial statements.

IAS 7, Statement of Cash Flows

In January 2016, the IASB released amendments to IAS 7 Statement of Cash Flows. The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The Company is currently evaluating the impact of the standard on its financial statements.

IFRS 2, Share-Based Payment

In June 2016, the IASB released amendments to IFRS 2 Share-based Payment. The amendments provide guidance on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments, share-based payment transactions with a net settlement feature for withholding tax obligations, and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments are effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company is currently evaluating the impact of the standard on its financial statements.

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4. Commercial Loans Receivable

As at December 31, 2016 and 2015, the Company held commercial loans receivable as part of its regular operations.

	2016 \$	2015 \$
Principal balance of commercial loans receivable	42,108,901	27,488,253
Unamortized fees and transactions costs	1,078,806	463,167
Commercial loans receivable	43,187,707	27,951,420
Less allowance for loan losses	(3,767,490)	(996,462)
Commercial loans receivable – net	39,420,217	26,954,958

The loans bear fixed interest at rates ranging between 12.99% and 16.99% (2015: 12.64% and 14.99%) and mature no later than 18 months after each statement of financial position date (12 months in 2015). Guarantee fees charged on each loan range between 7% and 17% (2015: 5% and 16%) of the original loan amount. The loans are all short term with an average date to maturity of 12.1 months (2015: 11.8 months) at time of origination. The loans are being repaid daily over their terms. Loans are not collateralized but are backed by a general security agreement against all of the assets of the business and are personally guaranteed by the owner(s) of the business. The commercial loans receivable are denominated in U.S. dollars. Transaction costs and unamortized fees comprise broker commissions and loan closing fees and are deferred over the term of the loan in accordance with the Company's accounting policy.

Impaired loans and allowances for loan losses

At period-end, the Company performed a comprehensive review of its loan portfolio for the purposes of determining any specific allowances for each loan.

If it is determined that no objective evidence of impairment exists for an individually assessed loan, this loan will be included in a group of loans with similar credit risk characteristics and the group is then collectively assessed for impairment in accordance with the Company's accounting policy.

The fair value of the loans (net of allowance), as at December 31, 2016 and 2015 was \$38,341,411 and \$26,491,791, respectively. The fair value of these loans is estimated to be equivalent to the carrying amount, due to the short-term nature of these loans.

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Movements in the allowance for loan losses are as follows:

	2016 \$	2015 \$
Allowance at the beginning of the period	996,462	349,528
Provision for receivables impairment	8,002,751	2,746,951
Receivables written off during the year as uncollectible	(5,231,723)	(2,100,017)
Allowance at the end of the period	3,767,490	996,462
Recoveries of loans previously written off	375,225	223,994

Amounts charged to the allowance are written off, when there is no expectation of recovering additional cash.

A summary of the collective and individual components of the allowance for loan losses is as follows:

	2016 \$	2015 \$
Allowance for loan losses - collective	1,017,224	349,400
Allowance for credit losses - individual	2,750,266	647,062
	3,767,490	996,462

Age and credit quality

An analysis of the age of the remaining loans receivable in each period presented is as follows:

Age	2016 \$	%	2015 \$	%
Current	34,404,939	79.66	25,782,425	92.24
Payments in arrears:				
1 to 21 payments	3,067,443	7.10	910,708	3.26
22-63 payments	3,793,337	8.78	947,191	3.39
64 + payments	1,921,988	4.46	311,096	1.11
Total	43,187,707	100.00	27,951,420	100.00

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An analysis of the credit quality of the loans receivable in each period presented is as follows:

Credit quality	2016		2015	
	\$	%	\$	%
Neither past due nor impaired	34,404,938	79.66	25,782,425	92.24
Past due but not impaired:				
1 to 21 payments	2,995,915	6.94	725,034	2.59
22 + payments	3,553,166	8.23	218,179	0.78
Impaired	2,233,688	5.17	1,225,782	4.39
Total	43,187,707	100.00	27,951,420	100.00

Past due but not impaired balances relate to financial assets which are contractually overdue but are not deemed to be impaired. Based on historical information on borrower default rates, management considers the credit quality of loan receivables that are neither past due nor impaired to be satisfactory.

Loan sales and servicing asset

During the year ended December 31, 2016, the Company sold some of its commercial loans receivable, on a non-recourse basis, at face value, for total proceeds of \$60,827,481 (2015: \$137,303,493). At the time of the sale, the Company transferred to the purchaser of such loans all rights and risks associated with the loans sold, and the Company determined that the criteria for derecognition contained in IAS 39 had been met.

However, as per the debt assignment agreements, the Company retained the servicing rights (payment collections) to the loans and the purchaser agreed to be charged a servicing fee over the term of the loans. In accordance with the Company's accounting policy, the Company recognized a net gain on sale of the commercial loans of \$2,520,448 for the year ended December 31, 2016 (2015: \$3,895,010), along with a servicing asset that is amortized to the statement of comprehensive loss over the term of the servicing asset. At December 31, 2016, the carrying amount of this asset amounted to \$891,652 (2015: \$938,015). The servicing asset is determined by comparing the actual expected cash flows to be received to the fair value of providing such services. The fair value of the servicing was determined by using readily available third-party pricing for a similar type of service, which is around 1% of the total principal and interest collected over the term of the servicing period.

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5. Equipment and Leasehold Improvements

	Office Equipment \$	Computer Equipment \$	Leasehold Improvements \$	Total \$
Cost				
Balance at January 1, 2015 ¹	88,837	63,390	-	152,227
Translation differences	15,443	16,607	-	32,050
Additions	83,140	50,233	115,703	249,076
Balance at December 31, 2015	187,420	130,230	115,703	433,353
Translation differences	(2,850)	(2,972)	-	(5,822)
Additions	13,644	25,705	28,557	67,906
Write offs	(20,546)	(3,178)	-	(23,724)
Balance at December 31, 2016	177,668	149,785	144,260	471,713
Accumulated Depreciation				
Balance at January 1, 2015	35,240	30,109	-	65,349
Translation differences	5,951	8,077	-	14,028
Depreciation charge for the year	27,988	28,854	9,869	66,711
Balance at December 31, 2015	69,179	67,040	9,869	146,088
Translation differences	(859)	(1,159)	-	(2,018)
Depreciation charge for the year	34,748	35,582	19,132	89,462
Write offs	(20,546)	(3,178)	-	(23,724)
Balance at December 31, 2016	82,522	98,285	29,001	209,808
Carrying Amounts				
At December 31, 2015	118,241	63,190	105,834	287,265
At December 31, 2016	95,146	51,500	115,259	261,905

¹ Total cost has been decreased by \$18,022 from 170,249 to \$152,227 as at January 1, 2015 to reflect the cumulative impact of prior year translation differences.

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6. Intangible Assets

Intangible asset comprises internal use software.

	2016 \$	2015 \$
Cost		
Balance at beginning of year ¹	1,978,200	1,268,306
Translation differences	(56,667)	316,950
Acquisitions	114,683	392,944
Balance at end of year	2,036,216	1,978,200
Accumulated Amortization		
Balance at beginning of year ¹	1,617,548	1,261,908
Translation differences	(57,164)	310,929
Amortization charge for the year	156,591	44,711
Balance at end of year	1,716,975	1,617,548
Carrying Amount	319,241	360,652

¹ Cost balance at January 1, 2015 have been increased by \$93,624 from \$1,174,682 to \$1,268,306 and accumulated depreciation by \$99,645 from \$1,162,263 to \$1,261,908 to reflect the cumulative impact of prior year translation differences.

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7. Accounts Payable and Accrued Liabilities

	2016 \$	2015 \$
Trade payables	508,270	908,059
Payable to loan purchasers	501,440	-
Other payables and accruals	459,225	749,024
Total	1,468,935	1,657,083

Payable to loan purchasers comprises amounts owing to third-party loan purchasers.

Other payables and accruals include the restructuring provision in the amount of \$110,882. In September 2016, the Company announced a restructuring plan to reduce operating expenses.

8. Financing Credit Facility

At December 31, 2016 and 2015, the carrying value of the liability amounted to:

	2016 \$	2015 \$
Financing credit facility	26,608,957	8,851,238
Unamortized transactions costs	(808,415)	-
	25,800,542	8,851,238

2016 credit facility

On April 22, 2016, the Company entered into a new US\$50 million credit facility with a third-party lender (the "2016 Credit Facility"). The facility consists of a US\$25 million term loan, expandable to US\$50 million at IOU's request and the lender's acceptance. The term of the facility is three years. The facility is denominated in US dollars and was arranged to help finance the Company's lending activities and to repay the existing credit facility. The interest rate on the facility is LIBOR plus 8.50%. If the facility is increased to US\$37.5 million, the interest rate will be LIBOR plus 8.20%, and if the facility is increased to US\$50 million, the interest rate will be LIBOR plus 7.75%. At December 31, 2016, the Company has undrawn borrowing facilities on the initial US\$25 million term loan of US\$5.2 million.

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As part of the 2016 Credit Facility, the Company must respect certain financial covenants. As at December 31, 2016, the Company did not meet the minimum consolidated tangible net worth covenant as defined in the agreement, however the third-party lender has agreed in April 2017 to waive the covenant breach. All other financial covenants were met for the year ended December 31, 2016. In April 2017, the Company and the lender have also mutually agreed to amend the 2016 Credit Facility with respect to this specific covenant effective January 1, 2017.

The fair value of current borrowings equals the carrying amount as the impact of discounting is not significant.

2012 credit facility

On April 30, 2012, the Company and its subsidiary entered into a financing credit facility agreement with a third-party lender (the "2012 Credit Facility"). In terms of this agreement, the lender had agreed to provide a one year, secured credit facility to the Company's subsidiary. The facility automatically renewed for one year periods unless either party gave termination notice. The facility was denominated in US dollars, bore interest at a variable rate and was arranged to help finance the Company's lending activities. The Company provided a termination notice and the loan was repaid in full on June 13, 2016 for US\$8,918,467.

Transaction costs

In accordance with IAS 39, transaction costs directly attributable to the implementation of the above financial liabilities have been included in the initial measurement of the liabilities and are amortized over the term of the agreements. For the year ended December 31, 2016, amortization of \$206,880 (2015: \$nil) has been included in "Operating expenses" (Note 15).

Pledged assets

In terms of the 2016 Credit Facility, all assets held by the Company's subsidiary IOUF SBAF are pledged as collateral for the facility. In terms of the 2012 Credit Facility, all assets held by the Company's subsidiary IOU USA were pledged as collateral for the facility, up to a maximum amount of US\$10 million. The following table present the carrying amounts of assets pledged as collateral for the respective facilities.

Asset	2016 \$	2015 \$
Equipment and leasehold improvements	-	287,265
Commercial loans receivable, net	39,670,217	26,954,958
Intangible asset	-	360,652
Cash	3,840,832	4,866,494

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Other

- 622,868

9. Convertible debentures

On November 2, 2015, November 20, 2015 and December 17, 2015, the Company closed an offering for convertible unsecured subordinated debentures ("the debentures"), for aggregate gross proceeds of \$11,500,000. The debentures mature on December 31, 2020 and bear interest at a rate of 10% per annum, payable monthly. The debentures are convertible at the holders' option into Common Shares of the Company at a price of \$0.75 per Common Share, representing a conversion rate of 1,333.33 Common Shares for each \$1,000 principal amount of debentures. The Company has the right to force the conversion of the debentures into Common Shares at any time on or after December 31, 2018 should the 20-day volume weighted average price of the Common Shares on the TSX Venture Exchange exceed 125% of the conversion price. The issue costs were \$621,159, resulting in net proceeds of \$10,878,841. The fair value of the liability component at the time of issuances was based on an estimated interest rate of 11.90% for a debt without the conversion feature. The net proceeds were attributed to the liability and equity components amounting to \$10,092,467 (net of transaction costs of \$576,268) and \$786,374 (net of transaction costs of \$44,891) respectively. Considering the issuance costs, the effective interest rate on the liability component of the debenture is 12.14%.

The convertible debentures recognized in the statement of financial position are calculated as follows:

	2016 \$	2015 \$
Par value of convertible debentures	11,500,000	11,500,000
Unamortized discount and transaction costs	(1,297,981)	(1,361,823)
Liability component amount	10,202,019	10,138,177

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10. Capital Stock

Authorized

Unlimited number of common shares (the "Common Shares").

Issued

	2016 \$	2015 \$
70,452,909 (2015: 61,628,783) Common Shares	24,032,349	21,688,794

On October 14, 2016 and November 8, 2016, IOU Financial closed a private placement for gross proceeds of \$2,297,082, which resulted in the issuance of 8,507,765 Common Shares. Transaction costs have been offset against share capital for net proceeds of \$2,162,346.

Warrants

A continuity schedule of outstanding common share purchase warrants for the periods presented is as follows:

	Warrants outstanding (#)	Average exercise price per warrant (\$)
Balance at January 1, 2015	981,322	0.45
Granted	545,650	0.40
Exercised	(155,491)	0.45
Balance at December 31, 2015	1,371,481	0.43
Exercised	(316,361)	0.45
Balance at December 31, 2016	1,055,120	0.46

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During the year ended December 31, 2016, 316,361 (2015: 155,491) warrants were exercised for an equivalent number of Common Shares.

As at December 31, 2016 outstanding share purchase warrants are:

Exercise Price	Expiry Date	Quantity	Note
\$0.40	May 2017	60,000	
\$0.40	June 2017	533,150	(i)
\$0.60	December 2017	111,229	(ii)
\$0.60	December 2017	18,718	(ii)
\$0.50	February 2018	169,631	(iii)
\$0.50	March 2018	144,454	(iii)
\$0.50	March 2018	17,938	(iii)
Total		1,055,120	

- (i) In connection with the \$2.7M private placement that close in June 2015, the Company granted warrants entitling the brokers to acquire up to an aggregate of 545,650 Common Shares of the Company at an exercise price of \$0.40 per share. These options vest immediately. Each warrant is exercisable for a period of two years from the date of grant.
- (ii) In connection with the private placement that closed in December of 2012, 585,905 warrants were issued to exempt market dealers as compensation. Each broker warrant entitles the holder to acquire one Common Share at a price of \$0.40 for a period of three years from the date of its issuance and at a price of \$0.50 and \$0.60, respectively for the fourth and fifth years from the date of its issuance.
- (iii) In connection with the \$5 million private placement that closed in February and March of 2013, 509,241 warrants were issued to exempt market dealers as compensation. Each broker warrant entitles the holder to acquire one Common Share at a price of \$0.40 for a period of three years from the date of its issuance and at a price of \$0.50 and \$0.60, respectively for the fourth and fifth years from the date of its issuance.

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Stock-Based Compensation

Movements in options for the periods presented are as follows:

	Options Outstanding (#)	Average Exercise Price (\$)
Balance as at January 1, 2015	4,728,500	0.49
Granted	1,758,500	0.47
Forfeited	(341,000)	0.52
Balance as at December 31, 2015	6,146,000	0.49
Granted	-	-
Forfeited	(472,166)	0.53
Balance as at December 31, 2016	5,673,834	0.49

The following summarizes information about share options outstanding as at December 31, 2016:

Exercise Price (\$)	Granted (#)	Exercisable (#)	Expiry Date
0.40	1,085,000	1,085,000	Apr-2017
0.55	150,000	150,000	Nov-2017
0.49	200,000	200,000	Mar-2018
0.40	1,254,000	1,254,000	Apr-2018
0.41	60,000	60,000	May-2018
0.60	1,418,500	1,418,500	Apr-2019
0.60	60,000	60,000	May-2019
0.55	1,446,334	964,668	Nov-2020
	5,673,834	5,192,168	

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Employee stock option plan

Share options are granted to directors, officers, selected employees and consultants. The exercise price of the granted options is determined by the Board of Directors at a price which shall not be lower than the greater of the closing market price of the shares on the Stock Exchange on: a) the trading day prior to the grant of the Options and b) the date of the grant of the options.

The employee options vest over a two-year period, with one-third vesting immediately and one-third vesting on each of the first and second anniversaries of the date of the grant. Each option is exercisable for a period of five years from the date of grant, provided that it has vested.

On November 26, 2015, the Company granted options entitling certain directors of the Company to acquire up to an aggregate of 1,563,500 Common Shares of the Company at an exercise price of \$0.55 per share. These options vest over a two-year period, with one-third vesting immediately and one-third vesting on each of the first and second anniversaries of the date of the grant. Each option is exercisable for a period of five years from the date of grant, provided that it has vested.

	Tranche 1	Tranche 2	Tranche 3
Number of options	521,167	521,167	521,166
Exercise price	\$0.55	\$0.55	\$0.55
Expected volatility	64%	62%	60%
Risk free interest rate	0.62%	0.62%	0.62%
Expected life (years)	5	5	5
Dividend yield	0%	0%	0%
Grant-date fair value (per option)	\$0.33	\$0.32	\$0.31

For the year ended December 31, 2016, the Company recognized a stock-based compensation cost relating to the above employee stock option plan of \$251,162.

Third party stock-based compensation

On November 26, 2015, the Company granted options to its strategic investor relations consultant, entitling them to acquire 150,000 Common Shares of the Company at an exercise price of \$0.55; these options have a term of two years and vest over a period of 12 months, at a rate of 25% at the end of each three-month period. The Company recognized a stock-based compensation cost relating to the above of \$6,960.

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11. Financial Risk Management

11.1 Financial Risk Factors

The Company is exposed to a variety of financial risks including credit risk, liquidity risk, and market risk (including foreign exchange and interest rate). The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. Even though there has been substantial growth in financial instruments, particularly commercial loans receivable, there has been no change in credit risk in 2016 and 2015 as there has been no significant change in average loan sizes and credit policies for approval of loan applications from the prior year. There have been no changes in the management of risks arising from financial instruments during the current year.

a) Credit risk

Credit risk is managed on a Company-wide basis and results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. The Company regularly monitors the credit risk exposure and takes steps to mitigate the likelihood of these exposures from resulting in actual loss.

The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit risk history of each customer. These policies cover the approval of credit applications, attribution of risk ratings, management of impaired loans, establishment of provisions and risk-based pricing. The Company establishes an allowance for losses that corresponds to the credit risk of its specific customers, historical trends and economic circumstances. The Company does not believe it is exposed to an unusual level of customer credit risk. The Company's maximum credit risk is the carrying value of the cash, restricted cash, other assets and commercial loans receivable. As at December 31, 2016, \$2,233,688 (2015: \$1,225,782) of the commercial loans receivable were impaired and an allowance for expected losses of \$3,767,490 (2015: \$996,462) has been established. (see Note 4)

In addition, financial instruments that potentially subject the Company to significant concentrations of credit risk consist of deposits in the form of cash and restricted cash. The Company invests with major North American financial institutions. The Company has investment policies that are designed to provide for the safety and preservation of principal, the Company's liquidity needs and appropriate yields.

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b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach in managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company manages liquidity risk through the management of its capital structure. The Company has been financed mainly through equity and debt offerings, loan sales, and the use of its credit facility. In order to meet its liabilities when they come due, the Company is dependent on the continued availability of such financing activities.

The following table presents the contractual maturities of financial liabilities.

	For the Year Ended December 31, 2016			
	Carrying Amount	0 to 1 Month	1 to 12 Months	Over 1 Year
	\$	\$	\$	\$
Accounts payable and accrued liabilities	1,468,935	1,377,459	76,073	15,403
Financing credit facility ¹	25,800,542	-	-	25,800,542
Convertible debentures	10,202,019	-	-	10,202,019

	For the Year Ended December 31, 2015			
	Carrying amount	0 to 1 month	1 to 12 months	Over 1 year
	\$	\$	\$	\$
Accounts payable and accrued liabilities	1,657,083	1,657,083	-	-
Financing credit facility	8,851,238	-	8,851,238	-
Convertible debentures	10,138,177	-	-	10,138,177
Loan commitment	359,673	-	359,673	-

¹ Reflects the effect of the waiver obtained in April 2017 (see note 8).

Amounts denominated in U.S. dollars or subject to variable interest rates are determined

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based on the spot rates at the relevant date.

c) Foreign exchange risk

The Company, due to its operations being conducted primarily in the United States, is exposed to foreign exchange risk arising from currency exposure with respect to the U.S. dollar. Foreign exchange risk arises from foreign denominated future commercial transactions and recognized assets and liabilities.

The Company does not use derivative financial instruments to reduce its foreign exchange exposure. Fluctuations in foreign exchange rates could cause unanticipated fluctuations in the Company's operating results.

The Company's foreign exchange exposure that would affect net income as at December 31, 2016 and 2015 relates to U.S. dollar cash, commercial loans receivable, accounts payable and accrued liabilities and financing credit facility. The exchange rate applied as at December 31, 2016 was 1.3427 (2015: 1.3840).

Based on the Company's foreign currency exposure noted above, varying the above foreign exchange rates to reflect a one (1) percent strengthening of the Canadian dollar would have increased the net loss by approximately \$347,130 (2015: \$202,668), assuming that all other variables remained constant. An assumed one (1) percent weakening of the Canadian dollar would have had an equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

d) Interest rate risk

The Company is subject to interest rate risk on its cash and restricted cash. Sensitivity to a 1% change in interest rates would not have a significant effect.

None of the Company's current commercial lending is based on variable interest rates. The Company is also exposed to changes in the value of a loan when that loan's interest rate is at a rate other than current market rate. The Company mitigates this risk by lending for short terms, with terms at the inception of the loan generally varying from six to eighteen months.

The Company is exposed to cash flow interest rate risk on its finance credit facility issued at a variable rate. During 2015 and 2016, the borrowings at a variable rate were denominated in USD. The Company mitigates this risk by borrowing for a 12-month term and therefore the Company does not believe that its exposure to interest rate risk is significant.

Financing revenue presented in the consolidated statement of comprehensive loss represents interest income on financial assets that are classified as loans and receivables.

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11.2 Capital Risk Management

The Company defines Capital to be total shareholders' equity, which includes share capital, and certain debt, specifically the financing credit facility and the convertible debentures.

The Company's objective in managing capital is to ensure a sufficient liquidity position to market its loans, to finance its sales and marketing activities, research and development activities, general and administrative expenses, working capital and overall capital expenditures, including those associated with equipment and intangible asset. The ability to fund these requirements in the future depends on the Company's ability to access additional capital and generate additional cash flow from its operations.

Since inception, the Company has financed its liquidity needs primarily through private placements, the sale of loans and convertible notes. When possible, the Company tries to optimize its liquidity needs by non-dilutive sources. During the current year, the Company has met its objectives by raising additional capital of \$2,162,346 (2015: \$13,590,585) net of transaction costs. Capital raised during 2016 consists of the conversion of shareholder warrants into shares of the Company, a private placement and the issuance of convertible debentures, as disclosed in the consolidated statement of shareholders' equity and notes 9 and 10. The capital management objectives listed above have not changed since the previous fiscal year.

The Company is not subject to externally imposed capital requirements.

12. Loss per Share

	2016	2015
	\$	\$
Basic and Diluted Loss per Share		
Net loss	(4,808,115)	(3,658,473)
Weighted average number of common shares for the purposes of basic loss per share	63,555,893	57,869,156
Basic and diluted loss per share	(0.08)	(0.06)

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The following potential common shares are anti-dilutive and are therefore excluded from the weighted average number of common shares for the purposes of diluted loss per share.

	2016 \$	2015 \$
Stock options	5,673,834	6,691,650
Warrants	1,055,120	825,831
Convertible debentures	15,333,333	15,333,333
Number of shares	22,062,287	22,850,814

13. Revenue by Category

The following table presents an analysis of revenue by category.

	2016 \$	2015 \$
Interest Revenue	13,310,052	6,755,070
Other Fees and Servicing Income		
Other fees	240,880	274,097
Servicing fees	4,018,120	5,075,977
Amortization of servicing asset	(2,688,973)	(4,029,006)
Total other fees and servicing income	1,570,027	1,321,068

The calculation of interest revenue takes into account all contractual terms of the financial instrument including fee income charged to the borrower on the origination of the loan net of any transactions costs that are directly attributable to the financial instrument. These fees are amortized over the period of the loan.

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14. Income Tax

Tax expense comprises:

	2016 \$	2015 \$
Current tax expense	-	-
Deferred tax expense (recovery)	137,983	(239,093)
Total tax recovery	137,983	(239,093)

Income taxes reported differ from the amount computed by applying the statutory rates to the net loss. The reasons are as follows:

	2016	2015
Canadian statutory tax rates	26.90%	26.90%
Statutory income taxes	\$ (1,256,266)	\$ (1,048,445)
Non-deductible expenses	141,573	164,134
Change in tax rate	22,039	-
Difference in foreign tax rates	(295,794)	(126,685)
Net change to unrecognized tax assets	1,526,431	771,903
Effective income taxes	\$ 137,983	\$ (239,093)

The adjustment in respect of differences in foreign tax rates includes amounts arising from the differences in taxable income under U.S. jurisdictions in which the Company operates.

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Recognized Deferred Tax Assets and Liabilities

The following tables presents the composition of unused tax losses and credits.

	For the Year Ended December 31, 2016				
	Opening balance \$	Recognized in net loss \$	Recognized in OCI ¹ \$	Recognized in equity \$	Closing balance \$
Temporary Differences					
Tax credit for salaries and wages	(66,722)	28,163	-	-	(38,559)
Financing fees	94,148	(78,592)	-	35,705	51,261
Fixed assets	(19,483)	(8,144)	-	-	(27,627)
Unrealized foreign exchange gain	(239,093)	-	137,983	-	(101,110)
Convertible debenture	(224,883)	25,726	-	-	(199,157)
	(456,033)	(32,847)	137,983	35,705	(315,192)
Unused Tax Losses and Credits					
Tax losses	456,033	(105,136)	-	(35,705)	315,192
	-	(137,983)	137,983	-	-

	For the Year Ended December 31, 2015				
	Opening balance \$	Recognized in net loss \$	Recognized in OCI ¹ \$	Recognized in equity \$	Closing balance \$
Temporary Differences					
Tax credit for salaries and wages	(30,657)	(36,065)	-	-	(66,722)
Financing fees	-	(21,698)	-	115,846	94,148
Fixed assets	-	(19,483)	-	-	(19,483)
Unrealized foreign exchange gain	-	-	(239,093)	-	(239,093)
Convertible debenture	-	-	-	(224,883)	(224,883)
	(30,657)	(77,246)	(239,093)	(109,037)	(456,033)
Unused Tax Losses and Credits					
Tax losses	30,657	316,339	-	109,037	456,033
	-	239,093	(239,093)	-	-

¹ OCI: Other comprehensive income

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As at December 31, 2016, no deferred income tax asset has been recognized on tax loss carryforwards of approximately \$5,198,000 Federal, \$5,198,000 Provincial and \$9,347,000 in the USA (expressed in Canadian dollars). These tax loss carryforwards remain available for use in the future to reduce taxable income, no later than as follows:

	Federal \$	Provincial \$	USA \$
2026	29,000	29,000	-
2027	-	-	-
2028	136,000	136,000	100,000
2029	-	-	1,164,000
2030	-	-	940,000
2031	-	-	844,000
2032	20,000	20,000	1,586,000
2033	187,000	187,000	1,466,000
2034	502,000	502,000	1,632,000
2035	2,551,000	2,551,000	749,000
2036	1,773,000	1,773,000	866,000
Total	5,198,000	5,198,000	9,347,000

As at December 31, 2016, the Company had approximately \$98,000 (2015: \$98,000) of unused Federal tax credits that are not recognized in the financial statements. Those unused tax credits will expire between 2026 and 2033.

As at December 31, 2016, the Company had other deductible temporary differences of approximately \$230,000 Federal, \$645,000 Quebec and \$3,454,000 in the USA (expressed in Canadian dollars) for which no deferred income tax asset is recognized.

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15. Operating Expenses

The following table presents the details of operating expenses.

	2016 \$	2015 \$
Wages and salaries	5,909,279	5,395,051
Credit on qualifying wages	(125,300)	(134,071)
Stock-based compensation	258,122	517,121
Consulting fees	88,510	107,588
Rental expense	570,539	470,458
Insurance	98,680	92,024
Amortization of transactions costs – credit facility (Note 8)	206,880	-
Interest and bank charges	227,774	117,550
Professional fees	776,534	832,700
Legal and accounting fees	778,458	1,289,373
Business fees and licenses	62,183	179,539
Travel and entertainment	99,796	184,472
Telecommunications	94,416	79,914
Data services, IT costs and other	974,339	909,233
Filing fees	23,885	74,570
Other	242,632	197,706
Advertising and promotion	809,601	1,181,269
Depreciation and amortization	246,053	111,422
Restructuring costs (Note 7)	220,411	-
Total Operating Expenses	11,562,792	11,605,919

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16. Supplemental Cash Flow Information

Non-cash items included in net loss comprise the following:

	2016 \$	2015 \$
Depreciation of equipment	89,462	66,711
Amortization of intangible asset	156,591	44,711
Amortization of servicing asset	2,688,973	4,029,006
Stock-based compensation	258,122	517,121
Interest revenue	(13,310,052)	(6,755,070)
Net gain on sale of loans	(2,520,448)	(3,895,010)
Unrealized foreign exchange gain	78,481	(81,573)
Income tax expense (recovery)	137,983	(239,093)
Amortization of transaction costs – financing credit facility	206,880	-
	(12,214,008)	(6,313,197)

Net change in non-cash working capital items comprises the following:

	2016 \$	2015 \$
Sales taxes receivable	4,649	(45,358)
Other assets	215,097	(303,140)
Commercial loans receivable	(74,217,150)	(148,156,669)
Prepaid and deposits	(52,546)	86,138
Accounts payable and accrued liabilities	(410,072)	1,032,917
	(74,460,022)	(147,386,112)

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17. Related Party Transactions

Transactions in the Normal Course

The Company had the following transactions with related parties in the normal course of its operations:

- i) The CEO and director of IOUF is a shareholder in a company that owns a significant stake in Palos Capital Corporation, the parent company of Palos Management Inc (“Palos”). During the year ended December 31, 2016, a fund managed by Palos purchased \$25,441,447 (2015: \$29,316,987) of commercial loans receivable from the Company for which the Company has retained the servicing rights. Servicing fees amounting to \$1,454,773 have been earned by the Company on these loans during the year ended December 31, 2016 (2015: \$1,501,557). Palos also received agency fees of \$31,002 (2015: \$71,435) relating to loans sold to a third-party purchaser, of which \$nil (2015: \$13,047,516) have been sold during the year.
- ii) In May 2011, the Company began renting its Canadian office space from Palos. This lease is renewable every 12 months under similar terms and may have been cancelled by IOU Financial by giving notice 6 months prior to the end of the lease term. The terms of this operating lease were similar to those that would have been present for an arm’s length transaction. In October 2014, IOUF entered into a new leasing agreement with Palos for its Canadian office space. The lease may be cancelled after 7 years upon the payment of a termination fee. The terms of this operating lease are similar to those that would have been present for an arm’s length transaction. The amount expensed as rent for the year relating to this lease amounts to \$232,153 excluding applicable taxes (2015: \$200,331). Future non-cancellable lease commitments under this agreement amount to \$1,507,902 and are included in the amounts disclosed in note 19 i).

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Key Management Compensation

Key management includes directors (executive and non-executive) and the Chief Financial Officer who is also the Company Secretary. The compensation paid or payable to key management for employee services is shown below:

	2016 \$	2015 \$
Salaries and other short-term employee benefits	960,351	756,453
Share-based payments	179,668	291,360
Other director compensation	-	65,000
	1,140,019	1,112,813

18. Segment Information

The Company determined its reportable operating segments according to the manner in which the information is used by the chief operating decision maker and determined that it operates in one reportable operating segment with two main activities: Lending and Servicing. These activities have been identified on the basis of services provided.

The Company's Lending activity originates and retains loans as part of its loans receivable portfolio. The Company's Servicing activity services loans that have been sold to third party purchasers on a non-recourse basis in exchange for a servicing fee.

Substantially all of the Company's non-current assets are located in the USA.

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Revenues by activity, are as follows:

	For the Year Ended December 31, 2016		
	Lending \$	Servicing \$	Total \$
Revenue			
Interest Revenue	13,310,052	-	13,310,052
Fee income	240,880	-	240,880
Servicing income	-	4,018,120	4,018,120
Accelerated recognition of transactions costs on loans sold	-	398,077	398,077
Amortization of servicing asset	-	(2,688,973)	(2,688,973)
Gain on servicing asset	-	2,122,371	2,122,371
Total	13,550,932	3,849,595	17,400,527

	For the year ended December 31, 2015		
	Lending \$	Servicing \$	Total \$
Revenue			
Interest Revenue	6,755,070	-	6,755,070
Fee income	274,097	-	274,097
Servicing income	-	5,075,977	5,075,977
Accelerated recognition of transactions costs on loans sold	-	222,587	222,587
Amortization of servicing asset	-	(4,029,006)	(4,029,006)
Gain on servicing asset	-	3,672,423	3,672,423
Total	7,029,167	4,941,981	11,971,148

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19. Commitments and Contingency

i) Operating lease commitments

The Group leases offices under non-cancellable operating lease agreements. The lease terms are between 3 and 12 years and are renewable at the end of the lease term.

The future aggregate minimum lease payments under the non-cancellable operating lease are as follows:

	\$
No later than 1 year	545,798
Later than 1 year and no later than 4 years	948,110
Later than 5 years	401,170
Total	1,895,078

ii) Loan contracts in transit

As at December 31, 2016, the Company has approved \$nil (2015: \$359,673) of loans that have not yet settled.