

JONES SODA CO  
Form 10-K/A  
April 06, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

\_\_\_\_\_  
**Amendment No. 1**

**FORM 10-K/A**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2006**

**.. TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 000-28820**

\_\_\_\_\_  
**JONES SODA CO.**

**(Exact name of small business issuer as specified in its charter)**

**Washington**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**234 Ninth Avenue North**

**Seattle, WA 98109**

**(Address of principal executive offices)**

**(206) 624-3357**

**(Issuer's telephone number)**

**91-1696175**  
**(I.R.S. Employer**

**Identification No.)**

## Edgar Filing: JONES SODA CO - Form 10-K/A

Securities registered under Section 12(b) of the Exchange Act

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
Common Stock, no par value	The NASDAQ Stock Market LLC
Securities registered under Section 12(g) of the Exchange Act: None	

Check whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Check if no disclosure of delinquent filers in response to Item 405 of Regulation S-K is contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Issuer's revenues for its most recent fiscal year: \$39,035,125

As of March 6, 2007, there were 25,667,491 shares of the Company's common stock issued and outstanding. As of the last business day of the second fiscal quarter, June 30, 2006, the aggregate market value of such common stock held by non-affiliates was approximately \$211,905,423 using the closing price on that day of \$9.00.

**Documents Incorporated By Reference:** The information required by Part III of this Report, to the extent not set forth herein, is incorporated in this Report by reference to the Company's definitive proxy statement relating to its 2007 annual meeting of shareholders. The definitive proxy statement will be filed with the Securities and Exchange Commission within 120 days after the end of the 2006 fiscal year.

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**EXPLANATORY NOTE**

We are filing this Amendment No. 1 to our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2006, originally filed on March 14, 2007 ( Original Report ), to refile (a) the audit report of KPMG LLP and (b) KPMG LLP's report regarding Management's Report on Internal Control Over Financial Reporting, because the Original Report inadvertently omitted the name of KPMG LLP on both such reports. In accordance with SEC rules, this Form 10-K/A only includes Item 8, which consists of the corrected audit report and the audited financial statements as of and for the fiscal years ended December 31, 2006, 2005 and 2005, and 2004, and Item 9A.

We have made no attempt in this Form 10-K/A to modify or update the disclosures presented in the Original Report, except as described above. The disclosures in this Form 10-K/A continue to speak as of the date of the Original Report, and do not reflect events occurring after the filing of the Original Report. Accordingly, this Form 10-K/A should be read in conjunction with our other filings made with the Securities and Exchange Commission subsequent to the filing of the Original Filing, including any amendments to those filings. The filing of this Form 10-K/A shall not be deemed an admission that the Original Report when made included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement not misleading.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

Financial Statements are listed in the [Index to Financial Statements](#) and filed and included elsewhere herein as a part of this Annual Report on Form 10-K.

**ITEM 9A. CONTROLS AND PROCEDURES.**

**Disclosure Control and Procedures**

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our filings under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (2) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K and have determined that such disclosure controls and procedures are effective.

During the fourth quarter of 2006, as part of our remediation efforts, the Company implemented improvements to its internal controls over financial reporting relating to stock compensation expense and deferred taxes. These weaknesses were deemed immaterial and, therefore, they did not have a material impact on the accuracy of our financial statements.

Other than those procedures we have implemented to correct certain weaknesses in the internal controls over stock compensation expense and deferred taxes, no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Management continually reviews, modifies and improves its systems of accounting and controls in response to changes in business conditions and operations and in response to recommendations in reports prepared by the independent registered public accounting firm and outside consultants.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our internal control over financial reporting as of December 31, 2006, based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on our evaluation under the framework in Internal Control Integrated Framework, management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

KPMG LLP, an independent registered public accounting firm, has audited management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, as stated in its report, which is included in this Annual Report on Form 10-K.

/s/ PETER M. VAN STOLK  
Peter M. van Stolk

Chief Executive Officer

/s/ HASSAN N. NATHA  
Hassan N. Natha

Chief Financial Officer

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**Management's Report on Internal Control Over Financial Reporting**

To the Board of Directors and Stockholders of Jones Soda Co.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Jones Soda Co. ("the Company") maintained effective internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Jones Soda Co. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Jones Soda Co. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Jones Soda Co. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years then ended, and our report dated March 13, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Vancouver, Canada

March 13, 2007

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized, on April 5, 2007.

JONES SODA CO.

By: /s/ **PETER M. VAN STOLK**  
**Peter M. van Stolk**

**President and Chief Executive Officer**

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Capacities	Date
/s/ PETER M. VAN STOLK <b>Peter M. van Stolk</b>	President, Chief Executive Officer and Chairman (Principal Executive Officer)	April 5, 2007
/s/ HASSAN N. NATHA <b>Hassan N. Natha</b>	Chief Financial Officer (Principal Financial and Accounting Officer)	April 5, 2007
/s/ SCOTT BEDBURY <b>Scott Bedbury</b>	Director	April 5, 2007
/s/ RICHARD S. EISWIRTH JR. <b>Rick Eiswirth</b>	Director	April 4, 2007
/s/ MICHAEL M. FLEMING <b>Michael M. Fleming</b>	Director	April 5, 2007
/s/ JOHN J. GALLAGHER, JR. <b>John J. Gallagher, Jr.</b>	Director	April 5, 2007
/s/ STEPHEN C. JONES <b>Stephen C. Jones</b>	Director	April 5, 2007
/s/ ALFRED W. ROSSOW, JR. <b>Alfred W. Rossow, Jr.</b>	Director	April 5, 2007

**JONES SODA CO.**

**FORM 10-K ANNUAL REPORT**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Jones Soda Co.

We have audited the accompanying consolidated balance sheets of Jones Soda Co. and subsidiaries ("the Company") as of December 31, 2006 and December 31, 2005 and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards established by the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Jones Soda Co. and subsidiaries as of December 31, 2006 and 2005 and the results of their operations and their cash flows for each of the years then ended in conformity with United States generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Vancouver, Canada

March 13, 2007



**JONES SODA CO. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****December 31, 2006 and 2005**

	2006	2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents (note 3)	\$ 13,905,870	\$ 1,176,101
Short-term investments (note 3)	16,318,510	
Accounts receivable (note 4)	6,914,422	3,699,994
Inventory (note 5)	5,783,067	4,694,213
Deferred income tax asset	1,507,145	
Prepaid expenses and deposits	712,690	146,614
	45,141,704	9,716,922
Deferred income tax asset	427,993	
Capital assets (note 6)	756,618	662,942
Other assets (note 7)	1,414,138	
Intangible assets (note 8)	211,931	72,753
	\$ 47,952,384	\$ 10,452,617
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,446,953	\$ 3,903,653
Taxes payable	150,141	
Current portion of capital lease obligations	70,471	114,110
	5,667,565	4,017,763
Capital lease obligations (note 10)	15,329	88,219
Shareholders' equity (note 11):		
Common stock:		
Authorized: 100,000,000 common stock, no par value Issued and outstanding: 25,637,491 (2005 21,616,596) common stock	41,890,777	12,491,133
Additional paid-in capital	2,832,865	764,622
Accumulated other comprehensive income	96,016	107,752
Deficit	(2,550,168)	(7,016,872)
	42,269,490	6,346,635
	\$ 47,952,384	\$ 10,452,617

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 Commitments and contingencies (note 12)

See accompanying notes to consolidated financial statements.

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**JONES SODA CO. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS****Years ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
Revenue	\$ 39,035,125	\$ 33,511,053	\$ 27,449,674
Cost of goods sold	23,730,059	21,915,930	17,885,811
Gross profit	15,305,066	11,595,123	9,563,863
Licensing revenue	684,256	724,183	109,234
	15,989,322	12,319,306	9,673,097
Operating expenses (1):			
Promotion and selling	8,480,088	7,666,733	5,955,645
General and administrative	4,750,102	3,347,615	2,426,555
	13,230,190	11,014,348	8,382,200
Income before interest income and incomes taxes	2,759,132	1,304,958	1,290,897
Interest income, net	912,557	28,600	53,093
Earnings before income taxes	3,671,689	1,333,558	1,343,990
Income tax benefit (expense) (Note 13)			
Current	(241,741)	(50,532)	(13,630)
Deferred	1,144,491		
	902,750	(50,532)	(13,630)
Earnings for the year	\$ 4,574,439	\$ 1,283,026	\$ 1,330,360
Earnings per share:			
Basic	\$ 0.19	\$ 0.06	\$ 0.06
Diluted	\$ 0.19	\$ 0.06	\$ 0.06
Weighted average number of common stock:			
Basic	23,890,313	21,412,214	20,639,402
Diluted	24,629,318	22,593,127	21,949,001

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(1) Includes non-cash stock-based compensation as follows:

Promotion and selling	\$ 323,085	\$	\$
General and administrative	734,042	5,745	19,737
	\$ 1,057,127	\$ 5,745	\$ 19,737

See accompanying notes to consolidated financial statements.

**JONES SODA CO. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME**

**Years ended December 31, 2006, 2005 and 2004**

	Common stock		Additional paid-in capital	Accumulated other comprehensive income	Deficit	Total shareholders equity
	Number	Amount				
Balance, December 31, 2003	20,089,096	11,178,475	739,140	107,752	(9,630,258)	2,395,109
Options exercised	867,250	602,521				602,521
Stock-based compensation			19,737			19,737
Earnings and comprehensive income for the year					1,330,360	1,330,360
Balance, December 31, 2004	20,956,346	11,780,996	758,877	107,752	(8,299,898)	4,347,727
Options exercised	660,250	710,137				710,137
Stock-based compensation			5,745			5,745
Earnings and comprehensive income for the year					1,283,026	1,283,026
Balance, December 31, 2005	21,616,596	\$ 12,491,133	\$ 764,622	\$ 107,752	\$ (7,016,872)	\$ 6,346,635
Cumulative effects of adjustments resulting from the adoption of SAB No. 108 (note 14)					(107,735)	(107,735)
Shares issued for PIPE	3,157,895	28,077,350				28,077,350
Options exercised	863,000	1,223,950				1,223,950
Stock options exercised, including income tax benefits		98,344	1,011,116			1,109,460
Stock-based compensation			1,057,127			1,057,127
Earnings for the year					4,574,439	
Other comprehensive income, unrealized loss on available-for-sale short-term investments					(11,736)	
Compensation income for the year						4,562,703
Balance, December 31, 2006	25,637,491	\$ 41,890,777	\$ 2,832,865	\$ 96,016	\$ (2,550,168)	\$ 42,269,490

See accompanying notes to consolidated financial statements.

**JONES SODA CO. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Years ended December 31, 2006, 2005 and 2004**

	2006	2005	2004
Cash flows from (used in) operating activities:			
Earnings for the year	\$ 4,574,439	\$ 1,283,026	\$ 1,330,360
Items not involving cash:			
Depreciation and amortization	256,046	220,283	193,223
Deferred income taxes	(1,144,491)		
Stock-based compensation	1,057,127	5,745	19,737
Excess tax benefit from exercise of stock options	(1,109,458)		
Changes in assets and liabilities:			
Accounts receivable	(3,214,428)	(865,112)	(1,327,508)
Inventory	(1,088,854)	(1,143,618)	(1,549,671)
Prepaid expenses	(566,076)	253,165	(124,156)
Taxes payable	150,141		
Accounts payable and accrued liabilities	1,543,300	1,058,051	636,015
Changes related to shareholders' equity accounts	198,591		
<b>Net cash from (used in) operating activities</b>	<b>656,337</b>	<b>811,540</b>	<b>(822,000)</b>
Cash flows used in investing activities:			
Purchase of short-term investments - net	(16,318,510)		
Purchase of capital assets	(313,556)	(50,871)	(167,019)
Purchase of other assets	(1,414,138)		
Purchase of intangible assets	(174,594)	(42,072)	(12,176)
<b>Net cash used in investing activities</b>	<b>(18,220,798)</b>	<b>(92,943)</b>	<b>(179,195)</b>
Cash flows from (used in) financing activities:			
Net borrowing (repayment) under line of credit		(480,285)	480,285
Repayment of capital lease obligations	(116,529)	(105,881)	(64,066)
Net proceeds from PIPE (note 11)	28,077,350		
Proceeds from exercise of options	1,223,951	710,137	602,521
Excess tax benefit from exercise of stock options	1,109,458		
<b>Cash flows from financing activities</b>	<b>30,294,230</b>	<b>123,971</b>	<b>1,018,740</b>
<b>Net increase in cash and cash equivalents</b>	<b>12,729,769</b>	<b>842,568</b>	<b>17,545</b>
Cash and cash equivalents, beginning of year	1,176,101	333,533	315,988
<b>Cash and cash equivalents, end of year</b>	<b>\$ 13,905,870</b>	<b>\$ 1,176,101</b>	<b>333,533</b>
Supplemental disclosure of non-cash financing and investing activities:			
Bad debt recovery	\$ 7,633	\$ 6,951	15,000
Assets acquired under capital leases		131,152	179,782
Cash paid during year for:			
Interest payments	\$ 9,965	\$ 20,000	7,288
Income taxes	135,134	55,373	

See accompanying notes to consolidated financial statements.



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**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended December 31, 2006 and 2005**

**1. Nature and continuance of operations:**

Jones Soda Co. develops, produces, markets, licenses and distributes premium beverages and related products. Our primary product lines include the brands Jones Soda Co.<sup>®</sup>, Jones Pure Cane Soda, Jones Organics, a ready to drink organic tea, Jones Energy, a high energy drink, WhoopAss, a high energy drink, Jones Naturals, a non-carbonated juice and tea drink and Jones 24C, an enhanced water beverage. We have three operating subsidiaries, Jones Soda Co. (USA) Inc., Jones Soda (Canada) Inc., and myJones.com Inc., as well as one non-operating subsidiary, Whoopass USA Inc

**2. Significant accounting policies:**

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material inter-company transactions between the Company and its subsidiaries have been eliminated in consolidation.

The Company, in accordance with Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatement in Current Year Financial Statements* (SAB 108), adjusted its beginning retained earnings for the fiscal year 2006 in the accompanying financial statements. See Note 14 for additional information on the adoption of SAB 108.

(b) Use of estimates:

The preparation of the consolidated financial statements requires management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of inventory, capital assets, intangible assets, valuation allowances for receivables, stock-based compensation expense, valuation allowance for deferred income tax assets, provision for income taxes and state and city taxes. Actual results could differ from those estimates.

(c) Foreign currency translation:

Except where otherwise stated, these consolidated financial statements are presented in U.S. dollars. All foreign exchange gains or losses, including those arising from translating the net monetary assets of the Company's Canadian operations to the Company's functional currency of US dollars, have been included in income. For the twelve month period ended December 31, 2006, the Company incurred a foreign exchange gain (loss) of \$(58,122) (2005 \$3,835, 2004 \$56,798).

(d) Cash and cash equivalents:

The Company considers all short-term investments with a maturity date at purchase of three months or less to be cash equivalents.

(e) Short term investments:

Short-term investments carried at fair value have a maturity of three months to twelve months at the date of purchase. The estimate of fair value is based on publicly available market information or other estimates determined by management and classified as available-for-sale securities.

**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

(f) Concentration of Risk

The Company maintains cash and cash equivalents with various major financial institutions which at times are in excess of the amount insured. In addition, the Company's marketable securities and money market accounts are principally held at one brokerage company. The Company invests its excess cash in accordance with its investment policy, which has been approved by the Board of Directors and is reviewed periodically by management and with the Company's Audit Committee to minimize credit risk.

(g) Inventory:

Inventory has been stated at the lower of cost and estimated net realizable value and includes adjustments for estimated obsolescence. Cost is determined principally using actual cost on a first-in first-out basis. Finished goods inventory older than 12 months are considered for obsolescence.

(h) Capital assets:

Property and equipment is recorded at cost and depreciated on the declining balance basis over the estimated useful lives of the assets as follows:

Asset	Rate
Equipment	20% to 50%
Vehicles and Office and computer equipment	30%
Equipment under capital lease	Lease term which approximates its useful life

(i) Intangible assets:

The Company's intangible assets include costs associated with securing trademarks, acquired distribution rights and patents for the Company's products and are amortized on a straight-line basis over 3 to 10 years.

(j) Impairment of long-lived assets and long-lived assets to be disposed of:

Long-lived assets, which include capital assets and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. The Company has not recorded any long-lived asset impairments.

(k) Revenue recognition:

Sales are recorded when title passes, which is when goods are received by the customer, and represent amounts realized net of provisions for sales returns, discounts and allowances which are recognized at the time of sale. The Company's sales arrangements are not subject to warranty. Cash received in advance of delivery is recorded as deferred revenue in the consolidated balance sheets.

Licensing revenue is recorded when confirmation of sale to third parties is received from the customer, and represents amounts realized net of provisions for sales returns.





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**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

The Company does not enter into any agreements that provide customers with a general right of return of product, including concentrate. The Company's sale of concentrate is not subject to warranty.

Discounts are offered to customers via promotional events. Discounts are recorded as a reduction of revenue at the time of sale by issuing a credit note for the discount relating to the shipment.

Consideration by way of cash given by the Company to a customer (including a reseller of the Company's products) is accounted for as a reduction of revenue when recognized in the Company's statements of operations. For the twelve month period ended December 31, 2006, revenue was reduced by \$479,744 (2005 \$293,295, 2004 361,068).

(l) Research and development:

Research and development costs, which consist primarily of product development costs, are expensed in the period incurred and are included in general and administrative expenses. During the year ended December 31, 2006, the Company incurred research and development costs of \$128,743 (2005 \$41,406, 2004 \$0).

(m) Stock-based compensation:

Prior to January 1, 2006, we accounted for our employee stock compensation arrangements using the intrinsic method, under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations and provided the disclosure-only provisions of the fair value method under SFAS 123. Under the intrinsic value method, no stock-based compensation related to employee options had been recognized in our consolidated statement of operations, because the exercise price of our stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant. For stock options issued to non-employees for services received the fair value of the stock options issued at the date of the performance completion was recognized as a compensating expense.

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), using the modified prospective transition method. Under this method, stock-based compensation expense is recognized using the fair-value based method for all awards granted on or after the date of adoption. In addition, compensation expense for unvested stock options that were outstanding on January 1, 2006 is recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated for the pro forma disclosures under SFAS 123, as adjusted for estimated forfeitures.

SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma information required under SFAS 123 for the periods prior to January 1, 2006, we accounted for forfeitures as they occurred.

The adoption of this standard resulted in a \$1,057,127 decrease in earnings and income before taxes, or \$0.04 basic and \$0.04 diluted earnings per share for the twelve-month period ended December 31, 2006. Non-cash stock based compensation expense of \$1,057,127 was added back to cash flows from operating activities during the twelve-month period ended December 31, 2006. There was no cumulative effect on adoption.

**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition principles of SFAS 123 to stock-based employee compensation during the corresponding periods in fiscal 2005 and 2004.

	Twelve months ended December 31, 2005	Twelve months ended December 31, 2004
Net Income :		
As reported	\$ 1,283,026	\$ 1,330,360
Add: Stock-based employee compensation expense included in reported income	\$ 5,745	\$ 19,737
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards	\$ (908,834)	\$ (333,405)
Pro forma income	\$ 379,937	\$ 1,016,692
Basic earnings per share:		
As reported	\$ 0.06	\$ 0.06
Pro forma	\$ 0.02	\$ 0.05
Diluted earnings per share:		
As reported	\$ 0.06	\$ 0.06
Pro forma income	\$ 0.02	\$ 0.05

For our pro forma disclosure we recognized the fair value calculated at the grant date of the stock options on a straight-line basis consistent with the vesting terms. The proforma disclosure with respect to the expense for the year ended December 31, 2005 and December 31, 2004 have been restated by \$144,219 and \$14,997, respectively from the amounts previously presented due to the amortization of stock-based compensation over the vesting term for certain grants that were previously recognized at the time stock options vested.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions. The expected life selected for options granted during the year represents the period of time that the options are expected to be outstanding based on historical data of option holder exercise and termination behavior. Expected volatilities are based upon historical volatility of our monthly stock closing prices over a period equal to the expected life of each option grant. The risk-free interest rate was selected based on yields from Government Bond yields with a term equal to the expected term of the options being valued.

	Twelve months ended December 31,		
	2006	2005	2004
Expected dividend yield			
Expected stock price volatility	55.5%	80.0%	82.0%
Risk-free interest rate	4.82%	3.26%	1.63%
Expected term (in years)	2.75 years	1.5 years	1.5 years
Weighted-average grant date fair-value	\$ 2.82	\$ 1.86	\$ 1.06

At December 31, 2006, we had \$683,000 of unrecognized compensation expense related to stock options, which we expect to recognize over a weighted-average period of up to 21 months.

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**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

(n) Advertising:

The Company expenses advertising costs as incurred. During the year ended December 31, 2006, the Company incurred advertising costs of \$5,032,520 (2005 \$5,120,326, 2004 \$3,891,751).

(o) Income taxes:

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable for the current year and deferred tax assets and liabilities for future tax consequences of events at enacted tax rates that have been recognized in the Company's financial statements or tax returns. The Company performs periodic evaluations of recorded tax assets and liabilities and maintains a valuation allowance if considered necessary. The determination of taxes payable for the current year includes estimates. In the event that actual results differ materially from management's expectations, the estimated taxes payable could materially change, directly impacting the Company's financial position or results of operations.

(p) Earnings per share:

Basic earnings per share is computed using the weighted average number of common shares outstanding during the periods, excluding reacquired stock and common stock held in escrow that is subject to cancellation if certain criteria are not achieved. Diluted earnings per share are computed by adjusting the weighted average number of common shares by the effective net exercise or conversion of all dilutive securities.

(q) Comprehensive income:

SFAS No. 130, Reporting Comprehensive Income, establishes standards for reporting and disclosure of comprehensive income and its components in a full set of general-purpose financial statements. The Company discloses the comprehensive income in the Consolidated Statements of Shareholders' Equity and Comprehensive Income.

The amount of comprehensive income related to available for sale investments is not significant in the prior year. The amount of accumulated other comprehensive income relates to the translation of the Company's U.S. operation prior to the Company's migration from Canada to the U.S.

(r) Volume rebates from vendors:

In 2004, the Company adopted EITF 02-16 on Accounting by a Customer for Certain Consideration Received from a Vendor. As a result, consideration received by the Company from a vendor is accounted for as a reduction of cost of goods sold or inventory, as appropriate. For the year ended December 31, 2006, the reduction of cost of goods sold is \$254,371 (2005 \$191,112, 2004 \$185,471) and inventory is \$108,584 (2005 \$10,534, 2004 \$40,488).

(s) Seasonality

Our sales are seasonal and we experience significant fluctuations in quarterly results as a result of many factors. We generate a substantial percentage of our revenues during the warm weather months of April through September. Timing of customer purchases will vary each year and sales can be expected to shift from one quarter to another. As a result, management believes that period-to-period comparisons of results of operations are not necessarily meaningful and should not be relied upon as any indication of future performance or results expected for the fiscal year.

(t) Other Assets

During the year the company invested in equipment at co-packing facilities to increase production and convert to pure cane sugar. These assets were not put in use at year-end.

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**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

(u) Recent accounting pronouncements:

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently assessing the impact, if any, this provision may have on our financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact to both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative effect adjustment to correct for misstatements for errors that were not deemed material under the Company's prior approach but are material under the SAB 108 approach. SAB 108 is effective the fiscal year ending December 31, 2006. We adopted SAB 108 as of December 31, 2006. See Note 14 for further discussion.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions including whether to file or not to file a return in a particular jurisdiction. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with any cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently evaluating the impact, if any, of adopting FIN 48 on our financial position, results of operations and cash flows.

(t) Reclassifications

Certain prior year amounts have been reclassified to conform to the 2006 presentation.

**3. Cash equivalents and short-term investments**

We generally invest cash in highly liquid debt securities that are classified as available for sale and are reflected in the balance sheet based on maturity dates. Investments in debt securities with original maturities of three months or less are considered to be cash equivalents.

	2006		2005	
	Cash and	Short-term	Cash and	Short-term
	cash equivalents	Investments	cash equivalents	Investments
Cash	\$ 1,857,154		\$ 501,101	
Money market funds	1,791,285		675,000	
Certificates of deposit	1,513,709			
	5,162,148		1,176,101	
Available-for sale securities:				
U.S. Government and agency securities	8,743,722			
Corporate notes		16,318,510		
	8,743,722	16,318,510		
<b>Total</b>	<b>\$ 13,905,870</b>	<b>\$ 16,318,510</b>	<b>\$ 1,176,101</b>	

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**JONES SODA CO. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005****4. Accounts receivable:**

	<b>2006</b>	<b>2005</b>
Trade	\$ 6,579,195	\$ 3,500,617
Other	519,959	306,783
Allowance for doubtful accounts	(184,732)	(107,406)
	\$ 6,914,422	\$ 3,699,994

Supplementary information on the allowance for doubtful accounts:

	<b>2006</b>	<b>2005</b>
Allowance for doubtful accounts:		
Beginning of year	\$ 107,406	\$ 175,124
Bad debt expense	69,693	86,699
Net recoveries and write offs	7,633	(154,417)
End of year	\$ 184,732	\$ 107,406

Of the \$154,417 of net recoveries and write offs in 2005, \$147,466 relate to bad debts expensed during 2001.

**5. Inventory:**

	<b>2006</b>	<b>2005</b>
Finished goods	\$ 2,919,396	\$ 2,911,815
Raw materials	2,863,671	1,782,398
	\$ 5,783,067	\$ 4,694,213

**6. Capital Assets:**

	<b>2006</b>	<b>2005</b>
Vehicles	\$ 294,278	\$ 276,532
Equipment	1,303,943	1,159,668
Office and computer equipment	804,427	652,892
	2,402,648	2,089,092
Accumulated depreciation	(1,646,030)	(1,426,150)

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\$ 756,618      \$ 662,942

Included in capital assets are assets under capital leases with a cost of \$586,492 (2005 \$586,492) and accumulated depreciation of \$274,654 (2005 \$176,203).

**7. Other Assets**

	<b>2006</b>	<b>2005</b>
Equipment at co-packing facilities	\$ 1,414,138	
	\$ 1,414,138	

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**JONES SODA CO. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005****8. Intangible assets:**

	2006	2005
Trademarks and patents	\$ 544,791	\$ 370,197
Accumulated amortization	(332,860)	(297,444)
	\$ 211,931	\$ 72,753

During the year ended December 31, 2006 amortization of \$35,416 (2005 \$18,762) related to intangible assets was recognized.

**9. Bank indebtedness:**

On June 27, 2006, we renewed our existing credit facility granted by Capco Financial Company, a division of Greater Bay Bank N.A, for a further one-year revolving line of credit of up to \$5,000,000. The amount available for borrowing from time to time under the revolving line of credit is dependent upon the levels of certain of our accounts receivable and inventory. This revolving line of credit is secured by all of our assets, including accounts receivable, inventory, trademarks and other intellectual property, and certain equipment. Borrowings under the credit facility bear interest at prime plus 0.5% per annum (8.25% at December 31, 2006). The credit facility does not impose any financial covenants. As of December 31, 2006, we had no borrowings outstanding under the line of credit and \$5,000,000 available for borrowing. In accordance with the terms of this agreement, all receivables collected are submitted to Capco as collateral for the line of credit. If no borrowings have been made against the line of credit, payments received by Capco are subject to a one-day hold to allow for the application of funds. As of December 31, 2006, \$23,936 included in cash and cash equivalents is subject to this one-day hold.

**10. Capital lease obligations:**

The Company's scheduled payments, including interest ranging from 5% to 15% at December 31, 2006 are as follows:

2007	\$ 73,214
2008	15,637
Total minimum capital lease payments	88,851
Less amount representing interest	3,051
Present value of total minimum capital lease payments	85,800
Less current portion of capital lease obligations	70,471
Capital lease obligations excluding current portion	\$ 15,329

**11. Shareholders equity:****(a) Common stock:**

On June 8, 2006, we completed a private placement in public equity ( PIPE ) of 3,157,895 shares of our common stock at a price of \$9.50 per share, and received \$28,077,350 in net proceeds after underwriting costs and expenses. The 3,157,895 newly issued shares were restricted from being traded until registered with the Securities and Exchange Commission ( SEC ). Per share amounts for 2006 reflect the effect of the PIPE

private placement on a weighted average basis for the periods presented.

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**JONES SODA CO. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005**

On July 28, 2006, the SEC declared effective the registration statement with respect to these shares of common stock permitting the shareholders participating in the private placement to resell to the public the shares of our common stock acquired in the private placement.

**(b) Stock options:**

In 1996, we adopted a stock option plan (the 1996 Plan) that provides for the issuance of incentive and non-qualified stock options to officers, directors, employees and consultants. In addition, in 2002 we adopted a second stock option plan for the issuance of incentive and non-qualified stock options to officers, directors, employees and consultants (the 2002 Plan). (The 1996 Plan and 2002 Plan are collectively referred to as the Plans ). On May 18, 2006, at the annual shareholders meeting, the shareholders ratified the amendment to the 2002 Plan to increase the total number of shares of common stock authorized for issuance during the life of the plan from an aggregate 3,750,000 shares to 4,500,000 shares. The 1996 Plan terminated by its terms on June 18, 2006 and no additional options may be granted thereunder, but all outstanding options continue for their respective remaining terms.

Under the terms of our employee stock option plan, our Board of Directors may grant options to employees, officers, directors and consultants. The plan provides for granting of options at the fair market value of our stock at the grant date. Historically, options generally vested over a period of eighteen months, with the first 25% vesting at the date of grant and the balance vesting in equal amounts every six months thereafter. Effective during the quarter ended September 30, 2006, we changed the vesting schedule for our prospective stock option grants, to vest over a period of forty-two months, with the first 1/7 vesting six months from the grant date and the balance vesting in equal amounts every six months thereafter. We determine the term of each option at the time it is granted, historically, options granted generally have a five-year term.

A summary of our stock option activity is as follows:

	<b>Outstanding options</b>	
	<b>Number of shares</b>	<b>Average exercise price</b>
Balance at December 31, 2003	2,404,500	\$ 0.58
Option granted	560,500	2.39
Options exercised	(867,250)	(0.69)
Options cancelled	(65,500)	(0.44)
Balance at December 31, 2004	2,032,250	\$ 1.06
Option granted	613,500	4.00
Options exercised	(660,250)	(1.08)
Options cancelled	(203,500)	(3.32)
Balance at December 31, 2005	1,782,000	1.83
Option granted	585,400	7.08
Options exercised	(863,000)	(1.42)
Options cancelled	(80,375)	(5.02)
Balance at December 31, 2006	1,424,025	\$ 4.05
Exercisable, December 31, 2006	1,106,709	\$ 3.09

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**JONES SODA CO. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005**

The following table summarizes information about stock options outstanding and exercisable under the Plans at December 31, 2006:

	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price
\$0.25 to \$0.50	342,000	0.51	\$ 0.43	342,000	0.51	\$ 0.43
\$1.10 to \$2.99	207,500	2.00	2.10	207,500	2.00	2.10
\$3.00 to \$4.00	318,750	2.80	3.96	318,750	2.80	3.96
\$4.01 to \$5.01	21,125	3.61	5.01	14,781	3.61	5.01
\$5.01 to \$9.33	534,650	4.44	7.14	223,688	4.25	6.73
	1,424,025		\$ 4.05	1,106,719		\$ 3.09

The total intrinsic value of options exercised during the year ended December 31, 2006 was \$4,966,642.

The aggregate intrinsic value of options outstanding during the year ended December 31, 2006 was \$11,747,210 and for options exercisable was \$10,188,111.

During the year ended December 31, 2006, no modifications were made to outstanding stock options, and there were no stock-based compensation costs capitalized as part of the cost of any asset.

The Company issues new shares of common stock upon exercise of options.

The tax benefit realized from the tax deductions for stock options for the year ended December 31, 2006 totaled \$1,216,559.

**12. Commitments and contingencies:**

During the year, we commenced a review of the availability of deductions of stock option and various other expenses in our tax returns filed in prior years and believe that there is a reasonable possibility that these additional tax deductions may be available to the Company. We will take into income, in future periods, any tax benefits when and to the extent they are available to the Company as stipulated in the IRS Code.

We are involved in various claims and legal actions arising in the ordinary course of business, including proceedings involving product liability claims and other employee claims, and tort and other general liability claims, for which we carry insurance, as well as trademark, copyright, and related claims and legal actions. In the opinion of our management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations or liquidity.

We have an employment agreement with one of our executive officers. The agreement generally continues until terminated by the executive or by us, and provide for severance payments under certain circumstances. As of December 31, 2006, if one of our executives were to be terminated by us without cause (as defined) or upon a change of control (as defined), our severance liability, including salary continuation, continuation of health care and insurance benefits, would have been approximately \$200,000.

We are party to many agreements executed in the ordinary course of business that provide for indemnification of third parties, under specified circumstances, such as lessors of real property leased by the



**JONES SODA CO. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005**

Company, distributors, suppliers, co-packers, customers, service providers for various types of services (including commercial banking, investments and other services), software licensors, marketing and advertising firms, and others. Generally, these agreements obligate the Company to indemnify the third parties only if certain events occur or claims are made, as these contingent events or claims are defined in each of these agreements. The Company believes that the resolution of any claims that might arise in the future, either individually or in the aggregate, would not materially affect the earnings or financial condition of the Company.

The Company has lease commitments for office equipment and warehouse premises expiring on August 31, 2011. Future minimum rent payments under this lease are;

2007	\$ 227,768
2008	176,291
2009	166,755
2010	172,856
2011	117,949
Thereafter	
<b>Total</b>	<b>\$ 861,619</b>

During the year ended December 31, 2006, the Company incurred rental expenses of \$113,421 (2005 \$95,670, 2004 \$101,345).

**13. Income taxes:**

The provision (recovery) for income taxes consisted of the following:

	2006	2005	2004
<b>Current</b>			
Federal	\$	\$ 10,532	\$ 13,630
State	5,591	40,000	
Foreign	236,150		
<b>Total</b>	<b>241,741</b>	<b>50,532</b>	<b>13,630</b>
<b>Deferred</b>			
Federal	\$ (712,553)	\$	\$
State	45,284		
Foreign	(477,222)		
<b>Total</b>	<b>(1,144,491)</b>		
<b>Provision for income taxes</b>	<b>\$ (902,750)</b>	<b>\$ 50,532</b>	<b>\$ 13,630</b>

Income before provision for income taxes was as follows:

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United States	\$ 2,704,673	\$ 766,811	\$ 1,088,967
Foreign	827,722	535,241	\$ 281,975
Total	\$ 3,532,395	\$ 1,302,052	\$ 1,370,942

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**JONES SODA CO. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005**

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes are as follows:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Federal statutory rate	34%	34%	34%
Effect of:			
Permanent differences	6.28%	2.4%	1.6%
State income taxes, net of federal benefit	0.29%	3.1%	
Alternative minimum tax	0.00%	0.8%	1.0%
Change in valuation allowance	(69.97)%	(44.1)%	(51.7)%
Other, net	3.85%	7.7%	16.1%
Provision for (recovery) income taxes	(25.56)%	3.9%	1.0%

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred income taxes were as follows:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Deferred tax assets			
Net operating loss carry forwards	\$ 1,401,117	\$ 1,731,023	\$ 2,225,494
Capital assets		82,258	135,268
Intangible assets	384,657	420,753	427,730
Other	198,185	120,971	135,914
Total deferred tax asset	1,983,959	2,355,005	2,924,406
Valuation allowance		(2,355,005)	(2,924,406)
Net deferred tax asset	\$ 1,983,959	\$	\$
Deferred tax liabilities			
Capital assets	(48,821)		
	(48,821)		
Total deferred tax asset balance	\$ 1,935,138	\$	\$
Classified as current	1,507,145		
Long-term asset	427,993		

Reclassifications have been made to the 2005 balances for certain components of deferred tax assets and liabilities in order to conform to the current year presentation.



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At December 31, 2006, the Company has net operating loss carry-forwards for income tax purposes of \$4,024,016, which expire at various times commencing in 2020. Net operating loss carry-forwards may be subject to certain limitations under Section 382 of the Internal Revenue Code.

We account for income taxes in accordance with SFAS 109, Accounting for Income Taxes, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements which differ from our tax returns.

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**JONES SODA CO. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Years Ended December 31, 2006 and 2005**

In assessing whether and to what extent we may realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Historically, we did not believe we met the criteria to recognize deferred tax assets, and accordingly, we provided a full valuation allowance.

During the second quarter of 2006, we re-evaluated our valuation allowance after recording taxable income for two successive years and we determined that it is more likely than not we would realize the deferred tax assets. Accordingly, during the twelve-months ended December 31, 2006, we recorded a tax benefit in the amount of \$2,471,790 by reversing the valuation allowance and recording the tax benefit against the 2006 tax provision resulting in a net deferred income tax benefit of \$1,144,491.

**14. Staff Accounting Bulletin No. 108**

As discussed under Recent Accounting Pronouncements in Note 1, in September 2006, the SEC released SAB 108. The transition provisions of SAB 108 permit the Company to adjust for the cumulative effect on deficit of immaterial errors relating to prior years. SAB 108 also requires the adjustment of any prior quarterly financial statements within the fiscal year of adoption for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. Effective the beginning of the fiscal year ended December 31, 2006, the Company adopted SAB 108. In accordance with SAB 108, the Company has adjusted opening deficit for fiscal 2006 in the accompanying consolidated financial statements for the items described below. The Company considers these adjustments to be immaterial to prior periods.

## Inter-company balances

The Company adjusted its beginning retained earnings for fiscal 2006 for a historical misstatement in inter-company balances of intangible transfers and accounts receivable balances. These differences had accumulated over a period of several years and were not material in any one year.

## Impact of adjustments

The impact of each of the items noted above on the fiscal 2006 beginning balances are presented below:

Reduction of intangibles	\$ 70,519
Reduction of receivable balances	36,756
<b>Increase in deficit</b>	<b>\$ 107,735</b>

**15. Segmented information and export sales:**

The Company operates in one industry segment, with operations during 2006 primarily in the United States and Canada. During the year ended December 31, 2006, sales in the United States were approximately \$34,209,000 (2005 \$29,620,000, 2004 \$24,186,000), sales in Canada were approximately \$4,662,000 (2005 \$3,788,000, 2004 \$3,152,000), and sales to other countries totaled \$165,000 (2005 \$103,000, 2004 \$111,000). Sales have been assigned to geographic locations based on the location of customers.

**JONES SODA CO. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Years Ended December 31, 2006 and 2005**

As at December 31, 2006, the net book value of long-lived assets held in the United States was \$2,111,351 (2005 \$603,854, 2004 \$612,468). The net book value of long-lived assets held in Canada was \$59,405 (2005 \$59,088, 2004 \$69,971).

**16. Financial instruments:**

(a) Fair values:

As of December 31, 2006, the carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, line of credit, accounts payable and accrued liabilities and capital lease obligations, approximate their fair values due to the short-term to maturity of these instruments.

(b) Concentration of credit risk:

The Company mainly sells its products to customers in the United States and Canada. Customers in the United States represent 95% (2005 92%, 2004 91%) while customers in Canada represent 5% (2005 8%, 2004 9%) of year end accounts receivable balances. Three of the Company's customers represent approximately 28% of revenues for the year ended December 31, 2006. Three customers represented approximately 21% of revenues for the year ended December 31, 2005. Two customers represented approximately 22% of revenues for the year ended December 31, 2004.