LML PAYMENT SYSTEMS INC
Form 10-K
June 24, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended March 31, 2010

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from ________ to ________

Commission File Number: 0-13959

LML PAYMENT SYSTEMS INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Yukon Territory | ###-##-#### |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 1680-1140 West Pender Street<br>Vancouver, British Columbia Canada | V6E 4G1 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's Telephone Number, Including Area Code: (604) 689-4440

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| None | None |

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, without par value
(Title of each class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).Yes [ ] No [X] (not applicable to the registrant)

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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. [X]

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

Large Accelerated Filed [ ] Accelerated Filer [ ] Non-Accelerated Filer [ ] Smaller Reporting Company [X]
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of September 30, 2009, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the Common Stock of the Registrant held by non-affiliates based upon the closing sale price of the Common Stock on such date as reported on the NASDAQ Capital Market was approximately $13.8 million.

As of May 28, 2010, the Registrant had 27,241,408 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s proxy statement for its 2010 Annual Meeting of Shareholders, which will be filed with the Commission within 120 days after the end of the Registrant’s fiscal year ended March 31, 2010, are incorporated by reference into Part III of this Annual Report on Form 10-K.

LML PAYMENT SYSTEMS INC.
2010 FORM 10-K ANNUAL REPORT

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# PART I

## ITEM 1. Business

Unless the context otherwise requires, references in this report on Form 10-K to the "Company", "LML," "we," "us" or "ou refer to LML Payment Systems Inc. and its direct and indirect subsidiaries. LML Payment Systems Inc.'s subsidiaries are Beanstream Internet Commerce, Inc,. LML Corp., Legacy Promotions Inc., 0858669 B.C. Ltd. and LHTW Properties, Inc. LML Corp.'s subsidiaries are LML Patent Corp., LML Payment Systems Corp. and Beanstream Internet Commerce Corp. Unless otherwise specified herein, all references herein to "$" are to United States ("U.S.") Dollars. From time to time the Company has made and may continue to make written or oral "forward-looking statements" including those contained in this Annual Report on Form 10-K. These forward-looking statements represent the Company's present expectations or beliefs concerning future events. The Company cautions that such statements are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements including those factors identified below in Item 1A – "Risk Factors".

### Overview

We are a leading provider of electronic payment, and risk management and authentication services primarily to businesses and organizations that use the Internet to receive or send payments.

We link merchants selling products or services to customers wanting to buy them and financial institutions who allow the transfer of payments to occur. We have partnership arrangements and certified connections to financial institutions, payment processors and other payment service providers in order to enable our customers to safely and reliably conduct e-Commerce. We provide our electronic payment, authentication and risk management services to over 8,500 businesses and organizations in Canada and the United States.

Our payment services allow our customers to accept or process a wide array of payments including credit cards, debit cards, electronic fund transfers and Automated Clearing House ("ACH") transactions. We process Mastercard, VISA, American Express, Diners, JCB, and Discover cards on behalf of the majority of Canadian and American merchant account acquirers. We also offer leading risk management solutions to both online and brick and mortar customers who wish to use the Internet as a cost effective means of communicating with their own bank or credit reporting agency.

On June 30, 2007, we acquired Beanstream Internet Commerce Inc., a leading provider of Internet-based electronic payment, risk management and authentication services to businesses and organizations in Canada and the United States. We believe the acquisition was complementary to our existing payment processing business. The transaction was a cash, stock and debt transaction valued at approximately $24,100,000 including the value of earn-out shares issued since the closing date of the acquisition.

We operate three separate lines of business: transaction payment processing, intellectual property licensing and check processing/software licensing. Our transaction payment processing services consist predominantly of Internet-based services, while our check processing services involve predominantly traditional and electronic check processing and recovery services that do not utilize the Internet. With the completion of our 2007 acquisition of Beanstream (which had a strong Internet-based product and service offering), we expect that our transaction payment processing services will be our principal line of business for the foreseeable future, while our other lines of business (including the electronic check processing services that we have historically relied on for a significant source of revenue) will become less important to our overall service offerings and less significant to the financial performance of our company. See "Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations --

Overview."

Our headquarters are located at Suite 1680, 1140 West Pender Street, Vancouver, British Columbia, Canada and we have office locations in Victoria, British Columbia, Canada and Wichita, Kansas and Marshall, Texas in the United States.

e-Commerce Market

The United States Department of Commerce reported that online retail sales in the United States grew by an estimated 8.9% to $144.1 billion in 2009 compared to 2008, despite an estimated 7.3% decline in total retail sales over the same period. In addition, estimates released by the Department of Commerce on May 18, 2010 for the first quarter of 2010 show online retail sales increased 14% from the first quarter of 2009 while overall retail sales increased 6.3% in the same period. It was also reported that online retail sales now comprise approximately 4% of total retail sales.

According to the Forrester Research's most recent five-year forecast of online retail sales, e-commerce spending in the United States is still projected to grow at a compound annual growth rate of 10% to reach $250 billion in 2014. Forrester Research also estimated that e-commerce will represent 8% of all retail sales in the U.S. by 2014.

We believe that the electronic payments and e-Commerce markets will continue to grow as more and more businesses decide to sell products or make payments electronically over the Internet.

Products and Services

Our transaction payment customers range in size from small, sole proprietorships to large corporations. However, most of our transaction payment processing business comes from services we provide to small to medium size firms. We support this market in three separate ways: first by providing services that can be integrated to a customer's website or financial platform through software plug-ins and application programming interfaces (API's); second, by providing hosted services where we can provide a turn-key e-Commerce website for a merchant; and third, by having our transaction payment services integrated directly into third party software solutions. In each instance, our products and services are designed to provide this market segment with bundled payment, risk management, authentication, shopping cart products and reporting forms that allow our customers to sell goods and services and receive payment in an efficient and secure manner.

Our customers include both online merchants and brick and mortar merchants, including government and financial institutions. We provide electronic payment and risk management solutions for brick and mortar retailers and mail-order and telephone-order call-centers ("MOTO") that allow these businesses to streamline payment processing. Our payment services can be integrated into a customer's accounting or financial system, thereby reducing administrative costs and removing some of the complexity of a paper-based environment.

We provide solutions for e-merchants where we integrate our services to the website of the e-merchant and their shopping cart or application software provider, which allows e-merchants to accept credit card and debit card payments, electronic funds transfers (EFT) and ACH payments. Our payment solutions have been integrated into many shopping cart and application service providers who integrate our payment services into their own products in order to provide their customers secure access to financial payment networks. Our payment products support both Canadian and U.S. dollar settlement and our products are available in both French and English.

Our hosted solutions offered to customers include a connection between the merchant's website and our host system that provides the merchant with a shopping cart with secure payment processing for credit cards and debit cards, electronic funds transfers (EFT) and ACH payments, a secure order management interface, multiple shipping options and sophisticated reporting and reconciliation tools. All required forms and images are hosted on our servers and are secured using secured socket layer (SSL) encryption. We operate equipment in two separate data centers to provide greater reliability to our merchants and customers.

In addition, we provide a robust selection of authentication tools for merchants to reduce the risk inherent in card-not-present credit card transactions. Our merchants are entitled to the fraud protection services offered by the card associations such as Mastercard's Securecode and Verified by Visa in addition to our own risk-management tools and applications. We also provide additional easy to use authentication services that provide our merchants with information that ranges from the validation of credit card orders to the fraud screening of applications by consumers. Our authentication services allow certification of addresses and telephone numbers and can identify addresses that have been known to be used as mail drops, and high risk postal codes. Our highest level of authentication involves the consumer providing answers to "out-of-wallet" questions as part of the transaction process. Finally, we supply merchants with a variety of risk management tools that, when combined with our cardholder authentication services, provide leading class functionality in the battle against payments fraud.

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Technology and Data Centers

We operate a transaction processing platform that is designed for reliability, scalability and security. We operate two separate data centers, one in Victoria, B.C. and one in Saanich, B.C. These secure data centers contain the technology necessary to provide our services to merchants over the Internet and to our financial institutions and payment processing partners. Our data centers contain our enterprise servers, network firewalls, routers and other technology we use to provide services to our merchants and partners. Our processing software is certified to process financial transactions with a majority of Canadian and US merchant acquirers, which allows us to act as a single point of integration and point of contact for our customers and the customers of our channel partners and the financial payments network.

Our systems are monitored 24 hours per day, 7 days per week, 365 days per year. We are also certified as a level 1 service provider under the Payment Card Industry (PCI) Data Security Standard (DSS) which is a comprehensive set of requirements for enhancing payment account data security that was developed by the PCI Security Standards Council including American Express, Discover Financial Services, JCB International, Mastercard Worldwide and VISA Inc., to help facilitate the broad adoption of consistent data security measures.

Sales and Marketing

Our products and services are primarily sold indirectly through both channel and technology partners, directly through our website and directly by an internal sales staff of five people.

We obtain new business as a result of our relationships with channel partners and our own internal marketing efforts. These channel partners can be payment processors, financial institutions, independent sales organizations or software application vendors who, in many cases, may provide a value-added service to our merchants. We typically pay either a referral fee or commission or residual fee for each merchant referred to us by our channel partners. We rely on the success of our channel partners for new sales. We currently have more than 500 channel partners.

Customer Service

We staff our own bilingual (French and English) customer support center and provide direct inbound access to highly qualified and trained customer service representatives who are fully capable of handling technical and non-technical inquiries. Our customer service desk is staffed by 7 people. Emergency support is available 24 hours a day, 7 days a week.

We view our customer service capabilities as a key competitive advantage in our market. Over 95% of our incoming calls are answered within 30 seconds by a live operator who in most cases can address a question immediately.

Competition

The market for our products and services is highly competitive and is characterized by rapidly changing technology, changing industry standards, merchant requirements, pricing competition and rapid rates of product obsolescence. Our competitors include other payment gateways and merchant acquirers, payment processors, technology service providers, Internet commerce providers and financial institutions. In Canada, our primary competition is Moneris and Elavon. In the U.S. market we compete against other third party processors and gateways such as Cybersource, Authorize.net, and Verisign/Paypal.

We believe we compete on certain factors including:

- Customer service
- Features and functionality
- Strategic partnerships and channel partners
- Ease of product integration for customers
- Broad range of certified connections to financial institutions and payment processors

We believe that we compete favorably with respect to these factors however, we believe that part of our success will be our ability to successfully market existing services. We operate in a market that is rapidly changing and we may not be able to successfully compete against current or future competitors. Many of our competitors have greater technical, financial and marketing resources than us and, as a result, may be able to respond more quickly to changes in technology, industry standards and merchant requirements or may be able to devote greater resources to product development and marketing than us. There can be no assurance that our current services will not become obsolete or that we will have the financial, technical and marketing resources and support facilities to compete successfully in the future. Our failure to compete favorably could materially and adversely affect our business, results of operations and financial condition.

Regulatory Matters

Various aspects of our business are either subject to or may be affected by current and future governmental and other regulations in many different jurisdictions. The rules, regulations, policies and procedures affecting our business are constantly subject to change.

Certain of our services in Canada may be subject to federal legislation called the Proceeds of Crime and Terrorist Financing Act.

Certain check collection and electronic check re-presentment services that we provide are governed by the Federal Fair Debt Collection Practices Act and the Federal Fair Credit Reporting Act and other similar state laws. Electronic check re-presentment transactions are subject to applicable National Automated Clearing House Association (“NACHA”) Operating Rules, and applicable Uniform Commercial Code statutes. Our electronic check re-presentment transactions currently utilize the facilities of the Automated Clearing House Network and therefore are governed by and subject to NACHA Operating Rules and Regulation E. We use commercially reasonable efforts to oversee compliance with the requirements of these acts and regulations.

Intellectual Property

Our Intellectual Property Licensing Operations ("IPL") involve licensing our intellectual property estate, which includes five U.S. patents describing electronic check processing methods. When we provide clients licenses to our intellectual property estate, we typically earn revenue or other income from ongoing royalty fees and, in some cases, release fees for potential past infringement. In some instances we also earn revenue from license agreements that provide for the payment of contractually determined paid-up license fees to us in consideration for the grant of a non-exclusive, retroactive and future license to our intellectual property estate and in other instances, where license agreements include multiple element arrangements, we may defer this revenue and recognize the revenue ratably over the license term.

Certain unique aspects of our intellectual property are protected by patents. Currently, our intellectual property estate includes U.S. patent nos. 5,484,988, 6,164,528, 6,283,366, 6,354,491, and RE40,220, all of which describe methods and systems for processing checks electronically. Moreover, our patent estate addresses, among other issues, the electronic submission and approval of transactions through a centralized database and authorization system, electronic debiting of consumer bank accounts and electronic crediting of designated merchant accounts in real-time or off-line modes using the facilities of the ACH Network or any competing network.

We rely upon a combination of patent, trademark, copyright, trade secret law and contractual provisions to establish and protect our proprietary rights in our trademarks, software and inventions. Our success will depend, in part, on our ability to protect and enforce intellectual property protection for the technology contained in our patents and trademarks. To protect and maximize the value of our patent estate, we have in the past and expect to in the future file patent litigation against third parties that we believe are infringing our patents.  In addition, we intend to continue to file additional patent applications to expand our intellectual property estate, seeking coverage of our developments in our business areas.  There can be no assurance that these protections will be adequate to deter misappropriation of our technologies or independent third-party development of similar technologies.

Although we do not believe that our technology, products or services infringe the patent rights of others, we have in the past been accused of infringing the patent rights of others. There can be no assurance that infringement claims will not be made against us in the future or that the validity or enforceability of any patent issued to us will be sustained if judicially tested or reexamined by the United States Patent and Trademark Office. The cost of both prosecuting a claim of infringement against others and defending a patent infringement claim may be substantial and there can be no assurance that we will have the resources necessary to successfully prosecute or defend a patent infringement claim. See “Item 3 – Legal Proceedings.”

Check Processing/Software Licensing

Our Check Processing/Software Licensing Operations ("CP/SL") involve primary and secondary check collection including electronic check re-presentment (RCK) and software licensing. Our check processing services involve return check management such as traditional and electronic recovery services to retail clients. When we provide return check management services, we typically receive revenue when we are successful at recovering the principal amount of the original transaction on behalf of the client. In some instances we also earn a percentage of the principal amount and in other instances our secondary recovery services provide for us to earn additional fees when legal action is required. Our check processing services are provided in the United States and are operated from our Wichita, Kansas location.

Corporate History

We were originally incorporated under the laws of the Province of British Columbia, Canada, as a “specially limited company” on January 24, 1974. In October 1997, after receipt of shareholder approval, our directors elected to change our governing corporate jurisdiction to the Yukon Territory, which change became effective in November 1997. Under the Yukon Business Corporations Act, we are a corporation that enjoys limited liability for its shareholders, is governed by its Board of Directors and generally has the powers and capacity attributable to a corporation.

Employees

There exists competition for personnel in the financial payment processing industry. We believe that our future success will depend in part on our continued ability to hire and retain qualified personnel. There can be no assurance that we will be successful in attracting and retaining a sufficient number of qualified employees to conduct our business in the future. As of May 28, 2010, we had 54 full-time employees including 6 employees in sales and marketing and 9 employees in administration and finance. We also employ consultants to perform services for us from time to time.

Business Concentration

During the fiscal year ended March 31, 2010, revenue from and associated with our largest customer amounted to approximately 16% of total revenue. In fiscal 2010, Disney Interactive was our largest customer. We are economically dependent on revenue from this customer. See “Part II, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 4 to our Consolidated Financial Statements included in this report.

Available Information

We maintain investor relations pages on our Internet website at http://www.lmlpayment.com. On these pages, we make available our annual, quarterly and other current reports filed or furnished with the SEC as soon as practicable. These reports may be reviewed or downloaded free of charge. Alternatively, if you would like a paper copy of any such SEC report (without exhibits) or document, write to the Corporate Secretary, LML Payment Systems Inc., Suite 1680, 1140 West Pender Street, Vancouver, BC V6E 4G1, and a copy of such requested document will be provided to you, free of charge.

ITEM 1A. Risk Factors

Introduction

In addition to the normal risks of business, we are subject to significant risks and uncertainties, including those listed below and others described elsewhere in this Annual Report on Form 10-K. Any of the risks described herein could result in a significant adverse effect on our results of operations and financial condition and could cause our actual results of operations to differ materially from the results contemplated by the forward-looking statements contained in this report.

Global economics, political and other conditions may adversely affect trends in consumer spending, which may adversely impact our revenue and profitability

The global electronic payments industry depends heavily upon the overall level of consumer, business and government spending. The industry also relies in part on the number and size of consumer transactions. A sustained deterioration in the general economic conditions in Canada, the United States or globally may adversely affect our financial performance by reducing the number of as well as the average purchase amount of transactions involving payment cards. A reduction in the amount of consumer spending could result in a decrease of our revenue and profits.

If our goodwill, indefinite-life intangible assets or other long-term assets become impaired, we will be required to record additional impairment charges, which may be significant.

A significant portion of our long-term assets continues to consist of goodwill and other definite and indefinite-life intangible assets recorded as a result of our acquisition of Beanstream. We do not amortize goodwill and indefinite-life intangible assets, but rather review them for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that their carrying value may not be recoverable. We consider whether circumstances or conditions exist which suggest that the carrying value of our goodwill and other long-lived assets might be impaired. If such circumstances or conditions exist, further steps are required in order to determine whether the carrying value of each of the individual assets exceeds its fair market value. If analysis indicates that an individual asset's carrying value does exceed its fair market value, the next step is to record a loss equal to the excess of the individual asset's carrying value over its fair value. The steps required by Canadian and U.S. generally accepted accounting principles entail significant amounts of judgment and subjectivity. We complete our analysis of the carrying value of our goodwill and other intangible assets during the fourth quarter of each fiscal year, or more frequently whenever events or changes in circumstances indicate that their carrying value may not be recoverable. Events and changes in circumstances that may indicate that there is impairment and which may indicate that interim impairment testing is necessary include, but are not limited to, strategic decisions to exit a business or dispose of an asset made in response to changes in economic, political and competitive conditions, the impact of the economic environment on our customer base and on broad market conditions that drive valuation considerations by market participants, our internal expectations with regard to future revenue growth and the assumptions we make when performing our impairment reviews, a significant decrease in the market price of our assets, a significant adverse change in the extent or manner in which our assets are used, a significant adverse change in legal factors or the business climate that could affect our assets, an accumulation of costs significantly in excess of the amount originally expected for the acquisition of an asset, and significant changes in the cash flows associated with an asset. We analyze these assets at the individual asset, reporting unit and corporate levels. As a result of such circumstances, we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill, indefinite-life intangible assets or other long-term assets is determined. Any such impairment charges could have a material adverse effect on our business, financial condition and operating results.

We have a general history of losses and may not operate profitably in the future.

We have incurred losses for four of the last five fiscal years. As of March 31, 2010, our accumulated deficit was approximately $28,877,282. We believe that our planned growth and profitability will depend in large part on our ability to expand our client base. Accordingly, we intend to invest in marketing, development of our client base and development of our marketing technology and operating infrastructure. If we are not successful in expanding our client base, it will have a material adverse effect on our financial condition and our ability to continue to operate our business.

Excessive chargeback losses could significantly affect our results of operations and liquidity.

Our agreements with our sponsoring financial institutions and certain payment processors require us to assume and bear the risk of "chargeback" losses. Under the rules of Visa and MasterCard, when a merchant processor acquires card transactions, it has certain contingent liabilities for the transactions processed. This contingent liability arises in the event of a billing dispute between the merchant and a cardholder that is ultimately resolved in the cardholder's favor. In such a case, the disputed transaction is charged back to the merchant and the disputed amount is credited or otherwise refunded to the cardholder. If we are unable to collect this amount from the merchant's account, or if the merchant refuses or is unable to reimburse us for the chargeback due to merchant fraud, insolvency or other reasons, we will bear the loss for the amount of the refund paid to the cardholders. In addition, if we are unable to recover these chargeback amounts from merchants, having to pay the aggregate of any such amounts could have a material adverse effect on our results of operations and liquidity.

Because a small number of customers have historically accounted for a substantial portion of our revenue, our financial results would be materially adversely affected if we are unable to retain customers.

We have had in the past and may have in the future, a small number of customers that have accounted for a significant portion of our revenue. During the fiscal year ended March 31, 2010, revenue from and associated with our largest customer amounted to approximately 16% of total revenue. Our revenue could materially decline because of a delay in signing agreements with a single customer or the failure to retain an existing customer.

Merchant fraud with respect to Internet-based bankcard and EFT transactions could cause us to incur significant losses.

We significantly rely on the processing revenue derived from bankcard and EFT transactions. If any merchant or customer were to submit or process unauthorized or fraudulent bankcard or EFT transactions, depending on the dollar amount, we could incur significant losses which could have a material adverse effect on our business and results of operations and liquidity.

Despite systems designed to manage such risk, we cannot guarantee that our systems will prevent fraudulent transactions from being submitted and processed or that the funds set aside to address such activity will be adequate to cover all potential situations that might occur. We do not have insurance to protect us from these losses. There is no assurance that any chargeback or processing reserve will be adequate to offset against any unauthorized or fraudulent processing losses that we may incur. Accordingly, should we experience such fraudulent activity and such losses, our results of operations could be immediately and materially adversely affected.

Our reliance on financial institutions, providers of financial payment networks and payment technology vendors could adversely affect our ability to provide our services to our clients on a timely and cost-efficient basis.

We rely to a substantial extent on third parties to provide access to networks and technology including software, data, systems and services. In some circumstances, we rely on a single supplier or limited group of suppliers. For example, we require the services of financial institutions and third-party payment processors for access to payment networks. If any of these processors cease to allow us to access their processing platforms and/or networks, our ability to process credit card, debit card, EFT and ACH payments would be severely impacted and this would, in turn, have a materially adverse impact on our results of operations and liquidity.

If we are unable to protect our intellectual property rights or if others claim that we are infringing on their intellectual property, we could lose any competitive advantage we may have with respect to our intellectual property or we may be required to incur significant costs with respect to the infringement of the intellectual property rights of others.

We may be unable to successfully assert patent infringement claims against others and could incur significant costs with respect to asserting such claims.  The failure to successfully assert our patent infringement claims could have a material adverse effect upon our business and our financial results.

We are currently asserting and have in the past asserted patent infringement claims against others. The cost of prosecuting a patent infringement claim against others is complex, carries a high degree of uncertainly and is expensive. While we believe our patents to be valid, we face the risk that our patents could ultimately be determined to be invalid or otherwise not infringed by a court, jury or the United States Patent and Trademark Office ("USPTO"). In addition, one of our patents currently is, and others in the future could be, subject to a re-examination request made by a third party with the USPTO, a request that if granted would commence a proceeding that could ultimately result in such patent being determined to be invalid (see "Item 3 – Legal Proceedings"). Furthermore, all patents have an expiration date and our patent nos. 5,484,988, 6,164,528, 6,283,366, 6,354,491 and RE40,220, regarding electronic check processing, expire on January 16, 2013. Failure to prevail in a patent infringement claim against others, or having any of our patents being determined to be invalid prior to their expiration, would have a material adverse impact on our business and our financial results and our stock price.

We may also be unable to successfully defend patent infringement claims brought against us by others which could cause us to incur significant costs. We have successfully defended patent infringement claims in the past, are currently defending patent infringement claims, and may have to defend patent infringement claims in the future, brought against us by others regarding our technology, products or services. An unfavorable resolution of these infringement claims could result in our being restricted from delivering the related product or service or result in an unfavorable monetary settlement or damage awards that could have a material adverse effect upon our business and our financial results.

We could be subject to liability as a result of security breaches, service interruptions by cyber terrorists or fraudulent or illegal use of our services.

Because some of our activities involve the storage and transmission of confidential personal or proprietary information, such as credit card numbers and bank account numbers, and because we are a link in the chain of e-Commerce, we are vulnerable to internal and external security breaches, service interruptions and third-party and employee fraud schemes that could damage our reputation and expose us to a risk of loss or litigation and monetary damages. Our payment services may be susceptible to credit card and other payment fraud schemes, including unauthorized use of credit cards, debit cards or bank account information, identity theft or merchant fraud. We expect that technically sophisticated criminals will continue to attempt to circumvent our anti-fraud systems. If such fraud schemes are successful or otherwise cause merchants, customers or partners to lose confidence in our services in particular, or in Internet systems generally, our business would be materially adversely affected.

Our business may also be susceptible to potentially illegal or improper uses. These uses may include illegal online gambling, fraudulent sales of goods or services, illicit sales of prescription medications or controlled substances, software and other intellectual property piracy, money laundering, bank fraud, child pornography trafficking, prohibited sales of alcoholic beverages and tobacco products and online securities fraud. Despite measures we have taken to detect and lessen the risk of this kind of conduct, we cannot ensure that these measures will succeed.

We believe we are compliant with the Payment Card Industry's (PCI) Security Standard which incorporates Visa's Cardholder Information Security Program (CISP) and MasterCard's Site Data Protection (SDP) standard. However, there is no guarantee that we will maintain such compliance or that compliance will prevent illegal or improper use of our payment system.

Our security measures may not prevent security breaches, service interruptions and fraud schemes and the failure to do so may disrupt our business, damage our reputation and expose us to risk of loss or litigation and possible monetary damages that would materially adversely affect our business, results of operation and financial condition.

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Changes to credit card association, debit networks and ACH rules or practices could adversely impact our business.

We do not belong to nor can we directly access the bank card associations. As a result, we must rely on banks and their processing providers to process our credit, debit, EFT and ACH transactions. However, we must comply with the operating rules of the credit card associations and other payment networks such as debit networks and ACH networks. The associations' member banks and network owners set these rules and the associations and network owners interpret them. Some of those member banks and network owners compete with us in certain situations. Visa, MasterCard, American Express, Discover, Interac or the Automated Clearing House could adopt new operating rules or interpretations of existing rules which we might find difficult or even impossible to comply with, resulting in our inability to give customers the option of using credit cards, debit cards, EFT and ACH facilities to fund their payments. If we were unable to provide a gateway for these payment services, our business would be materially and adversely affected.

If our internal controls over financial reporting are not effective, current and potential stockholders could lose confidence in our financial reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to conduct a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting and our management is required to assess and issue a report concerning our internal control over financial reporting. Management had previously concluded that we maintained effective internal control over financial reporting as of the end of our fiscal third quarter ended December 31, 2009, as reported by us in our quarterly report on Form 10-Q for the quarterly period ended December 31, 2009 as filed with the Securities and Exchange Commission (the "SEC") on February 12, 2010 (the "Original Form 10-Q"). In completing the financial statements for our fiscal year ended March 31, 2010, our management identified a material weakness in internal control over financial reporting, namely, that we did not have adequately designed procedures to calculate our future tax asset value and corresponding future income tax expense as at the completion of our fiscal third quarter ended December 31, 2009. Upon discovering such material weakness, we filed an amended Form 10-Q/A with respect to such third fiscal quarter (which was filed with the SEC on June 17, 2010) in which we disclosed such material weakness and concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of the end of our fiscal quarter ended December 31, 2009. In addition, as described in "Part II—Item 9A(T). Controls and Procedures" of this report, our Chief Executive Officer ("CEO") and Chief Accounting Officer ("CAO") have also concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of the end of our fiscal year ended March 31, 2010.

Since the discovery of the material weakness, we have undertaken efforts to remediate the weakness in our internal control over financial reporting (see "Part II—Item 9A(T). Controls and Procedures"). While we believe that these actions will remediate the material weakness control deficiencies we have identified and strengthen our internal control over financial reporting, our CEO and CAO will not be able to determine whether these additional controls are operating effectively until they have assessed their effectiveness as part of their evaluation of our internal control over financial reporting for the first two interim periods following implementation. As we improve our internal control over financial reporting and implement the remediation measures described above, we may supplement or modify such remediation measures with additional remediation measures. However, we cannot provide assurance that either we or our independent auditors will not in the future identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date.

Any failure to maintain or implement required new or improved controls, any difficulties we encounter in implementation and any failure to maintain the adequacy of our internal controls on an ongoing basis could cause us to not be able to conclude on an ongoing basis that we have effective internal controls and could cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements, and substantial costs and resources may be required to rectify these or other internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of our common stock could decline significantly, and our business and financial condition could be harmed.

We and our clients must comply with complex and changing laws and regulations.

Government regulation influences our activities and the activities of our current and prospective clients, as well as our clients' expectations and needs in relation to our products and services. Businesses that handle consumers' funds, such as ours, are subject to numerous state, federal, provincial and international regulations, including those related to banking, credit cards, electronic transactions and communication, escrow, fair credit reporting, privacy of personal information and financial records, internet gambling and others. State, federal and provincial money transmitter regulations and federal and international anti-money laundering and money services business regulations can also apply under some circumstances. The application of many of these laws with regard to electronic commerce is unclear. In addition, it is possible that a number of laws and regulations may be applicable or may be adopted in the future with respect to conducting business over the Internet concerning matters such as taxes, pricing, content and distribution. If applied to us, any of the foregoing rules and regulations could require us to change the way we do business in a way that increases costs or makes our business more complex. In addition, violation of some statutes may result in severe penalties or restrictions on our ability to engage in e-Commerce, which could have a material adverse effect on our business.

Privacy legislation, including the Gramm-Leach-Bliley Act and regulations thereunder, the Personal Information Protection and Electronic Documents Act in Canada, as well as provincial and state laws may also affect the nature and extent of the products or services that we can provide to clients as well as our ability to collect, monitor and disseminate information subject to privacy protection.

Consumer protection laws in the areas of privacy of personal information and credit and financial transactions have been evolving rapidly at the state, federal, provincial and international levels. As the electronic transmission, processing and storage of financial information regarding consumers continues to grow and develop, it is likely that more stringent consumer protection laws may impose additional burdens on companies involved in such transactions including, without limitation, notification of unauthorized disclosure of personal information of individuals. Uncertainty and new laws and regulations, as well as the application of existing laws, could limit our ability to operate in our markets, expose us to compliance costs, fines, penalties and substantial liability, and result in costly and time-consuming litigation. We have in the past collected personal data about consumers for use in our check authorization products, which has given rise to litigation involving our corporation (see "Item 3 – Legal Proceedings").

Furthermore, the growth and development of the market for e-Commerce may prompt more stringent consumer protection laws that may impose additional regulatory burdens on companies that provide services to online businesses. The adoption of additional laws or regulations, or taxation requirements may affect the ability to offer, or cost effectiveness of offering, goods or services online, which could, in turn, decrease the demand for our products and services and increase our cost of doing business.

The Canadian Securities Administrators in Canada and the Securities and Exchange Commission and the National Association of Securities Dealers, Inc. in the United States, have also enacted regulations affecting our corporate governance, securities disclosure and compliance practices. We expect these regulations to increase our compliance costs and require additional time and attention. If we fail to comply with any of these regulations, we could be subject to legal actions by regulatory authorities or private parties.

Our business is highly dependent on the efficient and uninterrupted operation of our computer network systems and data centers, and any disruption or material breach of security of our systems could materially harm our business.

Our ability to provide reliable service largely depends on the efficient and uninterrupted operation of our computer network systems and data centers. Any significant interruptions or security or privacy breaches in our facilities, computer networks, firewalls and databases could harm our business and reputation, result in a loss of customers or cause inquiries and fines or penalties from regulatory or governmental authorities. Our systems and operations could be exposed to damage or interruption from fire, natural disaster, power loss, telecommunications failure, unauthorized entry or physical break-ins, computer viruses and hackers. The measures we have enacted, such as the implementation of security access and disaster recovery plans, may not be successful and we may experience problems other than system failures. We may also experience software defects, development delays and installation difficulties, which would harm our business and reputation and expose us to potential liability and increased operating expenses.

Our business may be harmed by errors in our software.

The software that we develop and use in providing our transaction payment processing is extremely complex and contains thousands of lines of computer code. Complex software systems such as ours are susceptible to errors. We believe our software design, development and testing processes are adequate to detect errors in our software prior to its release. Because of the complexity of our systems and the large volume of transactions we process on a daily basis, it is possible that we may not detect software errors until after they have affected a significant number of transactions. Software errors can have the effect of causing merchants, customers or partners who utilize our products and services to fail to comply with their intended business policies, or to fail to comply with legal, credit card, debit card and banking requirements, such as those under the Fair Credit Reporting Act, Gramm-Leach-Bliley Act, NACHA rules, MasterCard's Site Data Protection (SDP) Standard, Visa's Cardholder Information Security Program (CISP) and Payment Card Industry's (PCI) Data Security Standard.

Our future revenues may be uncertain because of reliance on third parties for marketing and distribution.

We distribute our service offerings primarily through third party sales distribution partners and our revenues are derived predominantly through these relationships.

We intend to continue to market and distribute our current and future products and services through existing and other relationships both in and outside of Canada. There are no minimum purchase obligations applicable to any existing distributor or other sales and marketing partners and we do not expect to have any guarantees of continuing orders. Failure by our existing and future distributors or other sales and marketing partners to generate significant revenues, our failure to establish additional distribution or sales and marketing alliances, changes in the industry that render third party distribution networks obsolete, termination of relationships with significant distributors or marketing partners would have a material adverse effect on our business, operating results and financial condition. In addition, we may be required to pay higher commission rates in order to maintain loyalty among our third-party distribution partners, which may have a material adverse impact on our profitability.

We may require additional capital, which may not be available on commercially reasonable terms, or at all. Capital raised through the sale or issuance of equity securities may result in dilution to our shareholders. Failure to obtain such additional capital could have a materially adverse impact on our business development.

Our future business activities, the development or acquisition of new or enhanced products and services, the acquisition of additional computer and network equipment, the costs of compliance with government regulations and future expansions including acquisitions will require us to make significant capital expenditures. If our available cash resources prove to be insufficient, because of unanticipated expenses, previous acquisitions, revenue shortfalls or otherwise, we may need to seek additional financing or curtail our expansion activities. If we obtain equity financing for any reason, our existing shareholders may experience dilution in their investments. If we obtain debt financing, our business could become subject to restrictions that affect our operations or increase the level of risk in our business. It is also possible that, if we need additional financing, we will not be able to obtain it on acceptable terms, or at all.

Our ability to expand through acquisitions involves risks and may not be successful.

As part of our growth strategy, we have made business acquisitions in recent years and we expect to be an active business acquirer in the future. We anticipate that we will seek to acquire complementary businesses, products and services in the future. The acquisition and integration of businesses involves a number of risks and challenges, including:

- Maintaining the acquired business' customer relationships;

- Demonstrating to the customers of the acquired business that the acquisition has not resulted in changes that would adversely impact the ability of the acquired business to address the needs of its customers;
- The operations, technology and personnel of an acquired business may be difficult to integrate;
- An acquired business may not achieve anticipated revenues, earnings or cash flow;
- The allocation of management resources to complete a business acquisition may divert management resources from our business and disrupt our day-to-day operations.

There can be no assurance that we will be able to fully integrate all aspects of an acquired business successfully or fully realize the potential benefits of any business combination and our failure to successfully integrate acquired businesses may have a material adverse effect on our financial results and stock price.

Currency exchange rate fluctuations could adversely affect our financial results, which may have an adverse impact on our business, results of operations and financial condition as well as the value of our foreign assets.

Fluctuations in foreign currency exchange rates may have an adverse impact on our business, results of operations and financial condition, as well as the value of our foreign assets, which, in turn, may adversely affect reported earnings or losses and the comparability of period-to-period results of operations, with the exception of our newly acquired subsidiary Beanstream. The U.S. dollar is the functional currency of our operations since substantially all of our operations are conducted in U.S. currency. As a result, when we are paying any obligation that is denominated in a foreign currency (including, for example, the Beanstream promissory notes which are denominated in Canadian dollars), we must generate the equivalent amount of cash in U.S dollars that, when exchanged at the then-prevailing applicable foreign currency exchange rate, will equal the amount of the obligation to be paid (which means that we may pay more U.S. dollars than initially anticipated if the foreign currency strengthens against the U.S. dollar between the time we incur the obligation and the time we are required to pay the obligation). Changes in the U.S./Canadian currency exchange rate could have a significant adverse impact on our current liquidity and capital resources and could also have a material adverse impact on our profitability and results of operations.

We have historically experienced fluctuations in our operating results and expect these fluctuations to continue in future periods, which may result in volatility in our stock price.

Our operating results may fluctuate in the future based upon a number of factors, many of which are not within our control. Our revenue model is based largely on recurring revenues, billed monthly, predominately derived from growth in customers and the numbers of transactions processed within a monthly billing period. The number of transactions processed is affected by many factors, several of which are beyond our control, including general consumer trends and holiday shopping in the fourth quarter of the calendar year.

Our operating results may also fluctuate in the future due to a variety of other factors, including the timing and extent of restructuring, and impairment and other charges that may occur in a given fiscal year, the final disposition of any patent litigation and new changes in accounting rules, such as the requirement to record stock-based compensation expense for employee stock option grants made at fair market value. As a result of these factors, we believe that our fiscal year results are not predictable with any significant degree of certainty, and year-to-year comparisons of our results of operations are not necessarily meaningful. You should not rely on our fiscal year results of operations to predict our future performance.

If our operating results fall below the expectations of investors or public market analysts, the price of our common stock could fall dramatically. Our common stock price could also fall dramatically if investors or public market analysts reduce their estimates of our future quarterly operating results, whether as a result of information we disclose, or based on industry, market or economic trends, or other factors.

We may be required to offset future deferred tax assets with a valuation allowance.

During the previous fiscal year, we conducted an analysis of our ability to realize our future income tax assets. As a result of this analysis, we reduced the valuation allowance from prior years relating to our future tax assets resulting in an income tax benefit of approximately $5,268,000 for 2009, whereas we did not record an income tax benefit for 2008. However, if we fail to achieve future taxable income assumed in the calculation of our future tax assets or if we fail to implement feasible and prudent tax planning strategies, we may be required to offset future tax assets with a valuation allowance, resulting in an additional tax expense. The change in the valuation could have a material adverse impact on our profitability and results of operations. If we do not achieve sufficient Canadian and U.S. taxable income in future years to utilize all or some of our net operating loss carryforwards, they will expire.

We face competition from a broad and increasing range of vendors that could reduce or eliminate demand for our products and services.

The market for products and services offered to participants in online transactions is highly competitive and is characterized by rapid technological change, evolving industry standards, merchant requirements, pricing competition, rapid rates of product obsolescence, and rapid rates of new product introduction. This market is fragmented and a number of companies offer one or more products or services competitive with ours. We face competition from several providers of online payment processing services, including CyberSource Corporation, Plug & Pay Technologies, Inc., Verisign/PayPal, Inc., Google, Inc. and LinkPoint International, Inc., a subsidiary of First Data Corporation as well as financial services companies, credit card and payment processing companies. We anticipate continued growth and the formation of new alliances in the market in which we compete, which will result in the entrance of new or the creation of bigger competitors in the future.

Because competitors can penetrate one or more of our markets, we anticipate additional competition from other established and new companies. In addition, competition may intensify as competitors establish cooperative relationships among themselves or alliances with others.

Many of our current and potential competitors have significantly greater financial, marketing, technical and other competitive resources than we do. As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in client requirements, or may be able to devote greater resources to the promotion and sale of their products and services. In addition, in order to meet client requirements, we must often work cooperatively with companies that are, in other circumstances, competitors. The need for us to work cooperatively with such companies may limit our ability to compete aggressively with those companies in other circumstances. If we lose customers, our business operations may be materially adversely affected, which could cause us to cease our business or curtail our business to a point where we are no longer able to generate sufficient revenue to fund operations.

The demand for many of our products and services could be negatively affected by reduced growth of e-Commerce, delays in the development of the Internet infrastructure, a general economic slowdown or any other event causing a material slowing of consumer spending.

A significant portion of our revenue is derived from transaction processing fees. Any changes in economic factors that adversely affect consumer spending and related consumer debt, or a reduction in check writing or credit and debit card usage, could reduce the volume of transactions that we process, and have a materially adverse effect on our business, financial condition and results of operations. We depend on the growing use and acceptance of the Internet by merchants and customers in Canada and the United States as a means to grow our business. We cannot be certain that acceptance and use of the Internet will continue to grow or that a sufficiently broad base of merchants and consumers will adopt, and continue to use, the Internet as a medium of commerce.

It is also possible that continued growth in the number of Internet users and the use of the Internet generally, may overwhelm the existing Internet infrastructure. Delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity could also have a detrimental effect on the Internet and correspondingly on our business. These factors would adversely affect usage of the Internet and lower demand for our products and services.

If we do not continue to enhance our existing products and services and develop or acquire new ones, we will not be able to compete effectively.

As part of our business strategy, we are seeking to further penetrate into the transaction payment processing market and to expand our business into new markets or markets that are complementary to our existing transaction payment processing segment operations. If we are not able to successfully expand our penetration into the existing transaction payment processing market or into new or complementary markets, our financial results and future prospects may be harmed. Our ability to increase market penetration and enter new or complementary markets depends on a number of factors, including growth in our existing and targeted markets, our ability to provide products and services to address the needs of those markets and competition in those markets.

The industries in which we do business or intend to do business have been changing rapidly as a result of increasing competition, technological advances, changing consumer payment habits, regulatory changes and evolving industry practices and standards, and we expect these changes will continue. Current and potential clients have also experienced significant changes as the result of competition and economic conditions. In addition, the business practices and technical requirements of our clients are subject to changes that may require modifications to our products and services. In order to remain competitive and successfully address the evolving needs of our clients, we must commit a significant portion of our resources to:

- identify and anticipate emerging technological and market trends affecting the markets in which we do business;
- enhance our current products and services in order to increase their functionality, features and cost-effectiveness to clients that are seeking to control costs and to meet regulatory requirements;
- develop or acquire new products and services that meet emerging client needs, such as products and services for the online market;
- modify our products and services in response to changing business practices and technical requirements of our clients, as well as to new regulatory requirements;
- integrate our current and future products with third-party products; and
- create and maintain interfaces to changing client and third party systems.

We must achieve these goals in a timely and cost-effective manner and successfully market our new and enhanced products and services to clients. There is no assurance that our current products and services will stay competitive with those of our competitors or that we will be able to introduce new products and services to compete successfully in the future. If we are unable to expand or appropriately enhance or modify our products and services quickly and efficiently, our business and operating results will be adversely affected.

We may not be able to attract, retain or integrate key personnel, including executive officers, which may prevent us from successfully operating our business.

We may not be able to retain our key personnel or attract other qualified personnel in the future. Our success will depend upon the continued service of key management personnel as well as the skills, experience and efforts of our executive officers. The loss of services of any of the key members of our management team or our failure to attract and retain other key personnel could disrupt operations and have a negative effect on employee productivity and morale and have a material adverse impact upon our financial results. The loss of any of our executive officers could impair our ability to successfully manage our current business or implement our planned business objectives and our future operations may be adversely affected.

Our business depends on the services of skilled software engineers who can develop, maintain and enhance our products, consultants who can undertake complex client projects and sales and marketing personnel. In general, only highly qualified, highly educated personnel have the training and skills necessary to perform these tasks successfully. In order to maintain the competitiveness of our products and services and to meet client requirements, we need to attract, motivate and retain a significant number of software engineers, consultants and sales and marketing personnel. Qualified personnel such as these are in short supply and we face significant competition for these employees, from not only our competitors but also clients and other enterprises. Other employers may offer software engineers, consultants and sales and marketing personnel significantly greater compensation and benefits or more attractive career paths than we are able to offer. Any failure on our part to hire, train and retain a sufficient number of qualified personnel would seriously damage our business.

Consolidation in the industries we serve may adversely affect our ability to sell our products and services.

Mergers, acquisitions and personnel changes at financial institutions, payment processors and payment technology providers including brick and mortar and e-Commerce retailers may adversely affect our business, financial condition and results of operations. The payments industry continues to consolidate and this consolidation could cause us to lose:

- current and potential customers; and
- market share if an entity resulting from a combination of our customers determines that it is more efficient to develop in-house products and services similar to ours or to use our competitors' products and services.

Estimates of future financial results are inherently unreliable.

From time to time, the Corporation and its representatives may make public predictions or forecasts regarding the Corporation's future results, including estimates regarding future revenues, expense levels, tax rates, acquisition expenses, capital expenditures, earnings or earnings from operations. Any forecast regarding our future performance reflects various assumptions and judgments by management regarding the likelihood that certain possible future events will in fact occur. These assumptions and judgments are subject to significant uncertainties and shifting market dynamics, and, as a matter of course, many of them will prove to be incorrect. Further, events that may seem unlikely or relatively certain at the time a given prediction is made may in fact occur or fail to occur. Many of the factors that can influence the outcome of any prediction or projection are beyond our control. As a result, there can be no assurance that our performance will be consistent with any management forecasts or that the variation from such forecasts will not be material and adverse. Investors are cautioned that any prediction, projection or other forward looking statement made by us should be considered current only as of the date made. Investors are encouraged to utilize the entire available mix of historical and forward-looking information made available by us, and other information relating to our Corporation and our products and services, when evaluating our prospective results of operations.

We may not be able to successfully manage operational changes.

Over the last several years, our operations have experienced rapid significant growth in some areas and significant restructurings and cutbacks in others. These changes have created significant demands on our executive, operational, development and financial personnel and other resources. If we achieve future growth in our business, or if we are forced to make additional restructurings, we may further strain our management, financial and other resources. Our future operating results will depend on the ability of our officers and key employees to manage changing business conditions and to continue to improve our operational and financial controls and reporting systems. We cannot ensure that we will be able to successfully manage the future changes in our business.

## ITEM 1B. Unresolved Staff Comments

None.

## ITEM 2. Properties

As of May 28, 2010, we leased office space containing approximately 14,000 square feet of floor space for our operations. Our principal facilities include:

| Location | Approximate Square Feet | Lease Expiration Date | Description |
|---|---|---|---|
| Wichita, Kansas | 5,785 | November, 2013 | CP/SL Segment Operations |
| Vancouver, British Columbia | 3,400 | September, 2013 | Administration |
| Victoria, British Columbia | 4,411 | September, 2012 | Data Center/TPP Segment Operations |
| Marshall, Texas | 400 | December, 2010 | IPL Segment Operations |

We consider our current facilities to be adequate for our current needs and believe that suitable additional space will be available, as needed, to accommodate further physical expansion of our operations.

ITEM 3. Legal Proceedings

On March 6, 2007, we received notification that we had been named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants, including a subsidiary of the Corporation, violated the Driver's Privacy Protection Act regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. On September 8, 2008, the complaint was dismissed with prejudice and on October 8, 2008 the plaintiffs appealed this decision. On November 4, 2009 oral arguments were heard by the Fifth Circuit of appeals. While we have not received a ruling, we believe it is likely the dismissal will be affirmed. We believe that these allegations are without merit and do not expect them to have a material adverse effect on our results of operations, financial position or liquidity.

On November 19, 2008, we filed a patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against multiple financial institutions operating in the United States (the "LML Suit"). In the suit, we allege that the defendants infringe U.S. Patent No. RE40,220 and we are seeking damages and injunctive and other relief for the alleged infringement of this patent.

On April 9, 2009, CitiBank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the Northern District of Illinois, Eastern Division against our subsidiary LML Payment Systems Corp., in an action styled Citibank, N.A. as plaintiff vs. LML Payment Systems Corp. In the suit, Citibank, N.A. alleges that our subsidiary infringes U.S. Patent No. 7,020,639 and is seeking damages and injunctive and other relief. We believe these allegations are without merit and intend to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminate and any amount likely to be payable is unknown at this time.

On April 23, 2009, JP Morgan Chase Bank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the District of Delaware against our subsidiaries LML Payment Systems Corp. and Beanstream Internet Commerce Inc., in an action styled JP Morgan Chase Bank N.A. as plaintiff vs. LML Payment Systems Corp. and Beanstream Internet Commerce Inc. In the suit, JP Morgan Chase Bank N.A. alleges that our subsidiaries infringe U.S. Patent Nos. 5,917,965 and 6,341,724 and is seeking damages and injunctive and other relief. On May 13, 2009, the plaintiff in this suit filed an amended complaint alleging our subsidiaries additionally infringe U.S. Patent Nos. 5,940,844 and 6,098,052. We believe these allegations are without merit and intend to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminate and any amount likely to be payable is unknown at this time.

On June 4, 2009, we filed another patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against six financial institutions operating in the United States. In the suit, we allege that the defendants infringe U.S. Patent No. RE40,220 and we are seeking damages and injunctive and other relief for the alleged infringement of this patent.

On December 29, 2009, LML Patent Corp., our indirectly wholly-owned subsidiary, entered into a Settlement and License Agreement (the "License Agreement") with RBS Citizens Bank N.A. (the "Released Defendant"), one of the defendants in the patent infringement lawsuit originally filed on November 19, 2008 by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40,220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent (the "Patent Litigation"). The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to LML Patent Corp.'s patents for electronic check conversion transactions including “ARC”, “WEB”, “POP”, “TEL” and “BOC”. In connection with the License Agreement, t Released Defendant paid LML Patent Corp. compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to the License Agreement, the lawsuit against the Released Defendant was dismissed with prejudice on January 5, 2010.

Subsequent to the fiscal year ended March 31, 2010, on June 2, 2010, LML Patent Corp., our indirect wholly-owned subsidiary, also entered into a Settlement and License Agreement (the “PNC License Agreement”) with PNC Financial Services Group Inc., PNC Bank N.A. and PNC Bank N.A. as successor in interest to National City Bank (collectively “PNC”), one of the defendants in the patent infringement lawsuit originally filed by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40,220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent (the “Patent Litigation”). The PNC License Agreement was effective June 2, 2010 and provided PNC with a fully paid-up license to LML Patent Corp.’s patents for electronic check conversion transactions including “ARC”, “WEB”, “POP”, “TEL” and “BOC”. In connection with the PNC License Agreement, PNC p LML Patent Corp. compensation in the amount of $1,375,000 for releases, licenses, covenants and all other rights granted under the PNC License Agreement. Pursuant to the PNC License Agreement, the lawsuit against PNC was dismissed with prejudice on June 7, 2010.

On May 13, 2010, four of the defendants in the Patent Litigation submitted a request for inter partes reexamination to the United States Patent and Trademark Office (“USPTO”) regarding U.S. Patent RE40,220. The USPTO is evaluating the inter partes re-examination request and will make a determination as to whether it will order a re-examination. An inter partes re-examination is a USPTO administrative proceeding requested by a third party (the “Third Party Requester”) to challenge the validity of patents that have already issued. In inter partes re-examination, a person challenges the patent by submitting a “request” to the USPTO. The request must supply prior art references and make proposed rejections of claims. The request is assigned to a patent Examiner in the Central Re-examination Unit of the Patent Office. The Examiner decides whether the request raises a “substantial new question of patentability”, and if so, begins an inter partes re-examination proceeding.

In the event the re-examination is granted, the Examiner will typically issue a non-final office action rejecting one or more of the claims. We may file a response, which can amend the claims to avoid prior art, and, under certain circumstances, add new claims. Within one month of the service date of our response, the Third Party Requester may file comments. The Examiner will then consider the filings and issue an “Action Closing Prosecution”. The Action Closing Prosecution is not final and it may be appealed by either party. We may respond to the Action Closing Prosecution and if we do so, the Third Party Requester may again file comments. A “Right of Appeal Notice” typically follows. The “Right of Appeal Notice” is a final but appealable office action. From there, either party may appeal the decision to the Patent Office Board of Appeals and Interferences (“Board”) and then to the Court of Appeals for the Federal Circuit (“Federal Circuit”). Whether the Examiner will decide to order a re-examination and, if so, the results of such proceeding (including any appeals that may be made) are indeterminable at this time. While we believe that our patents are valid and will vigorously defend the validity of our patents in any re-examination proceeding, we cannot give any assurances as to the ultimate outcome of the pending request for re-examination or of any future requests that may be made by other third parties, and any re-examination proceeding that results in any of our patents being found invalid could have a material adverse effect on us.

Other than as described herein, we are not currently involved in any material legal proceedings. However, we are party from time to time to additional ordinary litigation incidental to our business, none of which is expected to have a material adverse effect on the results of our operations, financial position or liquidity.

ITEM 4. [Removed and Reserved]

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# PART II

## ITEM 5. Market For Registrant's Common Equity, Related Stockholder Security Matters and Issuer Purchases of Equity Securities

Our common stock is traded on The NASDAQ Stock Market's Capital Market, which is the principal market for our common stock, and trades under the symbol "LMLP". Our common stock is neither listed nor traded on any foreign trading market. The following table sets forth the range of high and low prices for our common stock during the fiscal periods indicated. The prices set forth below represent quotations between dealers and do not include retail markups, markdowns or commissions and may not represent actual transactions.

| Fiscal Year Ended March 31: | | High | Low |
|---|---|---|---|
| 2010 | 1Q | $1.01 | $0.45 |
| | 2Q | 0.87 | 0.47 |
| | 3Q | 1.59 | 0.74 |
| | 4Q | 3.10 | 1.28 |
| 2009 | 1Q | $3.11 | $2.35 |
| | 2Q | 2.95 | 0.65 |
| | 3Q | 1.37 | 0.44 |
| | 4Q | .87 | 0.30 |

The prices set forth above are not necessarily indicative of liquidity of the trading market for our common stock. Trading in our common stock is limited and sporadic.

Our common stock price is volatile.

The market price of our common stock has been volatile in the past and may change rapidly in the future. The following factors, among others, may cause significant volatility in our stock price:

- Actual or anticipated fluctuations in our operating results;
- Financial or business announcements by us, our competitors or our customers;
- Announcements of the introduction of new or enhanced products and services by us or our competitors;
- Announcements of mergers, joint development efforts or corporate partnerships in the electronic commerce market;
- Market conditions in the banking, telecommunications, technology and emerging growth sectors;
- Rumors relating to our competitors or us; and
- General market or economic conditions.

In addition, the U.S. stock markets have, in recent years, experienced significant price and volume fluctuations, which have particularly affected the trading price of equity securities of many technology companies.

Holders of Common Stock

As of May 28, 2010, there were approximately 390 record holders of our common stock, with approximately 27,241,408 shares outstanding. The number of holders of record is based on the actual number of holders registered on the books of our transfer agent and does not reflect holders of shares in "street name" or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

Dividend Policy

We have not paid any dividends on our common stock in the past and have no current plan to pay dividends in the future. We intend to devote all funds to the operation of our businesses.

Canadian Federal Tax Considerations

General

There are no foreign or currency controls in Canada, and there are no exchange restrictions on borrowing from abroad, on the repatriation of capital, or the ability to remit dividends, profits, interests, royalties, or other payments to non-resident holders of our common stock. However, any such remittance to a resident of the U.S. is subject to a reduced withholding tax pursuant to various Articles of the Canada-U.S. Income Tax Convention, 1980 (the “Treaty”) between Canada and the U.S.

Dividends

Generally, dividends that are paid or credited by Canadian corporations to non-resident shareholders are subject to a nonresident tax of 25%.  However, the Treaty provides that dividends paid by a Canadian corporation to a corporation resident of the U.S. with no permanent establishment in Canada, which owns at least 10% of our voting stock paying the dividend, are subject to the Canadian non-resident withholding tax of 5%.  In all other cases, when a dividend is paid by a Canadian corporation to the beneficial owner resident in the U.S., the Canadian non-resident withholding tax is 15% of the amount of the dividend.

The reduced withholding tax rates do not apply if the beneficial owner of the shares carries on business through a permanent establishment in Canada and the stock holding in respect of which the dividends are paid is effectively connected with such permanent establishment.  In such a case, the dividends are taxable in Canada as general business profits at rates that may exceed the 5% or 15% rates applicable to dividends that are not effectively connected with a Canadian permanent establishment.

The Treaty permits Canada to apply its domestic law rules for differentiating dividends from interest and other disbursements.  Stock dividends are subject to the normal Canadian non-resident withholding tax rules on the amount of the dividend.  The amount of a stock dividend is equal to the increase in our paid-up capital by virtue of the dividend.

Interest

Effective January 1, 2008, changes have been made to the Canadian Income Tax Act that eliminate withholding taxes on interest paid (excluding Participating debt interest) to arm’s lengths residents of the U.S. by a Canadian corporation.

Historically, interest paid or credited to a non-resident is subject to a 25% Canadian withholding tax. If, at a time when interest has accrued but is not yet payable, the holder of the debt transfers it to a Canadian resident or, in certain circumstances, a non-resident who carries on business in Canada, part of the proceeds of the disposition may be considered to be interest for Canadian income tax purposes. Previously, under the Treaty, the rate of withholding tax on interest paid to a U.S. resident is 10%.

For Treaty purposes, interest includes interest as defined by domestic Canadian income tax rules in the jurisdiction in which interest arises. The withholding tax applies to the gross amount of the interest payment.

Non-residents are subject to Canadian income tax on dispositions of "taxable Canadian property." Taxable Canadian property includes shares of a publicly traded Canadian corporation if, at any time during the preceding five years, the non-resident and persons with whom the non-resident did not deal at arm's length owned at least 25% of the issued and outstanding shares of any class of stock.

The applicable tax rate on capital gains realized by a non-resident is 30% for corporations and 21.85% for individuals. Under the Treaty, capital gains realized by a U.S. resident on the disposition of shares of a Canadian corporation are exempt from Canadian income tax, unless (i) the value of the shares is derived principally from Canadian real property, or (ii) the shares are effectively connected with a permanent Canadian establishment of such non-resident, the capital gains are attributable to such permanent establishment, and the gains are realized not later than twelve months after the termination of such permanent establishment.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of March 31, 2010 about our common stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans, including the 1996 Stock Option Plan, the 1998 Stock Incentive Plan and the 2009 Stock Incentive Plan:

| PLAN CATEGORY | (A) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (B) Weighted-average exercise price of outstanding options, warrants and rights | (C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A)) |
|---|---|---|---|
| Equity compensation plans approved by security holders(1) | 3,640,000 | $3.11 | 7,117,000(2) |
| Equity compensation plans not approved by security holders(3) | 400,000 | $3.40 | N/A |

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(1) These plans consist of: (i) the 1996 Stock Option Plan, (ii) the 1998 Stock Incentive Plan and (iii) the 2009 Stock Incentive Plan

(2) Represents the 1,317,000 shares that remain available for grant under the 1996 Stock Option Plan and 5,800,000 shares that remain available for grant under the 2009 Stock incentive Plan. The 10-year term of the 1998 Stock Incentive Plan has expired and, accordingly, no additional options or other equity awards may be granted under that plan (however, outstanding awards under the 1998 Stock Incentive Plan are not affected by the expiration of the term and will continue to be governed by the provisions of the plan).

(3) These securities consist of warrants issued to Ladenburg Thalmann & Co., Inc. who acted as placement agent and financial advisor to LML in connection with the private placement transaction with Millennium Partners LLP completed on March 31, 2008. The warrants are exercisable for 400,000 shares of LML’s common stock for a period of five years from March 26, 2008 at a price of $3.40 per share.

Stock Performance Graph

The graph set forth below compares the cumulative total shareholder return on our common stock between March 31, 2005 and March 31, 2010 with the cumulative return of (i) the NASDAQ Stock Market Index (US) and (ii) the NASDAQ Computer and Data Processing Index (US and Foreign), over the same period. This graph assumes the investment of $100 on March 31, 2005 in our common stock, the NASDAQ Stock Market Index (US) and the NASDAQ Computer and Data Processing Index (US and Foreign), and assumes the reinvestment of dividends, if any.

The comparisons shown in the graph below are based upon historical data. We caution that the share price performance shown in the graph below is not indicative of, nor intended to forecast, the potential future performance of the LML Shares.

Notwithstanding anything to the contrary set forth in any of our previous or future filings under the Securities Act of 1933 or the Securities Exchange Act of 1934 that might incorporate this Annual Report on Form 10-K or future filings made by us under those statutes, the stock price performance graph is not considered "soliciting material," is not deemed "filed" with the SEC and is not deemed to be incorporated by reference into any of those prior filings or into any future filings made by us under those statues.

## ITEM 6. Selected Financial Data

The selected financial data set forth below should be read together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our financial statements and related notes. We have derived the statement of operations data for the fiscal years ended March 31, 2008, 2009 and 2010 and the balance sheet data as at March 31, 2009 and 2010 from the audited financial statements included elsewhere in this report. The statement of operations data for the fiscal years ended March 31, 2006 and 2007 and the balance sheet data as at March 31, 2006, 2007 and 2008 were derived from audited financial statements that are not included in this report. Historical results are not necessarily indicative of results to be expected for future periods.

Table of Selected Financial Data1
Year Ended March 31
(Presented under Canadian and U.S. GAAP)
(Amounts in thousands, except per share data)

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| Statement of operations data: | | | | | |
| Revenue | $14,826 | $12,379 | $11,328 | $6,554 | $5,458 |
| Net (loss) income 2 | (126) | 5,455 | (2,221) | (1,073) | (4,647) |
| Net (loss) income per share – basic | - | .20 | (.10) | (.05) | (.23) |
| Net (loss) income per share – diluted | - | .20 | (.10) | (.05) | (.23) |
| Weighted average number of common shares outstanding – basic | 27,116 | 26,834 | 21,869 | 20,206 | 20,164 |
| Weighted average number of common shares outstanding – diluted | 27,116 | 26,834 | 21,869 | 20,206 | 20,164 |
| Balance sheet data: | | | | | |
| Current assets | $14,619 | $18,996 | $16,826 | $11,148 | $4,753 |
| Total assets | 40,561 | 47,499 | 39,642 | 13,679 | 6,078 |
| Current liabilities | 9,019 | 16,234 | 13,185 | 2,860 | 1,725 |
| Long-term debt, less current portion | 10 | - | 2,613 | 727 | - |

1 The financial information set forth in this table for the fiscal years ended March 31, 2006, 2007, 2008, 2009 and 2010 includes our accounts on a consolidated basis.

2 Net (loss) income for the fiscal years ended March 31, 2010, 2009, 2008, 2007 and 2006 include stock-based compensation expenses of approximately $1,238,000, $1,341,000, $1,287,000, $877,000, and $904,000, respectively, resulting from fair value accounting for all stock options issued during the year.

## ITEM 7. Management's Discussion and Analysis of Financial Condition And Results of Operations

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in this Form 10-K. See Item 8. "Financial Statements." This information is not necessarily indicative of future operating results. The Consolidated Financial Statements and Notes thereto have been prepared in accordance with Canadian GAAP.

### Forward Looking Information

All statements other than statements of historical fact contained in this Annual Report on Form 10-K are forward-looking statements. Forward-looking statements generally are accompanied by words such as "anticipate," "believe," "estimate," "intend," "project," "potential" or "expect" or similar statements. The forward-looking statements prepared on the basis of certain assumptions which relate, among other things, to the demand for and cost of marketing our services, the volume and total value of transactions processed by merchants utilizing our services, the technological adaptation of electronic check conversion end-users, the renewal of material contracts in our business, our ability to anticipate and respond to technological changes, particularly with respect to financial payments and e-Commerce, in a highly competitive industry characterized by rapid technological change and rapid rates of product obsolescence, our ability to develop and market new product enhancements and new products and services that respond to technological change or evolving industry standards, no unanticipated developments relating to previously disclosed lawsuits against us, and the cost of protecting our intellectual property. Even if the assumptions on which the forward-looking statements are based prove accurate and appropriate, the actual results of our operations in the future may vary widely due to technological changes, increased competition, new government regulation or intervention in the industry, general economic conditions and other risks described elsewhere in this Annual Report on Form 10-K. See Part I, Item 1A – "Risk Factors". Accordingly, the actual results of our operations in the future may vary widely from the forward-looking statements included herein. All forward-looking statements included herein are expressly qualified in their entirety by the cautionary statements in this paragraph.

### Overview

LML Payment Systems Inc. is a financial payment processor operating three separate lines of business: transaction payment processing, intellectual property licensing and check processing/software licensing. Our transaction payment processing services consist predominantly of Internet-based services, while our check processing services involve predominantly traditional and electronic check processing and recovery services that do not utilize the Internet. With the completion of our 2007 acquisition of Beanstream (which had a strong Internet-based product and service offering), we expect that our transaction payment processing services will be our principal line of business for the foreseeable future, while our other lines of business (including the electronic check processing services that we have historically relied on for a significant source of revenue) will become less important to our overall service offerings and less significant to the financial performance of our company.

### TPP Segment

Our Transaction Payment Processing Operations ("TPP") involve financial payment processing, authentication and risk management services. We provide a service that acts as a bank neutral interface between businesses and consumers processing financial or authentication transactions. Our transaction payment processing services are accessible via the Internet and are offered in an application service provider (ASP) model. We focus on product development, project management and third tier technical support of our products and services and rely primarily on strategic business partners to sell and market our products and services. In some instances, our transaction payment processing services and payment products are integrated into third party products in target vertical markets. Our revenues are derived from one-time set-up fees, monthly gateway fees, and transaction fees paid to us by merchants. Transaction fees are recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to our merchant customers for the use of our payment gateway. Gateway fees are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating our processing services. Although these fees are generally paid at the commencement of the agreement, they are recognized ratably over the estimated average life of the merchant relationship, which is determined through a series of analyses of active and deactivated merchants. We currently service a merchant base of over 8,500 customers primarily in Canada.

IPL Segment

Our Intellectual Property Licensing Operations ("IPL") involve licensing our intellectual property estate, which includes five U.S. patents describing electronic check processing methods. When we provide clients licenses to our intellectual property estate, we typically earn revenue or other income from ongoing royalty fees and, in some cases, release fees for potential past infringement. In some instances we also earn revenue from license agreements that provide for the payment of contractually determined paid-up license fees to us in consideration for the grant of a non-exclusive, retroactive and future license to our intellectual property estate and in other instances, where license agreements include multiple element arrangements, we may defer portions of this revenue and recognize the revenue ratably over the license term. See “Item 1. – Business.”

CP/SL Segment

Our Check Processing/Software Licensing Operations ("CP/SL") involve primary and secondary check collection including electronic check re-presentment (RCK) and software licensing. Our check processing services involve return check management such as traditional and electronic recovery services to retail clients. When we provide return check management services, we typically receive revenue when we are successful at recovering the principal amount of the original transaction on behalf of the client. In some instances we also earn a percentage of the principal amount and in other instances our secondary recovery services provide for us to earn additional fees when legal action is required. Our check processing services are provided in the United States and are operated from our Wichita, Kansas location.

Within these segments, performance is measured based on revenue, factoring in interest income and expenses and amortization and depreciation as well as earnings from operations before income taxes from each segment. There are no transactions between segments. We do not generally allocate corporate or centralized marketing and general and administrative expenses to our business unit segments because these activities are managed separately from the business units.

General Market Conditions

We operate in a highly competitive business environment that has many risks. Critical risk factors that affect or may affect us and the financial payment processing industry include changes in the level of spending by and transactions being processed for our customers and the ongoing credit worthiness and financial solvency of our customers. We believe that a prolonged global recession could affect consumer confidence and spending patterns which we believe could have a negative impact on the business of our customers and ultimately have a material adverse effect on our results of operations and financial condition. A full discussion of each of these risk factors (in addition to several other risk factors) is disclosed in Item 1A.

Results of Operations

Fiscal year 2010 compared to Fiscal year 2009

Revenue

Total revenue for fiscal year 2010 was approximately $14,826,000, an increase of approximately 19.8% from total revenue of approximately $12,379,000 for fiscal year 2009. This increase is primarily attributable to the increase in our TPP segment revenue of approximately $1,790,000 from approximately $7,849,000 for fiscal year 2009 to approximately $9,639,000 for fiscal year 2010 and an increase in our IPL segment revenue of approximately $1,168,000 from approximately $1,704,000 for fiscal year 2009 to approximately $2,872,000 for fiscal year 2010.

TPP Segment

Revenue pertaining to our TPP segment consists of one-time set-up fees, monthly gateway fees, and transaction fees. Transaction fees for fiscal year 2010 were approximately $7,754,000 compared to transaction fees of approximately $6,380,000 for fiscal year 2009, an increase of approximately $1,374,000 or approximately 21.5%; the amortized portion of one-time set-up fees recognized was approximately $173,000 for fiscal year 2010 compared to one-time set-up fees of approximately $142,000 for fiscal year 2009, an increase of approximately $31,000 or approximately 21.8%; and monthly gateway fees for fiscal year 2010 were approximately $1,212,000 compared to monthly gateway fees for fiscal year 2009 of approximately $982,000, an increase of approximately $230,000 or approximately 23.4%. The increase in transaction fees, one-time set-up fees and monthly gateway fees was primarily attributable to an 11.1% increase in new customer contracts during fiscal year 2010 as compared to fiscal year 2009.

IPL Segment

Revenue from licensing our patented intellectual property increased by approximately $1,168,000 or approximately 68.5% from approximately $1,704,000 for fiscal year 2009 to approximately $2,872,000 for fiscal year 2010. The increase in revenue from licensing our patented intellectual property was primarily attributable to the revenue recognized of approximately $1,077,000 from the License Agreement entered into during the third quarter of our fiscal year 2010 and partially attributable to an increase of approximately $91,000 in licensing revenue relating to aggregate licenses providing running royalties and other paid up license fees.

CP/SL Segment

CP/SL segment revenue for fiscal year 2010 was approximately $2,315,000, a decrease of approximately 18.1% from CP/SL segment revenue of approximately $2,826,000 for fiscal year 2009. The decrease in CP/SL segment revenue was primarily attributable to a reduction in revenue from our primary and secondary check collections business.

Revenue from our primary check collections business decreased approximately 16.6% from approximately $494,000 for fiscal year 2009 to approximately $412,000 for fiscal year 2010. Revenue from our secondary check collections business decreased approximately 14.4% from approximately $2,103,000 for fiscal year 2009 to approximately $1,800,000 for fiscal year 2010. The decrease in primary and secondary check collections business is primarily attributable to a reduction of approximately 26.8% in returned checks for primary collections business and partially attributable to a reduction in collections of the principal amount and related fees of returned checks assigned for secondary recovery. We believe as consumers continue to use checks less as a method of payment in favor of other methods of payment, particularly electronic forms of payments including debit and credit cards, the value of returned checks available for our primary and secondary check collections business may continue to decrease. We anticipate developing plans to increase the volume of returned checks in addition to developing plans to decrease expenses associated with this segment.

Cost of revenue

Cost of revenue consists primarily of costs incurred by the TPP and CP/SL operating segments. These costs are incurred in the delivery of e-commerce transaction services, customer service support and check collection services and include processing and interchange fees paid, other third-party fees, personnel costs and associated benefits and stock-based compensation. IPL segment costs of revenue are primarily legal retention fees and legal disbursement costs incurred in generating licensing revenue.

Cost of revenue increased from approximately $6,058,000 for fiscal year 2009 to approximately $7,656,000 for fiscal year 2010, an increase of approximately $1,598,000 or approximately 26.4%. This increase was primarily attributable to an increase in TPP segment cost of revenue of approximately $1,347,000 or approximately 31.5%, from approximately $4,278,000 for fiscal year 2009 to approximately $5,625,000 for fiscal year 2010. The increase in TPP segment cost of revenue was primarily attributable to an increase of approximately 3% in our transaction costs which include interchange, assessments and other transaction fees and partially attributable to an increase in staffing within our customer service support team. CP/SL segment cost of revenue was approximately $1,435,000 for fiscal year 2010 as compared to approximately $1,628,000 for fiscal year 2009, a decrease in CP/SL segment cost of revenue of approximately $193,000 or approximately 11.9%. IPL segment costs of revenue was approximately $448,000 for fiscal year 2010 as compared to approximately $2,000 for fiscal year 2009, an increase in IPL segment cost of revenue of approximately $446,000. The increase in IPL segment cost of revenue was primarily attributable to the costs incurred in entering into the License Agreement during fiscal year 2010. In fiscal year 2010, cost of revenue was approximately $1,624,000 in the first quarter, approximately $1,715,000 in the second quarter, approximately $2,330,000 in the third quarter and approximately $1,987,000 in the fourth quarter.

General and administrative expenses

General and administrative expenses consist primarily of personnel costs including associated stock-based compensation and employment benefits, office facilities, travel, public relations and professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002. General and administrative expenses also include the costs of corporate and support functions including our executive leadership and administration groups, finance, information technology, legal, human resources and corporate communication costs.

General and administrative expenses decreased to approximately $4,338,000 from approximately $4,341,000 for fiscal years 2010 and 2009 respectively, a decrease of approximately $3,000. Included in general and administrative expenses for fiscal year 2010 are TPP segment expenses of approximately $912,000 as compared to approximately $643,000 for fiscal year 2009. The increase in TPP segment general and administrative expenses was primarily attributable to an increase in accounting and legal fees, bank charges and interest expense of approximately $142,000 collectively. CP/SL segment expenses decreased to approximately $552,000 from approximately $639,000 for fiscal year 2010 and 2009 respectively, a decrease of approximately $87,000 or approximately 13.6%. The decrease in CP/SL segment general and administrative expenses is primarily attributable to staff reductions and cost savings relating to the relocation of our Wichita, Kansas office during the third quarter of our prior fiscal year. Also included in general and administrative expenses are stock-based compensation expenses of approximately $1,038,000 for fiscal year 2010 compared to approximately $1,140,000 for fiscal year 2009, a decrease of approximately $102,000 or approximately 8.9%.

Sales and Marketing

Sales and marketing expenses consist primarily of costs related to sales and marketing activities. These expenses include salaries, sales commissions, travel and related expenses, trade shows, costs of lead generation, consulting fees and costs of marketing programs, such as internet, print and direct mail advertising costs.

Sales and marketing expense increased to approximately $417,000 from approximately $323,000 for fiscal year 2010 and 2009 respectively, an increase of approximately $94,000 or approximately 29.1%. The increase is primarily attributable to an increase in our TPP segment sales and marketing expenses of approximately $97,000 from approximately $294,000 for fiscal year 2009 to approximately $391,000 for fiscal year 2010. The increase in TPP segment sales and marketing expenses is primarily attributable to increases in staffing levels throughout fiscal 2010, resulting in an increase in wages and commissions of approximately $84,000.

Product Development and Enhancement

Product development and enhancement expenses consist primarily of compensation and related costs of employees engaged in the research, design and development of new services and in the improvement and enhancement of the existing product and service lines.

Product development and enhancement expenses were approximately $468,000 for fiscal year 2010 as compared to approximately $272,000 for fiscal year 2009, an increase of approximately $196,000 or approximately 72.1%. The increase is primarily attributable to an increase in our TPP segment product development and enhancement expenses of approximately $195,000 from approximately $224,000 for fiscal year 2009 to approximately $419,000 for fiscal year 2010. The increase in TPP product development and enhancement expenses is primarily attributable to an increase in staffing levels for the fiscal year 2010 as compared to the fiscal year 2009. The increase in staff was required to support the development of a customized online order-management system as well as supporting new and existing product and service lines.

Amortization and depreciation

Amortization of intangibles was approximately $663,000 for fiscal year 2010, as compared to approximately $661,000 for fiscal year 2009. Depreciation expense for capital assets increased to approximately $138,000 for fiscal year 2010 from approximately $124,000 for fiscal year 2009, an increase of approximately $14,000 or approximately 11.3%. The increase is primarily attributable to an increase in depreciable assets for fiscal year 2010 as compared to fiscal year 2009.

Gain/(Loss) on disposal/abandonment of property and equipment

Gain on disposal/abandonment of property and equipment for fiscal year 2010 was approximately $4,000 compared to approximately $1,000 for fiscal year 2009.

Foreign exchange gain (loss)

Foreign exchange gain decreased approximately $355,000 or approximately 80% from approximately $444,000 for fiscal year 2009 to approximately $89,000 for fiscal year 2010. The decrease in foreign exchange gain was primarily attributable to a weakening U.S. dollar in relation to the Canadian dollar. The U.S. dollar weakened by approximately 24.4% from the prior fiscal year end date, March 31, 2009 to the current fiscal year end date March 31, 2010. As our TPP segment's functional currency is the Canadian dollar, net assets originating in U.S. dollars have exposure with a weakening U.S. dollar and resulted in foreign exchange losses of approximately $257,000. In addition, the final payment of the Canadian dollar denominated two-year promissory notes resulted in a realized foreign exchange loss of approximately $178,000 as compared to an unrealized foreign exchange gain of approximately $371,000 for fiscal year 2009. These fiscal year 2010 exchange losses of approximately $257,000 and approximately $178,000 were offset with foreign exchange gains of approximately $532,000 resulting from the conversion to U.S. dollars of our future income tax assets originating in Canadian dollars.

Other (expenses) income, net

During the fiscal year 2010, we had net other expenses of approximately $57,000 compared to net other income of approximately $11,000 for the fiscal year 2009. Net other expenses for fiscal year 2010 consist primarily of a $46,000 cost relating to a financial institution fee paid in relation to the execution of tax planning strategies during our second quarter of our fiscal year 2010. Net other income for fiscal year 2009 consists primarily of approximately $43,000, net of legal fees, attributable to the recognized current period portion of deferred other income from a certain standstill agreement contained in one of the licenses we entered into in April, 2006 offset by approximately $35,000 in costs relating to the early termination of one of our operating leases.

Interest income

Interest income for fiscal year 2010 decreased to approximately $25,000 from approximately $226,000 for fiscal year 2009. The decrease in interest income was primarily attributable to a decrease in interest bearing cash investments and a decrease in interest rates earned on cash investments.

Interest expense

Interest expense decreased to approximately $48,000 in fiscal year 2010 compared to approximately $248,000 in fiscal year 2009, a decrease of approximately $200,000 or approximately 80.6%. The decrease in interest expense was primarily attributable to a decrease of approximately $186,000 from approximately $229,000 in interest accrued on the two-year promissory notes issued in the Beanstream acquisition for fiscal year 2009 to approximately $43,000 for fiscal year 2010. During the first quarter of our fiscal year 2010 we made the final installment payment of approximately $2,321,000 on the two –year promissory notes.

Income Taxes

Income tax expense (recovery) consists of a recovery of current income taxes of approximately $826,000 for the fiscal year 2010 compared to an income tax expense of approximately $847,000 for the fiscal year 2009, a decrease of current income tax expense of approximately $1,673,000. The decrease is primarily attributable to the expected recovery of taxes for the current fiscal period resulting from the implementation of certain tax planning strategies during the fiscal year 2010. These strategies are intended to permit the recovery of income taxes previously paid on behalf of our subsidiary, Beanstream. Future income tax expense was approximately $2,113,000 for the fiscal year 2010 compared to future income tax recovery of $5,268,000 for the fiscal year 2009, an increase in future income tax expense of approximately $7,381,000. The increase in future income tax expense was primarily attributable to an approximate $6,547,000 reversal in the valuation allowance related to our future income tax assets which was recorded in the fourth quarter of the fiscal year 2009.

As of March 31, 2010, we had U.S. net operating loss carry-forwards of approximately $7,677,000 and Canadian non-capital loss carry-forwards of approximately $3,301,000. Of the U.S. net operating loss amounts, approximately $3,190,000 represents tax deductions from stock-based compensation which will be recorded as an adjustment to additional paid-in capital when they reduce taxes payable. If we are not able to use these loss carry-forwards, the U.S. and Canadian loss carry-forwards will expire in 2011 through 2030.

Net (Loss) Income

Net loss was approximately $126,000 for fiscal year 2010 compared to net income of approximately $5,455,000 for fiscal year 2009, a decrease in net income of approximately $5,581,000. The decrease in net income is primarily attributable to a decrease in income tax recovery of approximately $5,707,000 from fiscal year 2009 to fiscal year 2010 resulting from an approximate $6,547,000 reversal in the valuation allowance related to our future income tax assets which was recorded in the fourth quarter of the 2009 fiscal year. Loss per both basic and diluted share was approximately $0.00 for fiscal year 2010 as compared to earnings per share of approximately $0.20 for fiscal year 2009, a decrease in earnings per both basic and diluted share of approximately $0.20.

Results of Operations

Fiscal year 2009 compared to Fiscal year 2008

Revenue

Total revenue for fiscal year 2009 was approximately $12,379,000, an increase of approximately 9.3% from total revenue of approximately $11,328,000 for fiscal year 2008. This increase is primarily attributable to the increase in our TPP segment revenue of approximately $2,212,000 from approximately $5,637,000 for fiscal year 2008 to approximately $7,849,000 for fiscal year 2009. This increase was primarily attributable to our inclusion of twelve months worth of TPP segment revenue for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment revenue for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007.

TPP Segment

Revenue pertaining to our TPP segment consists of one-time set-up fees, monthly gateway fees, and transaction fees. Transaction fees for fiscal year 2009 were approximately $6,380,000 compared to transaction fees of approximately $4,608,000 for fiscal year 2008, an increase of approximately $1,772,000; the amortized portion of one-time set-up fees recognized was approximately $142,000 for fiscal year 2009 compared to one-time set-up fees of approximately $98,000 for fiscal year 2008, an increase of approximately $44,000; and monthly gateway fees for fiscal year 2009 were approximately $982,000 compared to monthly gateway fees for fiscal year 2008 of approximately $699,000, an increase of approximately $283,000. These increases were primarily attributable to our inclusion of twelve months worth of TPP segment revenue for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment revenue for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007.

IPL Segment

Revenue from licensing our patented intellectual property increased by approximately $34,000 from approximately $1,670,000 for fiscal year 2008 to approximately $1,704,000 for fiscal year 2009. The licensing revenue of approximately $1,704,000 consists of: (i) approximately $1,224,000, net of legal fees, pertaining to one granted license; and (ii) approximately $480,000 related to aggregate licenses providing running royalties.

CP/SL Segment

CP/SL segment revenue for fiscal year 2009 was approximately $2,826,000, a decrease of approximately 29.7% from CP/SL segment revenue of approximately $4,021,000 for fiscal year 2008. During the fourth quarter of our fiscal year 2008, and as part of our repositioning effort in this segment, we ceased providing certain CP/SL segment services, including check verification, and, consequently, expected a corresponding decrease in CP/SL segment revenue.

Revenue from electronic check verification was $nil for fiscal year 2009, as compared to approximately $327,000 for fiscal year 2008. This decrease is primarily attributable to our no longer providing electronic check verification services during fiscal year 2009. During the fourth quarter of our fiscal year 2008, we ceased providing certain CP/SL segment services, including electronic check verification.

Revenue from our primary check collections business decreased approximately 20.6% from approximately $622,000 for fiscal year 2008 to approximately $494,000 for fiscal year 2009. Revenue from our secondary check collections business decreased approximately 9% from approximately $2,311,000 for fiscal year 2008 to approximately $2,103,000 for fiscal year 2009. The decrease in primary and secondary check collections business is primarily attributable to our cessation of providing certain CP/SL segment services, including check verification during the fourth quarter of our fiscal year 2008. Historically, certain customers may have received bundled payment processing services from us including electronic check verification and returned check management services. Consequently, the cessation of electronic check verification services to these specific customers could also cause a reduction in primary and secondary check collections business.

Revenue from royalties received from CheckFree Corporation pertaining to their marketing of the PEP+ reACH™ product was approximately $43,000 for fiscal year 2009, versus approximately $370,000 for fiscal year 2008.

Cost of revenue

Cost of revenue consists primarily of costs incurred by the TPP and CP/SL operating segments. These costs are incurred in the delivery of e-commerce transaction services, customer service support and check collection services and include processing and interchange fees paid, other third-party fees, personnel costs and associated benefits and stock-based compensation.

Cost of revenue increased from approximately $4,808,000 for fiscal year 2008 to approximately $6,058,000 for fiscal year 2009, an increase of approximately $1,250,000 or approximately 26%. This increase was primarily attributable to our inclusion of twelve months worth of TPP segment cost of revenue totaling approximately $4,278,000 for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment cost of revenue totaling approximately $3,002,000 for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007. CP/SL segment cost of revenue was approximately $1,628,000 for fiscal year 2009 as compared to approximately $1,764,000 for fiscal year 2008, a decrease in CP/SL segment cost of revenue of approximately $136,000 or approximately 7.7%. In fiscal year 2009, cost of revenue was approximately $1,515,000 in the first quarter, approximately $1,505,000 in the second quarter, approximately $1,560,000 in the third quarter and approximately $1,478,000 in the fourth quarter.

General and administrative expenses

General and administrative expenses consist primarily of personnel costs including associated stock-based compensation and employment benefits, office facilities, travel, public relations and professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002. General and administrative expenses also include the costs of corporate and support functions including our executive leadership and administration groups, finance, information technology, legal, human resources and corporate communication costs.

General and administrative expenses decreased to approximately $4,341,000 from approximately $5,660,000 for fiscal years 2009 and 2008, respectively, a decrease of approximately $1,319,000 or approximately 23.3%. Included in general and administrative expenses for fiscal year 2009 are TPP segment expenses of approximately $643,000 as compared to approximately $337,000 for fiscal year 2008. The increase in TPP segment general and administrative expenses was primarily attributable to our inclusion of twelve months worth of TPP segment expenses for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment expenses for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007. CP/SL segment expenses decreased to approximately $639,000 from approximately $2,146,000 for fiscal year 2009 and 2008 respectively, a decrease of approximately $1,507,000 or approximately 70.2%. This expected decrease in CP/SL segment general and administrative expenses is primarily attributable to our repositioning of this segment, and in particular the consolidation of our four data centers into two which was completed during the fourth quarter of our fiscal year 2008. Also included in general and administrative expenses are stock-based compensation expenses of approximately $1,140,000 for fiscal year 2009 compared to approximately $1,218,000 for fiscal year 2008, a decrease of approximately $78,000 or approximately 6.4%.

Sales and Marketing

Sales and marketing expenses consist primarily of costs related to sales and marketing activities. These expenses include salaries, sales commissions, sales operations and other personnel-related expenses, travel and related expenses, trade shows, costs of lead generation, consulting fees and costs of marketing programs, such as internet, print and direct mail advertising costs.

Sales and marketing expense increased to approximately $323,000 from approximately $228,000 for fiscal year 2009 and 2008, respectively, an increase of approximately $95,000 or approximately 41.7%. The increase is primarily attributable to an increase in our TPP segment sales and marketing expenses of approximately $149,000 primarily associated with increased personnel costs, and partially attributable to our inclusion of twelve months worth of TPP segment sales and marketing expenses for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment expenses for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007.

Product Development and Enhancement

Product development and enhancement expenses consist primarily of compensation and related costs of employees engaged in the research, design and development of new services and in the improvement and enhancement of the existing product and service lines.

Product development and enhancement expenses were approximately $272,000 for fiscal year 2009 as compared to approximately $178,000 for fiscal year 2008. The increase is primarily attributable to an increase in our TPP segment product development and enhancement expenses of approximately $94,000 primarily associated with our inclusion of twelve months worth of TPP segment product development and enhancement expenses for fiscal year 2009 as compared to the inclusion of nine months worth of TPP segment expenses for fiscal year 2008 resulting from our acquisition of Beanstream on June 30, 2007.

Amortization and depreciation

Amortization of intangibles was approximately $661,000 for fiscal year 2009, as compared to approximately $537,000 for fiscal year 2008. The increase in amortization of intangibles of approximately $124,000 was primarily attributable to twelve months worth of amortization of acquired intangible assets for fiscal year 2009 versus nine months worth for fiscal 2008 resulting from our acquisition of Beanstream on June 30, 2007. Depreciation expense for capital assets decreased to approximately $124,000 for fiscal year 2009 from approximately $368,000 for fiscal year 2008, a decrease of approximately $244,000 resulting primarily from the disposal and abandonment of the two IBM mainframes during the fourth quarter of our fiscal 2008.

Gain/(loss) on disposal/abandonment of property and equipment

Gain on disposal/abandonment of property and equipment for fiscal year 2009 was approximately $1,000 compared to a loss on disposal/abandonment of property and equipment for fiscal year 2008 of approximately $726,000. The loss on disposal/abandonment of property and equipment for fiscal 2008 consist primarily of costs relating to the consolidation of our four data centers into two and the consequential consolidation of two distinct processing platforms into a single processing platform. We disposed and abandoned the two IBM Mainframes that were running the processing platform that was consolidated during the fourth quarter of our fiscal year 2008.

Foreign exchange gain (loss)

Foreign exchange gain increased to approximately $444,000 for fiscal year 2009 from a foreign exchange loss of approximately $230,000 for fiscal year 2008. The increase in foreign exchange gain was primarily attributable to an unrealized foreign exchange gain of approximately $371,000 relating to the conversion of the Canadian dollar denominated two-year promissory notes into U.S. dollars at March 31, 2009 closing exchange rates. The U.S. dollar strengthened by approximately 23.5% from the prior fiscal year end date, March 31, 2008 to the current fiscal year end date March 31, 2009.

Other (expenses) income, net

During the fiscal year 2009, we had net other income of approximately $11,000 compared to net other expenses of approximately $247,000 for the fiscal year 2008. Net other income for fiscal year 2009 consist primarily of approximately $43,000, net of legal fees, attributable to the recognized current period portion of deferred other income from a certain standstill agreement contained in one of the licenses we entered into in April, 2006 offset by approximately $35,000 in costs relating to the early termination of one of our operating leases. Net other expenses for fiscal year 2008 consist primarily of approximately $247,000 in costs relating to the consolidation of our four data centers into two which was completed during our fourth quarter of fiscal 2008.

Interest income

Interest income for fiscal year 2009 decreased to approximately $226,000 from approximately $406,000 for fiscal year 2008. The decrease in interest income was primarily attributable to a decrease in interest bearing cash investments.

Interest expense

Interest expense decreased to approximately $248,000 in fiscal year 2009 compared to approximately $359,000 in fiscal year 2008. The decrease in interest expense was primarily attributable to a decrease of approximately $68,000 from approximately $297,000 in interest accrued on the two-year promissory notes issued in the Beanstream acquisition for fiscal year 2008 to approximately $229,000 for fiscal year 2009.

Income Taxes

Income taxes decreased to a recovery position of approximately $4,421,000 from an expense position of approximately $614,000 for fiscal year 2009 and 2008, respectively. The recovery of income taxes was attributable to an approximate $6,547,000 reversal in the valuation allowance related to our future income tax assets which was recorded in the fourth quarter of the 2009 fiscal year, offset by amounts accrued for our estimated 2009 income tax liabilities.

In evaluating our ability to realize our future income tax assets we consider all available positive and negative evidence including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions to forecast future taxable income, the reversal of temporary differences, and the implementation of any feasible and prudent tax planning strategies. These assumptions require significant judgment regarding the forecasts of future taxable income, and are consistent with the forecasts used to manage our business. Valuation allowances are established when necessary to reduce future income tax assets to the amounts expected to be realized on a more likely than not basis. During 2009, we recorded an income tax benefit of approximately $5,268,000. This benefit included approximately a $6,547,000 reduction of our remaining valuation allowance related to our future income tax assets as we have determined that these assets will more likely than not be realized. If we fail to achieve future taxable income assumed in the calculation of our future tax assets or if we fail to implement feasible and prudent tax planning strategies, we may be required to offset future tax assets with a valuation allowance, resulting in an additional tax expense.

As of March 31, 2009, we had U.S. net operating loss carry-forwards of approximately $9,515,000 and Canadian non-capital loss carry-forwards of approximately $8,792,000. Of the U.S. net operating loss amounts, approximately $3,372,000 represents tax deductions from stock-based compensation which will be recorded as an adjustment to additional paid-in capital when they reduce taxes payable. If we are not able to use these loss carry-forwards, the U.S. and Canadian loss carry-forwards will expire in 2010 through 2029.

Net Income (Loss)

Net income was approximately $5,455,000 for fiscal year 2009 compared to a net loss of approximately $2,221,000 for fiscal year 2008, an increase in net income of approximately $7,676,000. The increase in net income is primarily attributable to an approximately $6,547,000 reversal in the valuation allowance related to our future income tax assets which was recorded in the fourth quarter of the 2009 fiscal year. Net earnings per both basic and diluted share was approximately $0.20 for fiscal year 2009, as compared to a net loss per basic and diluted share of approximately ($0.10) for fiscal year 2008, an increase in net earnings per basic and diluted share of approximately $0.30.

Liquidity and Capital Resources

Our liquidity and financial position consisted of approximately $5,600,000 in working capital as of March 31, 2010 compared to approximately $2,762,000 in working capital as of March 31, 2009. The increase in working capital was primarily attributable to an increase in corporate taxes receivable of approximately $1,073,000 and an increase in the current portion of future income taxes of approximately $442,000 resulting from the implementation of tax planning strategies during the fiscal year 2010. These strategies are intended to permit the recovery of income taxes previously paid on behalf of our subsidiary, Beanstream. Cash provided by operating activities increased approximately $1,438,000 from cash used in operating activities of approximately $303,000 for fiscal year 2009 to cash provided by operating activities of approximately $1,135,000 for fiscal year 2010. The increase in cash provided by operating activities was primarily attributable to increases in accounts payable and accrued liabilities balances as at March 31, 2010. Cash used in investing activities was approximately $76,000 for fiscal year 2010 as compared to approximately $119,000 for fiscal 2009, a decrease in cash used in investing activities of approximately $43,000. The decrease in cash used in investing activities was primarily attributable to a decrease in acquisition of property and equipment of approximately $46,000 for fiscal year 2010 as compared to fiscal year 2009. Cash used in financing activities was approximately $2,405,000 for fiscal year 2010 as compared to approximately $3,038,000 for fiscal year 2009, a decrease in cash used in financing activities of approximately $633,000. The decrease in cash used in financing activities was primarily due to the difference in the payments on the promissory notes relating to the acquisition of Beanstream. During fiscal year 2010 we made the second and final payment of approximately $2,321,000 on the promissory notes as compared to the first payment of approximately $2,844,000 on the promissory notes made during fiscal year 2009, a difference in payments of approximately $523,000.

Management tracks projected cash collections and projected cash outflows to monitor short-term liquidity requirements and to make decisions about future resource allocations and take actions to adjust our expenses with the goal of remaining cash flow positive from operations on an annual basis. We believe that, as of March 31, 2010, the Corporation's cash resources will be sufficient to meet our operating requirements for the next twelve months.

In light of our strategic objective of acquiring electronic payment volume across all our financial payment processing services and strengthening our position as a financial payment processor (as demonstrated by our acquisition of Beanstream), our long-term plans may include the potential to strategically acquire complementary businesses, products or technologies and may also include instituting actions against other entities who we believe are infringing our intellectual property. While we believe that existing cash and cash equivalent balances and potential cash flows from operations should satisfy our long-term cash requirements, we may nonetheless have to raise additional funds for these purposes, either through equity or debt financing, as appropriate. There can be no assurance that such financing would be available on acceptable terms, if at all.

Contingencies

On March 6, 2007, we received notification that we had been named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants, including a subsidiary of the Corporation, violated the Driver's Privacy Protection Act regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. On September 8, 2008, the complaint was dismissed with prejudice and on October 8, 2008 the plaintiffs appealed this decision. On November 4, 2009 oral arguments were heard by the Fifth Circuit of appeals. While we have not received a ruling, we believe it is likely the dismissal will be affirmed. We believe that these allegations are without merit and do not expect them to have a material adverse effect on our results of operations, financial position or liquidity.

On November 19, 2008, we filed a patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against multiple financial institutions operating in the United States (the "LML Suit"). In the suit, we allege that the defendants infringe U.S. Patent No. RE40,220 and we are seeking damages and injunctive and other relief for the alleged infringement of this patent.

On April 9, 2009, CitiBank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the Northern District of Illinois, Eastern Division against our subsidiary LML Payment Systems Corp., in an action styled Citibank, N.A. as plaintiff vs. LML Payment Systems Corp. In the suit, Citibank, N.A. alleges that our subsidiary infringes U.S. Patent No. 7,020,639 and is seeking damages and injunctive and other relief. We believe these allegations are without merit and intend to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminate and any amount likely to be payable is unknown at this time.

On April 23, 2009, JP Morgan Chase Bank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the District of Delaware against our subsidiaries LML Payment Systems Corp. and Beanstream Internet Commerce Inc., in an action styled JP Morgan Chase Bank N.A. as plaintiff vs. LML Payment Systems Corp. and Beanstream Internet Commerce Inc. In the suit, JP Morgan Chase Bank N.A. alleges that our subsidiaries infringe U.S. Patent Nos. 5,917,965 and 6,341,724 and is seeking damages and injunctive and other relief. On May 13, 2009, the plaintiff in this suit filed an amended complaint alleging our subsidiaries additionally infringe U.S. Patent Nos. 5,940,844 and 6,098,052. We believe these allegations are without merit and intend to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminate and any amount likely to be payable is unknown at this time.

On June 4, 2009, we filed another patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against six financial institutions operating in the United States. In the suit, we allege that the defendants infringe U.S. Patent No. RE40,220 and we are seeking damages and injunctive and other relief for the alleged infringement of this patent.

On December 29, 2009, LML Patent Corp., our indirectly wholly-owned subsidiary, entered into a Settlement and License Agreement (the “License Agreement”) with one of the defendants (the “Released Defendant”) in the patent infringement lawsuit originally filed on November 19, 2008 by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent. The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to LML Patent Corp’s patents for electronic check conversion transactions including “ARC”, “WEB”, “POP”, “TEL” and “BOC”. In connection with the License Agreement, the Released Defendant paid LML Patent Corp. compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to the License Agreement, the lawsuit against the Released Defendant was dismissed with prejudice on January 5, 2010.

Subsequent to the fiscal year ended March 31, 2010, on June 2, 2010, LML Patent Corp., our indirect wholly-owned subsidiary, also entered into a Settlement and License Agreement (the “PNC License Agreement”) with PNC Financial Services Group Inc., PNC Bank N.A. and PNC Bank N.A. as successor in interest to National City Bank (collectively “PNC”), one of the defendants in the patent infringement lawsuit originally filed by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40,220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent (the “Patent Litigation”). The PNC License Agreement was effective June 2, 2010 and provided PNC with a fully paid-up license to LML Patent Corp.’s patents for electronic check conversion transactions including “ARC”, “WEB”, “POP”, “TEL” and “BOC”. In connection with the PNC License Agreement, PNC p LML Patent Corp. compensation in the amount of $1,375,000 for releases, licenses, covenants and all other rights granted under the PNC License Agreement. Pursuant to the PNC License Agreement, the lawsuit against PNC was dismissed with prejudice on June 7, 2010.

On May 13, 2010, four of the defendants in the Patent Litigation submitted a request for inter partes reexamination to the United States Patent and Trademark Office (“USPTO”) regarding U.S. Patent RE40,220. The USPTO is evaluating the inter partes reexamination request and will make a determination as to whether it will order a re-examination. An inter partes re-examination is a USPTO administrative proceeding requested by a third party (the “Third Party Requester”) to challenge the validity of patents that have already issued. In inter partes re-examination, a person challenges the patent by submitting a “request” to the USPTO. The request must supply prior art references and make proposed rejections of claims. The request is assigned to a patent Examiner in the Central Re-examination Unit of the Patent Office. The Examiner decides whether the request raises a “substantial new question of patentability”, and if so, begins an inter partes re-examination proceeding.

In the event the re-examination is granted, the Examiner will typically issue a non-final office action rejecting one or more of the claims. We may file a response, which can amend the claims to avoid prior art, and, under certain circumstances, add new claims. Within one month of the service date of our response, the Third Party Requester may file comments. The Examiner will then consider the filings and issue an “Action Closing Prosecution”. The Action Closing Prosecution is not final and may be appealed by either party. We may respond to the Action Closing Prosecution and if we do so, the Third Party Requester may again file comments. A “Right of Appeal Notice” typically follows. The “Right of Appeal Notice” is a final but appealable office action. From there, either party may appeal the decision to the Patent Office Board of Appeals and Interferences (“Board”) and then to the Court of Appeals for the Federal Circuit (“Federal Circuit”). Whether the Examiner will decide to order a re-examination and, if so, the results of such proceeding (including any appeals that may be made) are indeterminable at this time. While we believe that our patents are valid and will vigorously defend the validity of our patents in any re-examination proceeding, we cannot give any assurances as to the ultimate outcome of the pending request for re-examination or of any future requests that may be made by other third parties, and any re-examination proceeding that results in any of our patents being found invalid could have a material adverse effect on us.

Contractual Obligations

In our fiscal year ended March 31, 2010, we entered into a lease agreement with Ikon Financial Services to finance an equipment purchase of $11,269. Lease payments are due monthly under the lease term of sixty (60) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Also in our fiscal year ended March 31, 2010, we entered into a lease agreement with Dell Financial Services Canada to finance an equipment purchase of $17,470. Lease payments are due monthly under the lease term of twelve (12) months. Title to the equipment will transfer to the Corporation at the expiration of the lease.

In our fiscal year ended March 31, 2007, we entered into a lease agreement with IBM Credit LLC to finance two IBM Mainframe hardware purchases totaling $1,139,106. Lease payments were due on the last day of each month under the lease term of thirty-six (36) months. Title to the equipment transferred to us at the expiration of the lease. Accordingly these amounts were recorded as a capital lease. During the fourth quarter of our fiscal year ended March 31, 2008, we consolidated our four data centers, which were running two distinct processing platforms, into two data centers with a single processing platform. Consequently, we disposed and abandoned the two IBM Mainframes for a net loss of approximately $726,000 and incurred other costs relating to the consolidation of the data centers of approximately $247,000. We sold two components of the IBM Mainframe and remained obligated on the balance of approximately $174,000 as at March 31, 2009, which was satisfied with monthly payments over the remaining ten (10) months of the lease agreement. As at March 31, 2010, we have no further obligation on the lease agreement with IBM Credit LLC.

The following table summarizes our significant contractual obligations and commitments as of March 31, 2010:

| | Payments due by: (in thousands) | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1 to 3 years | 4 to 5 years | More than 5 years |
| Long-Term Debt Obligations | $- | $- | $- | $- | $- |
| Capital Lease Obligations | 21 | 11 | 5 | 5 | - |
| Operating Lease Obligations | 826 | 226 | 486 | 114 | - |
| Purchase Obligations | 199 | 170 | 29 | - | - |
| Total | $1,046 | $407 | $520 | $119 | $- |

Critical Accounting Policies and Estimates

Our financial statements have been prepared in accordance with accounting principles generally accepted in Canada and form the basis for the following discussion and analysis of critical accounting policies and estimates. We make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities during the course of preparing these financial statements. On a regular basis, we evaluate our estimates and assumptions including those related to the recognition of revenues, valuation of other long-lived assets and stock-based compensation.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable. These estimates form the basis of our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from those estimates.

The following critical accounting policies reflect the more significant estimates and assumptions we have used in the preparation of our financial statements.

Revenue Recognition

TPP Segment

Our revenues are derived from one-time set-up fees, monthly gateway fees, and transaction fees paid to us by merchants. Transaction fees are recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to our merchant customers for the use of our payment gateway. Gateway fees are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating our processing services. Although these fees are generally paid at the commencement of the agreement, they are recognized ratably over the estimated average life of the merchant relationship, which is determined through a series of analyses of active and deactivated merchants.

IPL Segment

Within the Intellectual Property Licensing ("IPL") segment, revenue arrangements typically include the following elements:

- Licenses – licenses are issued for the use of existing patents;
- Release from litigation –we release the licensees from any claims or causes of action for patent infringement as of the effective date of the underlying agreement; and
- Covenant-not-to-sue provision –we agree to a covenant-not-to-sue provision for infringement of any patents for a specified period commencing on the effective date of the underlying agreement.

When we enter into intellectual property licensing and settlement agreements comprising multiple elements, the significant factors, inputs, assumptions and methods used to determine the estimated selling price of each element present in the arrangement include:

- Royalty rates from existing licenses;
- Actual usage, including transaction volumes by the existing licensees; and
- Expected usage by the customer.

Total arrangement consideration is then allocated to each of the deliverables using the relative selling price method.

Running royalties earned from electronic check transactions processed by the licensee are recognized on a monthly basis based on the volume of transactions processed.

CP/SL Segment

Check recovery fees are recognized in the period when cash is received for the services performed. These services typically consist of recovering the face amount of the original transaction and a service or collection fee. We are typically paid the service fee only when we are successful in the recovery of the face amount of the original transaction on behalf of our client.

Goodwill, Purchased Intangible Assets and Other Long-Lived Assets — Impairment Assessments

We make judgments about the recoverability of purchased intangible assets and other long-lived assets whenever events or changes in circumstances indicate that an other-than-temporary impairment in the remaining value of the assets recorded on our balance sheet may exist. We test the impairment of goodwill and indefinite-life intangibles annually in our fourth fiscal quarter or more frequently if indicators of impairment arise. The timing of the formal annual test may result in charges to our statement of operations in our fourth fiscal quarter that could not have been reasonably foreseen in prior periods. In order to estimate the fair value of long-lived assets, we typically make various assumptions about the future prospects for the business that the asset relates to, consider market factors specific to that business and estimate future cash flows to be generated by that business. Based on these assumptions and estimates, we determine whether we need to record an impairment charge to reduce the value of the asset stated on our balance sheet to reflect its estimated fair value. Assumptions and estimates about future values and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, different assumptions and estimates could materially impact our reported financial results. More conservative estimates of the anticipated future benefits from these businesses could result in impairment charges, which would decrease net income and result in lower asset values on our balance sheet. Conversely, less conservative estimates could result in smaller or no impairment charges, higher net income and higher asset values. As of March 31, 2010, we had recorded goodwill in connection with our acquisition of Beanstream with a carrying value of approximately $17,874,000. Significant judgments could be required to evaluate goodwill for impairment in the future including the determination of reporting units, estimating future cash flows, determining appropriate discount rates and other assumptions. We evaluate the goodwill related to the Beanstream acquisition on an annual basis as of March 31 or when indicators of impairment may exist.

We also evaluate the other intangible assets related to the Beanstream acquisition on an annual basis as of March 31 or when indicators of impairment may exist. As of March 31, 2010, we had recorded other intangible assets in connection with our acquisition of Beanstream, with a carrying value of approximately $4,710,000, consisting of partner relationships, merchant contracts, existing technology and trade names. The value of the partner relationships as well as the merchant contracts were derived by considering, among other factors, the expected income and discounted cash flows to be generated from such contracts and relationships. The value of the existing technology was derived by considering, among other factors, the expected income and discounted cash flows to be generated, taking into account risks related to the characteristics and applications of the technology and assessments of the life cycle state of the technology. The value of the trade name was derived by considering, among other factors, expected income and discounted cash flows to be generated, also taking into account the expected period in which we intend to utilize the trade name.

Stock-Based Compensation

We issue stock options to our employees and directors under the terms of our 1996 Stock Option Plan and our 2009 Stock Incentive Plan. We also have a 1998 Stock Incentive Plan, however, the 10-year term of our 1998 Stock Incentive Plan has expired and, accordingly, the shares that had remained available for grant pursuant to additional options or other equity awards may no longer be granted under that plan (although, outstanding awards under the 1998 Stock Incentive Plan are not affected by the expiration of the term and will continue to be governed by the provisions of the plan).

We determine the assumptions used in computing the fair value of the stock options by estimating the expected useful lives, giving consideration to the vesting periods, contractual lives, actual employee forfeitures and the relationship between the exercise price and the historical market value of our common stock, among other factors. The risk-free interest rate is the federal government zero-coupon bond rate for the relevant expected life. The fair value of the stock options are estimated on the date of grant using the Black-Scholes option-pricing model.

Future Income Taxes and Valuation Allowance

Future income taxes reflect the net tax effects of temporary differences between the carrying amount of our assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We assess the likelihood that our future tax assets will be recovered from our future taxable income, and to the extent we believe that recovery is not likely, we establish a valuation allowance. We consider all available positive and negative evidence including our past operating results, the existence of cumulative losses and our forecast of future taxable income. In determining future taxable income, we are responsible for assumptions utilized including the amount of pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we use to manage the underlying businesses. Based on various factors, including our taxable income for the past year and estimates of future profitability, we recorded a partial valuation allowance against our net future tax assets. If we fail to achieve future taxable income assumed in the calculation of our future tax assets or if we fail to implement feasible and prudent tax planning strategies, we may be required to offset future tax assets with a valuation allowance, resulting in an additional tax expense. The change in the valuation could have a material adverse impact on our profitability and results of operations. If we do not achieve sufficient Canadian and U.S. taxable income in future years to utilize all or some of our net operating loss carry-forwards, they will expire. See Note 13 to our Consolidated Financial Statements included elsewhere in this report.

Foreign Currency Translation

Our functional (except as described below) and reporting currency is the United States dollar. Monetary assets and liabilities denominated in foreign currencies are translated in accordance with CICA Handbook Section 1651 "Foreign Currency Translation" (which is consistent with the FASB issued authoritative guidance regarding foreign currency translation) using the exchange rate prevailing at the balance sheet date. Gains and losses arising on settlement of foreign currency denominated transactions or balances are included in the determination of income.

The functional currency of our Beanstream subsidiary is the Canadian dollar. Beanstream's financial statements are translated to United States dollars under the current rate method in accordance with CICA 1651, (which is consistent with the FASB issued authoritative guidance regarding foreign currency translation). Beanstream's assets and liabilities are translated into U.S. dollars at rates of exchange in effect at the balance sheet date. Average rates for the year are used to translate Beanstream's revenues and expenses. The cumulative translation adjustment is reported as a component of accumulated other comprehensive income.

Future Change in Accounting Policies

International Financial Reporting Standards

The Canadian Institute of Chartered Accountants has announced that public companies will be required to transition from Canadian Generally Accepted Accounting Principles (GAAP) to International Financial Accounting Standards (IFRS). For us, this will take place with our fiscal period commencing April 1, 2011. This transition will require the restatement for comparative purposes of amounts reported by us for all interim and annual periods beginning on or after April 1, 2010.

We continue our process of transition from current Canadian GAAP to IFRS. We have a project team assigned to plan for and achieve a smooth transition to IFRS. Progress reporting to the Audit Committee of the Board of Directors on the status of the IFRS implementation continues to take place.

The transition plan consists of the following three phases: (i) initial scoping and diagnostic phase; (ii) detailed analysis and design phase; and (iii) the implementation phase.

Initial scoping and diagnostic phase:

We have completed the initial scoping and diagnostic phase which included the review and identification of major differences between current Canadian GAAP and IFRS as well as an initial evaluation of IFRS 1 transition exemptions.

Detailed analysis and design phase:

We are currently working on the second phase of our conversion plan which entails a detailed analysis of all relevant accounting differences between IFRS and GAAP, as identified in the initial scoping and diagnostic phase, which will be impacted by the conversion to IFRS. The analysis includes a review of the changes required to the current accounting policies as well as any policy alternatives. The implications of these changes on business processes, information systems and internal control over financial reporting are also analyzed. We are also in the process of preparing draft financial statements and related note disclosure in accordance with IAS 1 – "Presentation of Financial Statements". Training is provided on a continuous basis to key employees. To date, we have completed a portion of the detailed analysis of the significant areas and we expect to complete the balance by the end of the second quarter of fiscal 2011.

Implementation phase:

The final phase of our IFRS changeover plan will entail the implementation of the changes identified in the second phase as well as the approval of IFRS financial statements. Training will continue to be provided on a ongoing basis to key employees. The final phase will be completed during the third and fourth quarters of fiscal 2011.

Based on the progress to date, the following are some of the significant accounting policy changes that have been identified as having a potential impact on our financial statements. We are in the process of reviewing other accounting policies and will disclose additional information when available.

- IAS 1 “Presentation of Financial Statements”, which will require classification changes to the Statement of Earnings by using either the Function of Expense Method or the Nature of Expense Method, as well as additional disclosure requirements. We have yet to conclude on which method of presentation we will follow.
  - IAS 17 “Leases”, which may require changes to the basis of the expense recognition over the lease term.
- IAS 36 “Impairment of Assets”, which will require the impairment of assets to be applied to the Cash Generating Units (CGU), the lowest level at which separately independent cash inflows can be identified. Assets will be assessed using a one-step test, where the carrying value of an asset or group of assets will be compared directly to its recoverable amount on a discounted cash flow basis.

We are currently evaluating the implications of these changes on business processes, information systems, internal control over financial reporting and disclosure controls and procedures.

As we prepare for our transition, we continue to monitor ongoing changes to IFRS and adjust our transition and implementation plans accordingly. Our transition remains in line with our implementation schedule and we are on track to meet the timelines essential to changeover.

New Accounting Guidance

Notes 2 and 18 in the accompanying consolidated financial statements in this report contains a discussion of new accounting pronouncements and the potential impact to our consolidated results of operations and financial position.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements as such term is defined in Item 303(a) (4) of Regulation S-K.

Summary Quarterly Financial Data (Unaudited)

The following summarizes our unaudited quarterly financial results for the fiscal years ended March 31, 2010 and March 31, 2009 (in thousands, except share data):

| | Year Ended March 31, 2010 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net revenue | $3,235 | $3,252 | $4,743 | $3,596 |
| Net income (loss) | 90 | 366 | (396) | (186) |
| Basic net earnings per common share | 0.01 | 0.01 | (0.02) | 0.00 |
| Diluted net earnings per common share | 0.01 | 0.01 | (0.02) | 0.00 |

| | Year Ended March 31, 2009 | | | |
|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net revenue | $3,177 | $3,087 | $3,037 | $3,078 |
| Net income (loss) | (47) | 65 | 281 | 5,156 |

| | | | | |
|---|---|---|---|---|
| Basic net earnings (loss) per common share | (0.00) | 0.00 | 0.01 | 0.19 |
| Diluted net earnings (loss) per common share | (0.00) | 0.00 | 0.01 | 0.19 |

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in marketable securities (which consist of money market and commercial paper). At March 31, 2010, our marketable securities were recorded at a fair value of approximately $2,414,000 with an overall weighted average return of .50% and an overall weighted average life of less than three months. Any exposure to price risk would have an immaterial effect on the recorded value of the marketable securities.

We are not exposed to material future earnings or cash flow fluctuations from changes in interest rates on long-term debt since we had no long-term debt as of March 31, 2010. To date, we have not entered into any derivative financial instruments to manage interest rate risk and are currently not evaluating the future use of any such financial instruments.

Foreign Exchange Risk

The U.S. dollar is the functional currency of our operations since primarily all of our operations are conducted in U.S. currency. As a result, when we are paying any obligation that is denominated in a foreign currency (including, for example, the Beanstream promissory notes), we must generate the amount of cash in U.S. dollars that, when exchanged at the then-prevailing applicable foreign currency exchange rate, will equal the amount of the obligation to be paid (which means that we may pay more U.S. dollars than initially anticipated if the foreign currency strengthens against the U.S. dollar between the time we incur the obligation and the time we are required to pay the obligation). Accordingly, we are exposed to the risk of future currency exchange rate fluctuations, which are accounted for as an adjustment to shareholders' equity until realized. Therefore, changes from reporting period to reporting period in the exchange rates between the Canadian currency and the U.S. dollar might have a material adverse effect on our results of operations and financial condition.

ITEM 8. Financial Statements and Supplementary Data

Information called for by this item is set forth in our Consolidated Financial Statements contained in this report. Our Consolidated Financial Statements begin in Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" and at page F-1.

ITEM 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosures

Not applicable

ITEM 9A(T). Controls and Procedures

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934 (Exchange Act), our management, including our Chief Executive Officer ('CEO") and Chief Accounting Officer ("CAO"), carried out an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" as of the end of the period covered by this report. As defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures of our Corporation that are designed to ensure that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act is accumulated and communicated to our Corporation's management, including our CEO and CAO, as appropriate, to allow timely decisions regarding required disclosure.

Material Weakness in Internal Controls

In completing the financial statements for the fiscal year ended March 31, 2010, management identified a material weakness in internal control over financial reporting, namely, that we did not have adequately designed procedures to calculate our future tax asset value and corresponding future income tax expense as at the completion of our fiscal third quarter ended December 31, 2009 or at the completion of the fiscal year ended March 31, 2010. As defined by the Public Company Accounting Oversight Board Auditing Standard No. 5, a material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

Based on their evaluation, our CEO and CAO concluded that, due to the aforementioned material weakness in internal controls as of the end of the period covered by this report, our disclosure controls and procedures were not effectively designed to provide reasonable assurance that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to provide reasonable assurance that such information is accumulated and communicated to our Corporation's management, including our CEO and CAO, as appropriate, to allow timely decisions regarding required disclosure. It should be noted that any system of controls, however well designed and operated, is based in part upon certain assumptions and can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

Since the discovery of the material weakness we have performed a detailed review of our procedures involved in the calculation and review of future tax asset values and corresponding future income tax expenses of the tax provision. Our efforts to remediate the weakness in our internal control over financial reporting include the engagement of external resources and the implementation of new procedures with respect to the segregation of the calculation and review processes of the tax provision. While we believe that these actions will remediate the material weakness control deficiency we have identified and strengthen our internal control over financial reporting, our CEO and CAO will not be able to determine whether these additional controls are operating effectively until they have assessed their effectiveness as part of their evaluation of our internal control over financial reporting for the first two interim periods following implementation. As we improve our internal control over financial reporting and implement the remediation measures described above, we may supplement or modify such remediation measures with additional remediation measures. However, we cannot provide assurance that either we or our independent auditors will not in the future identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date.

Changes in Internal Control over Financial Reporting. As required by Rule 13a-15(d) under the Exchange Act, our management, including our CEO and CAO, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on our evaluation, during our most recent fiscal quarter there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, subsequent to March 31, 2010, we took the remedial actions described above to materially improve our procedures relating to the calculation and review of future tax asset values and corresponding future income tax expenses of the tax provision.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Exchange Act Rules 13a-15(f) and 15d-15(f). Those rules define internal control over financial reporting as 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 ("GAAP"). It includes policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of management and directors; and

    - Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our 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.

Management assessed the effectiveness of the Corporation’s internal control over financial reporting as of March 31, 2010 based on the criteria set forth in the Internal Control-Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this assessment and those criteria, management concluded that the material weakness in internal control over financial reporting, identified in connection with the restatement of our consolidated financial statements for the quarterly period ended December 31, 2009, namely, that we did not have adequately designed procedures to calculate our future tax asset value and corresponding future income tax expense, continued to exist as at the completion of the fiscal year ended March 31, 2010.

This material weakness resulted in accounting errors which caused us to restate our consolidated financial statements as of December 31, 2009.

Based on their assessment, including consideration of the aforementioned material weakness, and the criteria discussed above, management has concluded that our internal control over financial reporting was not effective at a reasonable assurance level as of March 31, 2010.

Management’s Remediation Initiatives

As of the date of this filing we have performed a detailed review of our procedures involved in the calculation and review of future tax asset values and corresponding future income tax expenses of the tax provision. Our efforts to remediate the weakness in our internal control over financial reporting include the engagement of external resources and the implementation of new procedures with respect to the segregation of the calculation and review processes of the tax provision. While we believe that these actions will remediate the material weakness control deficiency we have identified and strengthen our internal control over financial reporting, our CEO and CAO will not be able to determine whether these additional controls are operating effectively until they have assessed their effectiveness as part of their evaluation of our internal control over financial reporting for the first two interim periods following implementation. As we improve our internal control over financial reporting and implement the remediation measures described above, we may supplement or modify such remediation measures with additional remediation measures. However, we cannot provide assurance that either we or our independent auditors will not in the future identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date.

This annual report on Form 10-K does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report on Form 10-K.

ITEM 9B. Other Information

Not applicable.

## PART III

### ITEM 10. Directors, Executive Officers and Corporate Governance

Information on our directors, executive officers, and audit committee, compliance with Section 16(a) of the Exchange Act and our code of ethics applicable to our Chief Executive Officer and Chief Accounting Officer will be contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2010, and is incorporated herein by reference.

We have adopted a Code of Ethics applicable to our principal executive officer, principal financial officer, controller and others performing similar functions. Our Code of Ethics also applies to all of our other employees and to our directors. Our Code of Ethics is available on our website located at www.lmlpayment.com under the heading "Investor Relations; Corporate Governance". We intend to satisfy any disclosure requirements pursuant to Item 5.05 of Form 8-K regarding any amendment to, or a waiver from, certain provisions of our Code of Ethics by posting such information on our website (unless we are otherwise required to file a Form 8-K under the rules and regulations of The NASDAQ Stock Market).

There were no material changes to the procedures by which our stockholders may recommend nominees to our Board of Directors implemented during fiscal 2010.

### ITEM 11. Executive Compensation

Information on compensation of our directors and executive officers will be contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2010, and is incorporated herein by reference.

### ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Security Matters

Information on the securities ownership of certain beneficial owners and our management will be contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2010, and is incorporated herein by reference.

Information required by Item 201(d) of Regulation S-K is set forth under Item 5. "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities".

### ITEM 13. Certain Relationships and Related Transactions and Director Independence

Information on certain relationships, related transactions and director independence will be contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2010, and is incorporated herein by reference.

### ITEM 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services will be contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed with the SEC within 120 days after the end of our fiscal 2010, and is incorporated herein by reference.

## PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements



All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto.

(b) Exhibits:

| Exhibit Number | Description of Document |
|---|---|
| 2.1 | Arrangement Agreement dated as of April 30, 2007, between LML Payment Systems Inc. and Beanstream Internet Commerce Inc. and the schedules thereto (incorporated by reference to Exhibit 2.1 to the Form 8-K dated April 30, 2007 of LML (file No. 000-13959)). |
| 2.2 | Amending Agreement between LML Payment Systems Inc. and Beanstream Internet Commerce Inc. dated as of May 24, 2007 (incorporated by reference to Exhibit 99.2 to the Form 8-K dated June 4, 2007 of LML (file No. 000-13959)). |
| 3.1 | Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K for the period ended March 31, 2006 of LML (File No. 000-13959)). |
| 3.2 | Bylaws of LML, as amended (incorporated by reference to Exhibit 3.2 to the Quarterly Report on Form 10-Q for the period ended September 30, 2007 of LML (File No. 000-13959)). |
| 10.1 | Securities Purchase Agreement dated as of March 26, 2008, between LML Payment Systems Inc. and Millennium Partners, L.P. (incorporated by reference to Exhibit 10.1 to the Form 8-K dated March 26, 2008 of LML (file 000-13959)). |
| 10.2 | Registration Rights Agreement dated as of March 26, 2008, between LML Payment Systems Inc. and Millennium Partners, L.P. (incorporated by reference to Exhibit 10.2 to the Form 8-K dated March 26, 2008 of LML (file 000-13959)). |
| 10.3 | Warrant dated as of March 26, 2008, between LML Payment Systems Inc. and Ladenburg Thalmann & Co., Inc. (incorporated by reference to Exhibit 10.3 to the Form 8-K dated March 26, 2008 of LML (file 000-13959)). |
| 10.4† | Employment agreement between LML Payment Systems Inc. and Patrick H. Gaines dated March 31, 2008 (incorporated by reference to Exhibit 10.1 to the Form 8-K dated March 31, 2008 of LML (file 000-13959)). |
| 10.5† | Employment agreement between LML Payment Systems Inc. and Richard R. Schulz dated March 31, 2008 (incorporated by reference to Exhibit 10.2 to the Form 8-K dated March 31, 2008 of LML (file 000-13959)). |
| 10.6† | Employment agreement between LML Payment Systems Inc. and Carolyn L. Gaines dated March 31, 2008 (incorporated by reference to Exhibit 10.3 to the Form 8-K dated March 31, 2008 of LML (file 000-13959)). |
| 10.7† | Employment agreement between LML Payment Systems Inc. and Craig Thomson dated February 5, 2009 (incorporated by reference to Exhibit 10.1 to the Form 8-K dated February 5, 2009 of LML (file 000-13959)). |
| 10.8† | Employment agreement between LML Payment Systems Inc. and Chris Koide dated February 5, 2009 (incorporated by reference to Exhibit 10.2 to the Form 8-K dated February 5, 2009 of |

LML (file 000-13959)).

| | |
|---|---|
| 10.9† | Amending agreement to the employment agreement between LML Payment Systems Inc. and Patrick H. Gaines dated February 5, 2009 (incorporated by reference to Exhibit 10.3 to the Form 8-K dated February 5, 2009 of LML (file 000-13959)). |
| 10.10† | Amending agreement to the employment agreement between LML Payment Systems Inc. and Richard R. Schulz dated February 5, 2009 (incorporated by reference to Exhibit 10.4 to the Form 8-K dated February 5, 2009 of LML (file 000-13959)). |
| 10.11† | 1996 Stock Option Plan and amendments to 1996 Stock Option Plan dated August 31, 1998, September 30, 1999 and September 18, 2000 (incorporated by reference to Appendix A to the Schedule 14A of LML dated August 8, 2007 (file 000-13959)). |

(b) Exhibits (continued)

| | |
|---|---|
| 10.12† | 1998 Stock Incentive Plan and amendment to 1998 Stock Incentive Plan dated September 18, 2000 (incorporated by reference to Appendix B to the Schedule 14A of LML dated August 8, 2007 (file 0-13959)). |
| 10.13† | 2009 Stock Incentive Plan dated June 17, 2009 (incorporated by reference to Appendix A to the Schedule 14A of LML dated August 6, 2010 (file 000-13959)). |
| 10.14†† | Settlement and License Agreement between LML Patent Corp and RBS Citizens Bank N.A. dated December 29, 2009 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the period ending December 31, 2009, as filed with the SEC on February 12, 2010 (File No. 000-13959)). |
| 10.15* | Settlement and License Agreement effective as of June 2, 2010 among LML Patent Corp. and PNC Financial Services Group Inc., PNC Bank N.A. and PNC Bank N.A. as successor in interest for National City Bank (collectively, “PNC”). |
| 21* | Subsidiaries of LML |
| 23.1* | Consent of Grant Thornton LLP |
| 31.1* | Rule 13a-14(a) Certification of Principal Executive Officer. |
| 31.2* | Rule 13a-14(a) Certification of Principal Financial Officer. |
| 32* | Section 1350 Certification of Principal Executive Officer and Principal Financial Officer. |

* filed herewith

† Management contract or compensatory plan or arrangement

†† Confidential Treatment has been granted.

LML PAYMENT SYSTEMS INC.

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LML PAYMENT SYSTEMS INC.

/s/ Patrick H. Gaines
Patrick H. Gaines
Chairman of the Board and Chief Executive Officer

Date: June 24, 2010

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated and on the dates indicated below.

| | Title | Date |
|---|---|---|
| /s/ Patrick H. Gaines<br>Patrick H. Gaines | Chairman of the Board, Chief Executive Officer and Director<br>(Principal Executive Officer) | June 24, 2010 |
| /s/ A. Craig Thomson<br>A. Craig Thomson | President | June 24, 2010 |
| /s/ Richard R. Schulz<br>Richard R. Schulz | Controller and Chief Accounting Officer<br>(Principal Financial and Accounting Officer) | June 24, 2010 |
| /s/ David C. Cooke<br>David C. Cooke | Director | June 24, 2010 |
| /s/ Jacqueline Pace<br>Jacqueline Pace | Director | June 24, 2010 |
| /s/ Greg A. MacRae<br>Greg A. MacRae | Director | June 24, 2010 |

# REPORT OF THE INDEPENDENT REGISTERED CHARTERED ACCOUNTING FIRM

To the Shareholders of
LML Payment Systems Inc.

We have audited the accompanying consolidated balance sheets of LML Payment Systems Inc. and subsidiaries (together, the "Corporation") as of March 31, 2010 and 2009 and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for each of the three years in the period ended March 31, 2010. These consolidated financial statements are the responsibility of the Corporation'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 Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 LML Payment Systems Inc. and subsidiaries as of March 31, 2010 and 2009 and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2010 in accordance with Canadian generally accepted accounting principles.

Canadian generally accepted accounting principles vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 18 to the consolidated financial statements.

| | |
|---|---|
| Vancouver, Canada | /s/ GRANT THORNTON LLP |
| June 17 , 2010 | Chartered Accountants |

Comments by Auditor for U.S. Readers on Canada-U.S. Reporting Difference

In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the Corporation's financial statements, such as the change described in Note 2(r) to the financial statements relating to multiple deliverable revenue arrangements. Our report to the shareholders dated June 17, 2010 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the auditors' report when the change is properly accounted for and adequately disclosed in the financial statements.

| | |
|---|---|
| Vancouver, Canada | /s/ GRANT THORNTON LLP |
| June 17 , 2010 | Chartered Accountants |

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED BALANCE SHEETS
(In U.S. Dollars)

| | March 31, | |
|---|---|---|
| | 2010 | 2009 |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents (Note 6) | $5,069,763 | $6,138,530 |
| Funds held for merchants (Note 6) | 5,804,752 | 10,746,731 |
| Restricted cash (Note 5(b)) | 175,000 | 175,000 |
| Accounts receivable, less allowance of $31,463 (2009: $31,785) | 799,584 | 801,087 |
| Corporate taxes receivable | 1,072,930 | - |
| Prepaid expenses | 416,507 | 295,702 |
| Current portion of future income tax assets (Note 13) | 1,280,860 | 838,575 |
| Total current assets | 14,619,396 | 18,995,625 |
| PROPERTY AND EQUIPMENT, net (Notes 7 and 10) | 219,580 | 227,324 |
| PATENTS (Note 8) | 455,304 | 622,730 |
| RESTRICTED CASH (Note 5(b)) | 255,247 | 125,030 |
| FUTURE INCOME TAX ASSETS (Note 13) | 2,406,473 | 4,429,578 |
| GOODWILL (Note 9) | 17,874,202 | 17,874,202 |
| INTANGIBLE ASSETS (Note 9) | 4,710,337 | 5,205,487 |
| OTHER ASSETS | 20,641 | 19,020 |
| Total assets | $40,561,180 | $47,498,996 |
| LIABILITIES | | |
| CURRENT LIABILITIES | | |
| Accounts payable | $836,274 | $756,845 |
| Accrued liabilities | 1,040,443 | 814,094 |
| Corporate taxes payable | - | 283,794 |
| Funds due to merchants (Note 6) | 5,804,752 | 10,746,731 |
| Current portion of obligations under capital lease (Note 10) | 11,195 | 170,243 |
| Current portion of promissory notes (Note 3) | - | 2,100,920 |
| Current portion of deferred revenue | 1,325,983 | 1,361,046 |
| Total current liabilities | 9,018,647 | 16,233,673 |
| OBLIGATIONS UNDER CAPITAL LEASE (Note 10) | 9,840 | - |

| | | |
|---|---|---|
| DEFERRED REVENUE | 2,155,162 | 3,330,630 |
| | | |
| Total liabilities | 11,183,649 | 19,564,303 |
| | | |
| COMMITMENTS AND CONTINGENCIES (Note 14) | | |
| | | |
| SHAREHOLDERS' EQUITY | | |
| | | |
| CAPITAL STOCK | | |
| Class A, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding | - | - |
| Class B, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding | - | - |
| Common shares, no par value, 100,000,000 shares authorized, 27,241,408 issued and outstanding (2009: 27,116,408) | 50,152,385 | 50,039,568 |
| | | |
| CONTRIBUTED SURPLUS (Note 11(b)) | 7,952,343 | 6,732,059 |
| DEFICIT | (28,877,282) | (28,751,456) |
| ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | 150,085 | (85,478) |
| Total shareholders' equity | 29,377,531 | 27,934,693 |
| | | |
| Total liabilities and shareholders' equity | $40,561,180 | $47,498,996 |

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In U.S. Dollars, except share data)

| | Years ended March 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| REVENUE (Note 4) | $14,825,667 | $12,378,848 | $11,327,878 |
| COSTS OF REVENUE (includes stock-based compensation expense of $148,228 (2009 - $149,716; 2008 - $42,449)) | 7,655,551 | 6,057,817 | 4,807,946 |
| GROSS PROFIT (excludes amortization and depreciation expense) | 7,170,116 | 6,321,031 | 6,519,932 |
| OPERATING EXPENSES | | | |
| General and administrative (includes stock-based compensation expense of $1,038,447 (2009 - $1,139,589; 2008 - $1,217,984)) | 4,337,914 | 4,341,159 | 5,659,694 |
| Sales and marketing (includes stock-based compensation expense of $3,025 (2009 - $3,033; 2008 - $2,975)) | 416,617 | 323,103 | 227,935 |
| Product development and enhancement (includes stock-based compensation expense of $48,401 (2009 - $48,534; 2008 - $23,802)) | 467,686 | 272,499 | 177,704 |
| Amortization of property and equipment | 138,271 | 124,441 | 367,809 |
| Amortization of intangible assets | 662,576 | 660,893 | 537,679 |
| (Gain) Loss on disposal/abandonment of property and equipment | (3,830) | (864) | 726,325 |
| INCOME (LOSS) BEFORE OTHER INCOME (EXPENSES) AND INCOME TAXES | 1,150,882 | 599,800 | (1,177,214) |
| Foreign exchange gain (loss) | 89,455 | 444,050 | (229,661) |
| Other (expense) income , net | (57,044) | 10,898 | (246,918) |
| Interest income | 25,036 | 226,472 | 406,063 |
| Interest expense | (47,771) | (247,536) | (358,756) |
| INCOME (LOSS) BEFORE INCOME TAXES | 1,160,558 | 1,033,684 | (1,606,486) |
| Income tax expense (recovery) (Note 13) | | | |
| Current | (826,246) | 846,671 | 614,342 |
| Future | 2,112,630 | (5,268,153) | - |
| | 1,286,384 | (4,421,482) | 614,342 |
| NET (LOSS) INCOME | $(125,826) | $5,455,166 | $(2,220,828) |
| (LOSS) EARNINGS PER SHARE, basic and diluted | $- | $0.20 | $(0.10) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING, (Note 11(a)) | | | |
| Basic | 27,116,408 | 26,834,165 | 21,869,404 |
| Diluted | 27,116,408 | 26,834,165 | 21,869,404 |

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In U.S. Dollars)

| | Years ended March 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| Net (loss) income | $(125,826) | $5,455,166 | $(2,220,828) |
| Unrealized foreign exchange gain (loss) on translation of self-sustaining operations | 235,563 | (66,432) | (19,046) |
| Comprehensive income (loss) | $109,737 | $5,388,734 | $(2,239,874) |

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In U.S. Dollars)

| | Common Shares | Amount | Contributed Surplus | Accumulated Other Comprehensive Income (Loss) | Deficit | Total |
|---|---|---|---|---|---|---|
| Balance as at March 31, 2007 | 20,207,094 | $32,774,368 | $3,443,292 | $ - | $(31,985,794) | $4,231,866 |
| | | | | | | |
| Net loss | - | - | - | - | (2,220,828 ) | (2,220,828 ) |
| Change in cumulative translation adjustment | - | - | - | (19,046 ) | - | (19,046 ) |
| Exercise of stock options | 26,250 | 77,437 | - | - | - | 77,437 |
| Acquisition (Note 3) | 1,963,555 | 8,538,737 | - | - | - | 8,538,737 |
| Finders fee on Acquisition (Note 3) | 144,933 | 640,604 | - | - | - | 640,604 |
| Private Placement (Note 11(e)) | 4,000,000 | 7,200,000 | - | - | - | 7,200,000 |
| Financial advisor fee | - | - | 649,500 | - | - | 649,500 |
| Share issuance cost | - | (1,159,166 ) | - | - | - | (1,159,166 ) |
| Stock-based compensation (Note 11(c)) | - | - | 1,287,210 | - | - | 1,287,210 |
| Stock-based compensation – future income taxes | - | - | 11,185 | - | - | 11,185 |
| Balance as at March 31, 2008 | 26,341,832 | 48,071,980 | 5,391,187 | (19,046 ) | (34,206,622) | 19,237,499 |
| | | | | | | |
| Net income | - | - | - | - | 5,455,166 | 5,455,166 |
| Change in cumulative translation adjustment | - | - | - | (66,432 ) | - | (66,432 ) |
| Acquisition (Note 9) | 774,576 | 1,971,125 | - | - | - | 1,971,125 |
| Share issuance cost | - | (3,537 ) | - | - | - | (3,537 ) |
| Stock-based compensation (Note 11(c)) | - | - | 1,340,872 | - | - | 1,340,872 |
| Balance as at March 31, 2009 | 27,116,408 | 50,039,568 | 6,732,059 | (85,478 ) | (28,751,456) | 27,934,693 |
| | | | | | | |
| Net income | - | - | - | - | (125,826 ) | (125,826 ) |
| Change in cumulative translation adjustment | - | - | - | 235,563 | - | 235,563 |
| Exercise of stock options | 125,000 | 95,000 | - | - | - | 95,000 |
| Reallocation of contributed surplus on | - | 17,817 | (17,817 ) | - | - | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| exercise of options | | | | | | |
| Stock-based compensation (Note 11(c)) | - | - | 1,238,101 | - | - | 1,238,101 |
| Balance as at March 31, 2010 | 27,241,408 | $50,152,385 | $7,952,343 | $ 150,085 | $(28,877,282) | $29,377,531 |

See accompanying notes to the consolidated financial statements

LML PAYMENT SYSTEMS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In U.S. Dollars)

| | Years ended March 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| OPERATING ACTIVITIES: | | | |
| Net (loss) income | $(125,826) | $5,455,166 | $(2,220,828) |
| Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities | | | |
| Provisions for losses on accounts receivable | 5,705 | 17,461 | 10,942 |
| Amortization of property and equipment | 138,271 | 124,441 | 367,809 |
| Amortization of intangible assets | 662,576 | 660,893 | 537,679 |
| (Gain) loss on disposal/abandonment of property and equipment | (3,830) | (864) | 726,325 |
| Stock-based compensation | 1,238,101 | 1,340,872 | 1,287,210 |
| Stock-based compensation – future income taxes | - | - | 11,185 |
| Future income taxes | 2,112,630 | (5,268,153) | - |
| Foreign exchange (gain) loss | (353,935) | (370,692) | 177,847 |
| Changes in non-cash operating working capital | | | |
| Restricted cash | (100,000) | 75,000 | - |
| Accounts receivable | 50,004 | (214,903) | (130,694) |
| Corporate taxes receivable | (1,072,930) | - | - |
| Prepaid expenses | (110,661) | (28,405) | 214,414 |
| Other assets | - | - | (8,360) |
| Accounts payable and accrued liabilities | 255,012 | (536,940) | 323,496 |
| Corporate taxes payable | (334,296) | (204,471) | 582,538 |
| Deferred revenue | (1,225,382) | (1,352,311) | (1,339,390) |
| Net cash provided by (used in) operating activities | 1,135,439 | (302,906) | 540,173 |
| INVESTING ACTIVITIES: | | | |
| Other assets | - | 2,785 | - |
| Acquisition of Beanstream, net of cash acquired (Note 3) | - | - | (7,286,834) |
| Proceeds from disposal of property and equipment | 3,830 | 5,500 | 107,900 |
| Acquisition of property and equipment | (80,223) | (126,076) | (144,241) |
| Development of patents | - | (1,652) | (10,804) |
| Net cash used in investing activities | (76,393) | (119,443) | (7,333,979) |
| FINANCING ACTIVITIES: | | | |
| Payments on capital leases | (178,423) | (190,746) | (575,234) |
| Payment of promissory note | (2,321,460) | (2,843,974) | - |
| Proceeds from exercise of stock options | 95,000 | - | 77,438 |
| Proceeds from private placement of common shares | - | - | 7,200,000 |
| Share capital financing costs | - | (3,537) | (509,666) |
| Net cash (used in) provided by financing activities | (2,404,883) | (3,038,257) | 6,192,538 |
| Effects of foreign exchange rate changes on cash and cash equivalents | 277,070 | (150,632) | 188,028 |

| | | | |
|---|---|---|---|
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1,068,767) | (3,611,238) | (413,240) |
| Cash and cash equivalents, beginning of year | 6,138,530 | 9,749,768 | 10,163,008 |
| Cash and cash equivalents, end of year | $5,069,763 | $6,138,530 | $9,749,768 |
| Cash and cash equivalents consist of: | | | |
| Cash | $2,655,681 | $558,571 | $8,348,906 |
| Money market fund | 109,787 | 109,524 | 107,233 |
| Commercial paper | 2,304,295 | 5,470,435 | 1,293,629 |
| | $5,069,763 | $6,138,530 | $9,749,768 |
| Supplemental disclosure of cash flow information: | | | |
| Interest paid | $48,034 | $414,603 | $61,640 |
| Taxes paid | $435,138 | $1,240,310 | $44,120 |
| Non-cash investing and financing transactions not included in cash flows: | | | |
| Property and equipment acquired through capital leases | $28,574 | $- | $- |

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

## 1. NATURE OF OPERATIONS

LML Payment Systems Inc. (a Yukon Territory corporation) and its subsidiaries (the "Corporation"), see Note 2(a), is a financial payment processor providing electronic payment and risk management and authentication services primarily to businesses and organizations who use the Internet to receive or send payments. The Corporation links merchants selling products or services to customers wanting to buy them and financial institutions who allow the transfer of payments to occur. The Corporation has partnership arrangements and certified connections to financial institutions, payment processors and other payment service providers in order to enable its customers to safely and reliably conduct e-Commerce. The Corporation provides its electronic payment, authentication and risk management services to over 8,500 businesses and organizations in Canada and the United States of America (“U.S.”). The Corporation also provides check processing solutions including primary and secondary check collection including electronic check re-presentment (RCK) to retailers in the U.S.

The Corporation also provides licenses to its intellectual property. The Corporation’s intellectual property estate, owned by subsidiary LML Patent Corp., includes U.S. Patent No. 6,354,491, No. 6,283,366, No. 6,164,528, No. 5,484,988, and No. RE40,220, all of which describe electronic check processing methods.

## 2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Except as disclosed in Note 18, these principles do not differ materially from generally accepted accounting principles in the U.S. (“U.S. GAAP”).

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries as set out below. All significant inter-company balances and transactions have been eliminated on consolidation.

CANADA
Legacy Promotions Inc.
Beanstream Internet Commerce Inc. (“Beanstream”) *
0858669 B.C. Ltd.

UNITED STATES
LHTW Properties Inc.
LML Corp.
LML Patent Corp.
LML Payment Systems Corp.
Beanstream Internet Commerce Corp.

* Effective June 30, 2007, the Corporation completed the acquisition of Beanstream. The consolidated balance sheets as of March 31, 2010 and 2009, and the consolidated statements of operations, consolidated statements of comprehensive income (loss), consolidated statements of shareholders’ equity and the consolidated statements of cash

flows for the years ended March 31, 2010, 2009 and 2008 include the accounts of Beanstream since its acquisition by the Corporation on June 30, 2007.

Certain of the prior year financial statement amounts have been reclassified to conform to the current year presentation.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Use of Estimates and Measurement Uncertainty

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to, among others, the allowance for doubtful accounts, determination of impairment of assets, determination of stock-based compensation expense, allocation of the purchase price of business acquisitions, useful lives for depreciation and amortization and future income taxes. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and all highly liquid debt instruments purchased with a maturity of three months or less at the date of purchase.

(d) Accounts Receivable

Accounts receivable are stated net of allowances for uncollectible accounts. Management develops the estimate of the allowance based on the Corporation’s experience with specific customers, its understanding of their current economic circumstances and its own judgment as to the likelihood of their ultimate payment. Management also considers the Corporation’s collection experience with the balance of its receivables portfolio and makes estimates regarding collectability based on trends in aging.

(e) Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. The straight-line method is used to depreciate assets over their estimated useful lives as follows:

| | |
|---|---|
| Computer equipment | 3 – 5 years |
| Computer software | 3 – 5 years |
| Furniture and fixtures | 3 years |
| Leasehold improvements | Lesser of the life of the lease or the useful life of the leasehold improvement |
| Office equipment | 5 years |
| Website & trademarks | 5 years |

(f) Leases

Leases are classified as either capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the future minimum lease payments and the property's fair value at the beginning of such lease. Amortization of the equipment under capital lease is on the same basis as similar property and equipment.

(g) Research and Development Costs

The Corporation incurs costs to research and develop its proprietary software products to be sold, licensed or otherwise marketed. Costs incurred in the research phase are expensed as incurred. Costs incurred in the development phase are expensed as incurred unless a project meets the criteria under Canadian GAAP for deferral and amortization, in which case the development costs are deferred and amortized over the estimated useful life of the software product developed. Amortization commences when development of the software is complete and the product is available for sale to customers. During the fiscal years ended March 31, 2010 and 2009, the Corporation did not defer any development costs.

(h) Patents

Patent costs are amortized using the straight-line method over the estimated useful life of 15 years.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Impairment of Long-lived Assets

Long-lived assets subject to amortization 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 an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

(j) Goodwill

Goodwill relates to the acquisition of Beanstream and represents the excess of purchase price over the fair values of the identifiable assets acquired and liabilities assumed. Goodwill is not amortized and is tested at least annually for impairment or more frequently if an event or circumstance occurs that more likely than not reduces the fair value of a reporting unit below its carrying amount. Any resulting write-down, representing the difference between fair value and the carrying amount, is recorded in the period in which the impairment occurs.

(k) Intangible Assets

Definite-life intangible assets are regularly reviewed for impairment whenever events or changes in circumstances indicate that their carrying values may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from use plus its residual value. If such an asset is considered impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value, generally determined on a discounted cash flow basis.

Intangible assets related to the acquisition of Beanstream include partner relationships, merchant contracts, existing technology and trade names. The partner relationships and merchant contracts are amortized over ten years on a straight-line basis. The existing technology is amortized over five years on a straight-line basis. Trade names are considered indefinite-life intangible assets and as such are not amortized.

(l) Revenue Recognition

The Corporation's revenue is derived from three separate lines of business: (i) transaction payment processing; (ii) intellectual property licensing and (iii) check processing and software licensing. Prior to the fiscal year ended March 31, 2010, revenue was recognized in accordance with Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3400, "Revenue" ("CICA 3400") and with the corresponding FASB issued authoritative guidance on revenue recognition. In addition to these revenue recognition policies, effective fiscal year March 31, 2010, for revenue arrangements with multiple deliverables that are outside the scope of the FASB issued authoritative guidance on software revenue recognition, the Corporation has adopted the provisions of CICA's Emerging Issues Committee Abstract of Issues Discussed, "Multiple Deliverable Revenue Arrangements" ("EIC 175"), issued on December 24, 2009.

Revenue from the Corporation's transaction payment processing ("TPP") segment is derived from one-time set-up fees, monthly gateway fees, and transaction fees paid to the TPP segment by merchants. Transaction fees are recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to the TPP segment merchant customers for the use of its payment gateway. Gateway fees are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating the TPP segment's processing services. Although these fees are generally paid at the commencement of the agreement, they are recognized ratably over the estimated average life of the merchant relationship, which is determined through a series of analyses of active and deactivated merchants.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Within the Intellectual Property Licensing (“IPL”) segment, revenue arrangements typically include the following elements:

- Licenses – licenses are issued for the use of existing patents;
- Release from litigation – the Corporation releases the licensees from any claims or causes of action for patent infringement as of the effective date of the underlying agreement;
- Covenant-not-to-sue provision – the Corporation agrees to a covenant-not-to-sue provision for infringement of any patents for a specified period commencing on the effective date of the underlying agreement.

When the Corporation enters into intellectual property licensing and settlement agreements comprising multiple elements, the significant factors, inputs, assumptions and methods used to determine the estimated selling price of each element present in the arrangement include:

- Royalty rates from existing licenses;
- Actual usage, including transaction volumes, by the existing licensees; and
- Expected usage by the customer.

Total arrangement consideration is then allocated to each of the deliverables using the relative selling price method.

As the license and release elements are fully delivered as of the effective date of the underlying agreement, revenue related to these elements is recognized at that time, assuming (i) there is persuasive evidence of an arrangement, (ii) the fee is fixed or determinable and (iii) there are no concerns over collectability of the arrangement proceeds. As the covenant-not-to-sue typically includes as-yet unidentified patents which may be acquired during the specified term (a when-and-if available deliverable), proceeds allocated to this element are recognized ratably over the specified period, assuming all other revenue recognition criteria have been met.

Revenue from the Corporation’s check processing and software licensing (“CP/SL”) segment consists primarily of transaction charges from primary and secondary check collection business, including electronic check re-presentment. Fees associated with the CP/SL segment’s primary and secondary check collection business, including electronic check re-presentment, are contingent on successful recovery; accordingly, revenue is recognized as cash is received.

(m) Income Taxes

The liability method is used in accounting for income taxes. Under this method, income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided against net deferred tax assets when it is more likely than not those assets may not be realized.

(n) (Loss) Earnings Per Common Share

Basic (loss) earnings per common share is calculated based on net (loss) income divided by the weighted-average number of common shares outstanding during the period. Diluted (loss) earnings per share includes the dilutive effect of stock options granted using the treasury stock method.

LML PAYMENT SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) Stock-based Compensation Plans

The Corporation has three stock-based compensation plans, described more fully in Note 11. The Corporation applies the fair value recognition provisions of CICA Handbook Section 3870 "Stock-based compensation and other stock-based payments" ("Section 3870") which does not differ materially from the application required under the FASB issued authoritative guidance regarding share-based payment. Under these standards, share-based payment transactions with employees are required to be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period. The Corporation recognizes stock-based compensation costs over the requisite service period during which an employee is required to provide service in exchange for the award, which generally is the vesting period with the offsetting credit to contributed surplus. Upon the exercise of these options, any amounts originally credited to contributed surplus are credited to capital stock. The impact of forfeitures that may occur prior to vesting is also estimated and considered in the amount of expense recognized. Forfeiture estimates are revised, if necessary, in subsequent periods when actual forfeitures differ from those estimates.

Any consideration paid on the exercise of stock options or purchase of stock is credited to share capital.

(p) Foreign currency translation

Except as described below, the Corporation's functional and reporting currency is the United States dollar. Monetary assets and liabilities denominated in foreign currencies are translated in accordance with CICA Handbook Section 1651 "Foreign Currency Translation" ("Section 1651") (and the Financial Accounting Standards Board ("FASB") issued authoritative guidance regarding foreign currency translation) using the exchange rate prevailing at the balance sheet date and non-monetary assets and liabilities are translated at exchange rates prevailing at the historical transaction date. Average rates for the period are used to translate the Corporation's revenue and expenses. Gains and losses arising on settlement of foreign currency denominated transactions or balances are included in the determination of income.

The functional currency of the Corporation's Beanstream subsidiary is the Canadian dollar. Beanstream's financial statements are translated to United States dollars under the current rate method in accordance with Section 1651 and the FASB issued authoritative guidance regarding foreign currency translation. Beanstream's assets and liabilities are translated into U.S. dollars at rates of exchange in effect at the balance sheet date. Average rates for the period are used to translate Beanstream's revenues and expenses. Gains and losses arising on the translation of Beanstream's financial statements are reported as a cumulative translation adjustment which is a component of accumulated other comprehensive income.

(q) Financial Instruments

All financial instruments are classified into one of five categories: held-for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) Change in accounting policies

Revenue recognition

During the fiscal year ended March 31, 2010, the Corporation early adopted the provisions of EIC 175 and applied the guidance retrospectively to April 1, 2009.

EIC 175 does not differ materially from the FASB's newly issued authoritative guidance on multiple-deliverable revenue arrangements. Under the new FASB guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. Under the previous revenue recognition guidance, some of the revenue related to the IPL segment may have been deferred.

EIC 175 had no impact on the Corporation's treatment of multiple element arrangements that include software elements essential to the functionality of tangible products included in the arrangement. Recently issued FASB authoritative guidance confirmed that such software elements are outside the scope of the software revenue recognition guidance.

Financial Instruments – Recognition and Measurement

In 2009 CICA's Accounting Standards Board ("AcSB") approved certain amendments to CICA Handbook Section 3855, "Financial Instruments — Recognition and Measurement", to converge with international standards. The amendments addressed the following matters:

- The amendments clarify that if an entity reclassifies a financial asset out of the held-for-trading category, it must assess whether the financial asset contains an embedded derivative that is required to be separated from the host contract. This assessment is made on the basis of circumstances that existed on the later date of specified dates provided in the amendment.

- If an embedded derivative cannot be measured reliably, the entity is prohibited from reclassifying the asset from held-for-trading.

- When a financial asset or a group of similar financial assets (other than the loans and receivables category) has been written down as a result of an impairment loss, interest income is recognized thereafter using the rate of interest used in the measurement of the impairment loss.

-

An embedded call, put, surrender or prepayment option is closely related to the host debt instrument when its exercise price reimburses the lender for an amount up to the approximate present value of the lost interest. Calculation guidance to determine the lost interest is provided in the amendment.

These amendments are required to be applied prospectively to fiscal years ending on or after October 31, 2009. The adoption of these amendments had no impact on the Corporation's consolidated financial statements.

Financial Instruments – Disclosures

In June 2009, the Canadian Accounting Standards Board issued an amendment to CICA Section 3862, "Financial Instruments – Disclosures" in order to harmonize Section 3862 with International Financial Reporting Standard No. 7 – Financial Instruments Disclosures ("IFRS 7"). The purpose was to establish a framework for measuring fair value and expand disclosures about fair value measurements. According to amended Section 3862, an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels: (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). These standards apply to interim and annual consolidated financial statements relating to fiscal years ending after September 30, 2009. The disclosures required as a result of these amendments are included in Note 5.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Credit Risk and Fair Value of Financial Assets and Financial Liabilities

Effective January 1, 2009, the Corporation adopted EIC Abstract 173, “Credit Risk and Fair Value of Financial Assets and Financial Liabilities”. This abstract requires that credit risk be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not result in a material impact on the Corporation’s consolidated financial statements.

(s) Recent accounting pronouncements

Business Combinations

In December 2008, the CICA issued Section 1582 – “Business Combinations”, which will replace Section 1581 – “Business Combinations”. This section establishes revised standards for the accounting for a business combination which are aligned with International Financial Reporting Standards (“IFRS”) on business combinations. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Corporation will not be adopting this standard because, effective April 1, 2011, it will be required to adopt IFRS.

International Financial Reporting Standards

The Accounting Standards Board of the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced with IFRS, as published by the International Accounting Standards Board, for fiscal years beginning on or after January 1, 2011. Early conversion to IFRS for fiscal years beginning on or after January 1, 2009 may also be permitted.

Implementing IFRS will have an impact on accounting, financial reporting and supporting IT systems and processes. It may also have an impact on taxes, contractual commitments involving clauses based on generally accepted accounting principles, long-term employee compensation plans and performance metrics. Accordingly, when the Corporation executes its IFRS implementation plan, it will have to include measures to provide extensive training to key finance personnel, to review contracts and agreements and to increase the level of awareness and knowledge amongst management, the Board of Directors and Audit Committee. Additional resources will be engaged to ensure the timely conversion to IFRS. As at March 31, 2010, the Corporation has completed an IFRS diagnostic, is in the process of finalizing the elections under IFRS 1 “First Time Adoption to IFRS”, is in the process of determining accounting policies choices and procedures, IT and data systems, internal control over financial reporting, and training of its employees impacted in the IFRS conversion. The Corporation is planning to have an IFRS compliant opening balance sheet in place shortly after the first quarter of fiscal 2011.

Consolidated Financial Statements and Non-Controlling Interests

In January 2009, the CICA issued CICA Handbook Section 1601, “Consolidated Financial Statements” and Section 1602, “Non-controlling interest”. Together these sections replace the former Section 1600, “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination and is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27, “Consolidated and Separate Financial Statements”.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

The new standards result in measuring business acquisitions at the fair value of the acquired business and a prospectively applied shift from a parent corporation conceptual view of consolidation theory (which results in the parent corporation recording book values attributable to non-controlling interests) to an entity conceptual view (which results in the parent corporation recording fair values attributable to non-controlling interests).

These sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011 and are to be applied prospectively. Earlier adoption is permitted as of the beginning of a fiscal year. An entity adopting these Sections for a fiscal year beginning before January 1, 2011 also adopts Section 1582, “Business Combinations”.

The Corporation will not be adopting these standards because, effective April 1, 2011, it will be required to adopt IFRS.

3. ACQUISITION OF BEANSTREAM

On April 30, 2007, the Corporation entered into an arrangement agreement to acquire all of the outstanding capital stock of Beanstream, a leading provider of authentication and Internet payment processing solutions. The transaction closed on June 30, 2007. The purchase price originally agreed to in the arrangement agreement was approximately CDN$19.5 million (U.S.$18.3 million) consisting of CDN$7.6 million in cash (U.S.$7.1 million), CDN$5.0 million (U.S.$4.7 million) in two-year promissory notes and CDN$6.9 million (U.S.$6.5 million) in the Corporation’s common stock paid at closing. On June 30, 2008, former Beanstream shareholders also received an additional CDN$2.0 million (U.S.$1.97 million) in the Corporation’s common stock upon the Corporation’s achievement of certain revenue milestones by June 30, 2008 (see Note 9).

In accordance with CICA Section 1581, “Business Combinations” (“CICA 1581”) which corresponds to the FASB issued authoritative guidance on business combinations as applicable to the Corporation, the Corporation has applied the purchase method and has consolidated the results of operations of Beanstream commencing July 1, 2007.

Pursuant to the arrangement agreement, the Beanstream shareholders had an option to elect to accept shares of the Corporation in lieu of a portion of the cash consideration. The amount of the share-for-cash election was not known until June 27, 2007, therefore, the measurement date for the consideration paid by the Corporation was determined to be June 27, 2007 rather than April 30, 2007. Consequently, the measurement date is June 27, 2007 and the total purchase price paid has been calculated as follows:

| | Number of Shares | U.S. ($) |
|---|---|---|
| Cash | - | 7,153,759 |
| Promissory Notes 1 | - | 4,693,073 |

| | | |
|---|---|---|
| Common Shares 2 | 1,963,555 | 8,538,737 |
| Finders Fee Common Shares | 144,933 | 640,604 |
| Transaction Costs | - | 1,102,578 |
| | | |
| Purchase Price | | 22,128,751 |

1 The promissory notes are secured by Beanstream's assets, bear interest at 8% per annum and are payable in two equal installments on June 30, 2008 and June 30, 2009. The Corporation has the ability to prepay the promissory notes without penalty at its discretion. The balance of $2,100,920 at March 31, 2009 (March 31, 2008 - $5,167,383) includes $118,920 in accrued interest (March 31, 2008 - $296,462) and $370,692 in an unrealized foreign exchange gain (March 31, 2008 – ($177,847)).

2 The value of shares issued to complete the transaction was determined using the weighted average share price of approximately $4.35 per share for the Corporation's stock for the period of five days prior to and following the measurement date of the acquisition.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

3. ACQUISITION OF BEANSTREAM (continued)

The increase in purchase price from the U.S.$18.3 million above to the U.S.$22.1 million recorded was a result of changes in the Canadian/U.S. currency exchange rate and increases in the trading price of the Corporation's common stock between April 30, 2007 and June 27, 2007, and also due to a finders fee and other transaction costs related to the acquisition.

The purchase price was allocated as follows:

| | |
|---|---|
| Cash | $3,989,336 |
| Funds held for merchants | 2,812,117 |
| Accounts receivable, net | 258,223 |
| Prepaid expenses | 79,124 |
| Restricted cash | 158,520 |
| Accounts payable and accrued liabilities | (1,052,378 ) |
| Funds due to merchants | (2,812,117 ) |
| Amounts due to former shareholders of Beanstream 1 | (3,350,552 ) |
| Book value of deferred revenue (recorded as goodwill2) | (82,273 ) |
| Net working capital acquired 1 | - |
| Property and equipment | 71,401 |
| Net identifiable assets | 71,401 |
| Goodwill 2 | 15,985,350 |
| Intangible assets | 6,072,000 |
| | $22,128,751 |

1 The arrangement agreement included a provision whereby the Corporation acquired Beanstream with a $NIL working capital (as defined in the arrangement agreement) balance. Accordingly, the working capital acquired from Beanstream on June 30, 2007 included an accrual in the amount of $3,350,552 recognizing the excess working capital balance of Beanstream due to the former shareholders of Beanstream.

2 The goodwill is not deductible for tax purposes.

On the statement of cash flows, the acquisition of Beanstream, net of cash acquired, is shown as a net cash outflow of $7,286,834 calculated as follows:

| | |
|---|---|
| Cash consideration paid | $(7,153,759) |
| Beanstream cash acquired | 6,801,453 |
| Funds held for merchants (Note 6) | (2,812,117) |
| Amounts due to former shareholders of Beanstream | (3,229,078) |
| Transaction costs incurred 1 | (893,333 ) |

| | |
|---|---|
| Acquisition of Beanstream, net of cash acquired | $(7,286,834) |

1 In addition to the $893,333 transaction costs paid, the Corporation incurred transaction costs of $209,245 that were incurred and paid prior to March 31, 2007.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

3. ACQUISITION OF BEANSTREAM (continued)

Pro forma Information (Unaudited)

The following pro forma consolidated financial summary is presented as if the acquisition of Beanstream was completed as of April 1, 2007. The pro forma combined results have been prepared for informational purposes only and do not purport to be indicative of the results which could have actually been attained had the business combination been consummated on the dates indicated or of the results which may be expected to occur in the future.

| | Year Ended March 31, 2008 |
|---|---|
| REVENUE | $12,962,645 |
| COSTS OF REVENUE | 5,649,699 |
| GROSS PROFIT | 7,312,946 |
| OPERATING EXPENSES | |
| General and administrative | 5,777,830 |
| Sales and marketing | 271,545 |
| Product development and enhancement | 222,993 |
| Amortization and depreciation | 1,038,750 |
| INCOME (LOSS) BEFORE OTHER INCOME (EXPENSES) AND INCOME TAXES | 1,828 |
| Foreign exchange loss | (229,661) |
| Other (expense) income, net | (246,918) |
| (Loss) gain on disposal/abandonment of property and equipment | (726,325) |
| Interest income | 372,252 |
| Interest expense | (449,822) |
| LOSS BEFORE INCOME TAXES | (1,278,646) |
| Income taxes | 784,704 |
| NET LOSS | $(2,063,350) |
| LOSS PER SHARE, basic and diluted | $(0.09) |

| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING | |
|---|---|
| Basic | 22,388,183 |
| Diluted | 22,388,183 |

4. ECONOMIC DEPENDENCE

During the fiscal year ended March 31, 2010, revenue from the Corporation’s largest customer amounted to approximately 15.8% of total revenue (2009 – 18.9%; 2008 – 15.1%). Revenue from the Corporation’s largest customer amounted to approximately $2,335,078 (2009 – $2,337,761; 2008 - $1,715,753). The Corporation is economically dependent on revenue from this customer.

5. FINANCIAL INSTRUMENTS

(a) The Corporation classifies its cash and cash equivalents, funds held for merchants and restricted cash as held-for-trading. Accounts receivable are classified as loans and receivables. Accounts payable and certain accrued liabilities, funds due to merchants, and promissory notes are classified as other liabilities, all of which are measured at amortized cost (using the effective interest rate method).

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

5. FINANCIAL INSTRUMENTS (continued)

CICA Handbook Section 3862, "Financial Instruments – Disclosures", establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair values. The Corporation's held-for-trading financial instruments at March 31, 2010 and 2009 are classified as "Level One – Quoted prices in active markets" and consist of cash and cash equivalents, funds held for merchants and restricted cash.

Carrying value and fair value of financial assets and liabilities as at March 31, 2010 and 2009 are summarized as follows:

| | March 31, 2010 | | March 31, 2009 | |
|---|---|---|---|---|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Held-for-Trading | $11,304,762 | $11,304,762 | $17,185,291 | $17,185,291 |
| Loans and receivables | 799,584 | 799,584 | 801,087 | 801,087 |
| Held-to-maturity | - | - | - | - |
| Available-for-sale | - | - | - | - |
| Other liabilities | 7,681,469 | 7,681,469 | 14,418,590 | 14,418,590 |

Management reviewed all significant financial instruments held by the Corporation and determined that no material differences between fair value and carrying value existed as at the reporting date.

(b) Restricted cash

Under the terms of the processing agreement with one of the Corporation's processing banks, the Corporation pledged a deposit of $175,000 (March 31, 2009 - $175,000) against charge back losses. Non-current restricted cash represents funds held by a third party processor as security for the Corporation's merchant accounts.

(c) Market Risk

Currency Risk

The Corporation's functional currency is the U.S. dollar except for the Corporation's Beanstream subsidiary whose functional currency is the Canadian dollar. The Corporation is exposed to foreign exchange risk from fluctuations in exchange rates between the U.S. dollar and the Canadian dollar. Significant losses may occur due to significant balances of cash and cash equivalents and short-term investments held in Canadian dollars that may be affected negatively by an increase in the value of the U.S. dollar as compared to the Canadian dollar. The Corporation has not hedged its exposure to foreign currency fluctuations.

As at March 31, 2010 and March 31, 2009, the Corporation is exposed to currency risk through its cash and restricted cash, accounts receivable, accounts payable, accrued liabilities, and promissory notes denominated in Canadian dollars as follows:

| | March 31, 2010 | March 31, 2009 |
|---|---|---|
| Cash and restricted cash | CDN$4,905 | CDN$1,172,539 |
| Accounts receivable | 6,147 | 50,476 |
| Accounts payable | 93,041 | 132,570 |
| Accrued liabilities | 320,259 | 333,360 |
| Promissory notes | - | 2,100,920 |

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

5. FINANCIAL INSTRUMENTS (continued)

Based on the above foreign currency exposure as at March 31, 2010 and March 31, 2009 and assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in an increase/decrease of $40,225 and $134,384 respectively, in the Corporation's foreign currency loss/gain.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Corporation's exposure to interest rate risk is limited as its cash and payment processing accounts earn minimal interest and its promissory notes bear a fixed interest rate.

Other Price Risk

Other price risk is the risk that the future value or cash flows of a financial instrument will fluctuate because of changes in market prices. Exposure to price risk is low as the Corporation's cash management policy is to invest excess cash in high grade/low risk investments over short periods of time.

(d) Credit Risk

Credit risk is the risk of a financial loss if a customer or counter party to a financial instrument fails to meet its contractual obligations. Any credit risk exposure on cash balances is considered negligible as the Corporation places funds or deposits only with major established banks in the countries in which it has payment processing services. The credit risk arises primarily from the Corporation's trade receivables from customers.

On a regular basis, the Corporation reviews the collectability of its trade accounts receivable and establishes an allowance for doubtful accounts based on its best estimates of any potentially uncollectible accounts. As at March 31, 2010, the balance of the Corporation's allowance for doubtful accounts was $31,463 (March 31, 2009 - $31,785).  The Corporation has good credit history with its customers and the amounts due from them are received as expected.

Pursuant to their respective terms, accounts receivable are aged as follows at March 31, 2010:

| | |
|---|---|
| 0-30 days | $675,562 |
| 31-60 days | 112,843 |
| 61-90 days | 17,804 |
| Over 90 days due | 24,838 |
| | $831,047 |

Concentration of credit risk

Financial instruments that potentially subject the Corporation and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable.

Cash and cash equivalents are invested in major financial institutions in the U.S. and Canada. Such deposits may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Corporation's investments are financially sound and, accordingly, relatively minimal credit risk exists with respect to these investments.

LML PAYMENT SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

5. FINANCIAL INSTRUMENTS (continued)

The accounts receivable of the Corporation and its subsidiaries are derived from sales to customers located primarily in the U.S. and Canada. The Corporation performs ongoing credit evaluations of its customers. The Corporation generally does not require collateral.

An allowance for doubtful accounts is determined with respect to those amounts that the Corporation has determined to be doubtful of collection. At March 31, 2010, three customers accounted for 25%, 19% and 4% of the Corporation's accounts receivable balance (March 31, 2009 – 26%, 16% and - %).

(e) Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are due. The Corporation continuously monitors actual and forecasted cash flows to ensure, as far as possible, there is sufficient working capital to satisfy its operating requirements.

| | Total | Less than 1 year | 2-3 years | 4-5 years | After 5 years |
|---|---|---|---|---|---|
| Contractual Obligations | | | | | |
| Accounts payable and accrued liabilities | $1,876,717 | $1,876,717 | $- | $- | $- |
| Funds due to merchants | 5,804,752 | 5,804,752 | - | - | - |
| Capital lease obligations | 21,035 | 11,195 | 4,920 | 4,920 | - |
| Operating lease obligations | 826,322 | 225,939 | 486,485 | 113,898 | - |
| Purchase obligations | 198,740 | 169,940 | 28,800 | - | - |
| Total | $8,727,566 | $8,088,543 | $520,205 | $118,818 | $- |

6. CASH AND CASH EQUIVALENTS AND FUNDS HELD FOR/DUE MERCHANTS

Cash and cash equivalents

At March 31, 2010, the Corporation held $5,069,763 (March 31, 2009: $6,138,530) in cash and cash equivalents. Included in this balance is $1 million in cash and cash equivalents used as continuing collateral security with the Corporation's primary financial institution which is available for use to the Corporation.

Funds held for/due to merchants

At March 31, 2010, the Corporation was holding funds due to merchants in the amount of $5,804,752 (2009 – $10,746,731). The funds held for/due to merchants are comprised of the following:

- funds held in reserves calculated by applying contractually determined percentages of the gross transaction volume for a hold-back period of up to six months;
- funds from transaction payment processing which may be held for up to approximately fifteen days, the actual number of days depends on the contractual terms with each merchant; and

- funds from payroll/pre-authorized debit services provided on behalf of merchants, which may be held for up to approximately two days.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

## 7. PROPERTY AND EQUIPMENT

| | 2010 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization and Depreciation | Net Book Value |
| Computer equipment | $1,573,735 | $ 1,512,148 | $61,587 |
| Computer software | 1,321,428 | 1,232,253 | 89,175 |
| Furniture and fixtures | 293,768 | 291,717 | 2,051 |
| Leasehold improvements | 260,692 | 259,423 | 1,269 |
| Office equipment | 744,269 | 678,886 | 65,383 |
| Website & trademarks | 38,186 | 38,071 | 115 |
| Total cost | $4,232,078 | $ 4,012,498 | $219,580 |

| | 2009 | | |
|---|---|---|---|
| | Cost | Accumulated Amortization and Depreciation | Net Book Value |
| Computer equipment | $1,502,769 | $ 1,431,452 | $71,317 |
| Computer software | 1,237,098 | 1,158,332 | 78,766 |
| Furniture and fixtures | 293,768 | 290,660 | 3,108 |
| Leasehold improvements | 260,143 | 258,667 | 1,476 |
| Office equipment | 715,886 | 643,730 | 72,156 |
| Website & trademarks | 38,186 | 37,685 | 501 |
| Total cost | $4,047,850 | $ 3,820,526 | $227,324 |

Depreciation expense on property and equipment totaled $138,270 in 2010, $124,441 in 2009 and $367,809 in 2008. Property and equipment include $29,770 of assets that are financed under capital leases for the year ended March 31, 2010 and $7,367 of an asset that is financed under a capital lease for the years ended March 31, 2009 and 2008. Accumulated amortization on these assets totals $1,849, $3,806 and $2,333 for the years ended March 31, 2010, 2009 and 2008, respectively. Amortization of assets under capital lease is included in depreciation expense and totaled $1,731 in 2010, $1,473 in 2009 and $245,115 in 2008.

## 8. PATENTS

| | 2010 | 2009 |
|---|---|---|
| Cost | $2,045,715 | $2,045,715 |
| Less: accumulated amortization | 1,590,411 | 1,422,985 |
| Net book value | $455,304 | $622,730 |

Amortization expense totaled $167,426 in 2010, $165,743 in 2009 and $166,316 in 2008.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unless otherwise indicated, all dollar amounts are U.S. dollars)

8. PATENTS (continued)

Estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows:

Years ending March 31

| | |
|---|---|
| 2011 | $ 165,950 |
| 2012 | $ 165,950 |
| 2013 | $ 123,404 |
| 2014 | $ - |
| 2015 | $ - |

9. GOODWILL AND INTANGIBLE ASSETS

On June 30, 2008, additional contingent consideration became payable under the Beanstream arrangement agreement. Pursuant to the agreement and due to Beanstream meeting certain performance related criteria, additional consideration from the Corporation of CDN$2,000,000 became payable. The payment of this additional consideration resulted in an increase in the purchase price and goodwill recorded.

| | |
|---|---|
| Original goodwill recognized on acquisition | $15,903,077 |
| Additional contingent consideration (CDN $2,000,000) | 1,971,125 |
| Goodwill related to Beanstream acquisition on March 31, 2009 | $17,874,202 |

The Corporation had the right to pay the additional consideration in cash or through the issuance of shares of its common stock with such shares to be issued at a price equal to the volume weighted average of the closing price of one share of the Corporation's common stock as reported on the NASDAQ Stock Exchange during the ten trading days immediately before the earn-out record date (June 30, 2008). The Corporation elected to pay such additional consideration through the issuance of 774,576 shares of its common stock to the former Beanstream shareholders.

During the fiscal year ended March 31, 2008, the Corporation recorded intangible assets of $6,072,000 in connection with the acquisition of Beanstream (see Note 3).

Acquired intangible assets related to the acquisition of Beanstream include partner relationships, merchant contracts, existing technology and trade names. The partner relationships and merchant contracts are amortized over ten years on a straight-line basis. The existing technology is amortized over five years on a straight-line basis. Trade names are not amortized.

The components of acquired intangible assets are as follows:

| | 2010 | | | 2009 | |
|---|---|---|---|---|---|
| | Accumulated | | | Accumulated | |
| Gross | Amortization | Net | Gross | Amortization | Net |

| | | | | | | |
|---|---|---|---|---|---|---|
| Amortizable intangible assets: | | | | | | |
| Partner relationships | $928,000 | $ 255,200 | $672,800 | $928,000 | $ 162,400 | $765,600 |
| Merchant contracts | 2,963,500 | 814,963 | 2,148,537 | 2,963,500 | 518,613 | 2,444,887 |
| Existing technology | 530,000 | 291,500 | 238,500 | 530,000 | 185,500 | 344,500 |
| Unamortized intangible assets: | | | | | | |
| Trade names | 1,650,500 | - | 1,650,500 | 1,650,500 | - | 1,650,500 |
| | $6,072,000 | $ 1,361,663 | $4,710,337 | $6,072,000 | $ 866,513 | $5,205,487 |

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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9. GOODWILL AND INTANGIBLE ASSETS (continued)

Amortization expense for intangible assets totaled $495,150 for the fiscal year ended March 31, 2010 (2009 - $495,150; 2008 - $371,363).

10. OBLIGATIONS UNDER CAPITAL LEASE

In March 2010, the Corporation entered into a lease agreement with Ikon Financial Services to finance an equipment purchase of $11,269. Lease payments are due monthly under the lease term of sixty (60) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Accordingly, these amounts have been recorded as a capital lease.

In September 2009, the Corporation entered into a lease agreement with Dell Financial Services Canada to finance an equipment purchase of $17,470. Lease payments are due monthly under the lease term of twelve (12) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Accordingly, these amounts have been recorded as a capital lease.

In February 2007, the Corporation entered into a lease agreement with IBM Credit LLC to finance two IBM Mainframe hardware purchases totaling $1,139,106. Lease payments were due on the last day of each month under the lease term of thirty-six (36) months. Title to the equipment transferred to the Corporation at the expiration of the lease. Accordingly these amounts were recorded as a capital lease. During the fourth quarter of our fiscal year ended March 31, 2008, the Corporation consolidated its four data centers, which were running two distinct processing platforms, into two data centers with a single processing platform. Consequently, the Corporation disposed and abandoned the two IBM Mainframes for a net loss of approximately $726,000 and incurred other costs relating to the consolidation of the data centers of approximately $247,000. The Corporation sold two components of the IBM Mainframe and remained obligated on the balance of approximately $174,000 as at March 31, 2009, which was satisfied with monthly payments over the remaining ten (10) months of the lease agreement. As at March 31, 2010, the Corporation has no further obligation on the lease agreement with IBM Credit LLC.

| Future minimum payments due | 2010 | 2009 |
|---|---|---|
| 2010 | $ - | $ 174,927 |
| 2011 | 12,226 | - |
| 2012 | 2,460 | - |
| 2013 | 2,460 | - |
| 2014 | 2,460 | - |
| 2015 | 2,460 | - |
| Less amount representing interest | (1,031) | (4,684) |
| Net principal balance | 21,035 | 170,243 |

| | | |
|---|---|---|
| Less current portion | (11,195 ) | (170,243 ) |
| | $9,840 | $- |

The lease is collateralized by the equipment under capital lease.

LML PAYMENT SYSTEMS INC.

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## 11. SHARE CAPITAL

### (a) Weighted average common shares outstanding

As a result of the net losses incurred for 2010, the effect of dilutive securities would have been anti-dilutive to the diluted loss per common share computations and were thus excluded. Dilutive securities that would otherwise have been included in the determination of the weighted average number of common shares outstanding for the purposes of computing diluted earnings per common share included 500,000 issuable under stock options.

For the fiscal years ended March 31, 2009, the Corporation's stock options and warrants have been excluded from the calculation of diluted earnings per share and diluted weighted average common shares outstanding. This is because the average trading price of the Corporation's publically traded shares was below the stock option and warrants exercise price.

As a result of the net losses incurred for 2008, the effect of dilutive securities would have been anti-dilutive to the diluted loss per common share computations and were thus excluded. Dilutive securities that would have otherwise been included in the determination of the weighted-average number of common shares outstanding for the purposes of computing diluted earnings per common share included 2,162,500 for 2008.

### (b) Contributed Surplus

| | Years ended March 31 | | |
|---|---|---|---|
| Contributed Surplus | 2010 | 2009 | 2008 |
| Opening contributed surplus | $6,732,059 | $5,391,187 | $3,443,292 |
| Financial advisor fee (see Note 11(e)) | - | - | 649,500 |
| Reallocation of contributed surplus on exercise of options | (17,817) | - | - |
| Stock-based compensation | 1,238,101 | 1,340,872 | 1,287,210 |
| Stock-based compensation – future income taxes | - | - | 11,185 |
| Closing contributed surplus | $7,952,343 | $6,732,059 | $5,391,187 |

### (c) Stock Options

The Corporation maintains three stock option plans; the 1996 Stock Option Plan (the "1996 Plan"), the 1998 Stock Incentive Plan (the "1998 Plan") and the 2009 Stock Incentive Plan (the "2009 Plan"). The 10-year term of the 1998 Plan expired on July 28, 2008 and, accordingly, the 4,825,217 shares that had remained available for grant pursuant to additional options or other equity awards may no longer be granted under that plan (although, outstanding awards under the 1998 Plan are not affected by the expiration of the term and will continue to be governed by the provisions of the plan). A total of 6 million shares may be granted under each of the 1996 Plan and the 2009 Plan. All director, officer and employee stock options are granted under either the 1996 Plan or the 2009 Plan. The exercise price of stock options granted under the 1996 Plan and the 2009 Plan is 100% of the fair market value on the date the stock option is granted. Stock options granted to independent directors vest one year from the date of grant and are exercisable for a period of five years in accordance with the compensation plan adopted for the Corporation's independent directors during the fiscal year ended March 31, 2005. Stock options granted to executive officers have varying vesting schedules, which range from immediate vesting of all of the stock options granted to vesting over a five-year period, and are exercisable for periods ranging from five to ten years. Stock options granted to employees normally vest over a three-year period and are exercisable for a period of five years from the date of grant. Generally, stock options granted to employees are forfeited 30 days after leaving the employment of the Corporation.

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11. SHARE CAPITAL (continued)

The 500,000 stock options granted in the fiscal year ended March 31, 2010 have a grant date fair value of a range from a low of $0.38 to a high of $0.44.

The fair value for the 2010 stock option grants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

- Risk-free interest rate of 2.30% to 2.32%;
- Expected volatility of 77.93% to 78.09%;
- Expected life of the stock option of 4 years; and
- No dividend yields.

The total fair value of stock-based compensation is amortized over the vesting of previously issued stock options and resulted in a stock-based compensation expense of $1,238,101 for the fiscal year ended March 31, 2010 (2009 - $1,340,872; 2008 - $1,287,210).

There were no stock options issued during the fiscal year ended March 31, 2009.

The 2,775,000 stock options granted in the fiscal year ended March 31, 2008 have a grant date fair value of a range from a low of $1.43 to a high of $1.82.

The fair value for the 2008 stock option grants was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

- Risk-free interest rate of 3.8% to 4.5%;
- Expected volatility of 54.3% to 57.5%;
- Expected life of the stock option of 4 years; and
- No dividend yields.

At March 31, 2010, 1,317,000 common shares were reserved for issuance pursuant to the 1996 Plan and 5,800,000 common shares were reserved for issuance pursuant to the 2009 Plan. This amount reflects the limit of shares collectively to be granted pursuant to the 1996 Plan and the 2009 Plan less the number of shares that have been granted and are still outstanding and the number of shares that have been granted and exercised. The 10-year term of the 1998 Stock Incentive Plan has expired and, accordingly, no additional options or other equity awards may be granted under that plan (however, outstanding awards under the 1998 Stock Incentive Plan are not affected by the expiration of the term and will continue to be governed by the provisions of the plan).

The following table summarizes information about the stock options outstanding:

| | Options outstanding | | | Options exercisable | | |
|---|---|---|---|---|---|---|
| Range ($) | Total # of Shares | Weighted average | Weighted average | Total # of Shares | Weighted average | Weighted average |

| | | exercise price | contract life remaining (years) | | exercise price | contract life remaining (years) |
|---|---|---|---|---|---|---|
| 0.65 | 375,000 | $0.65 | 4.38 | 93,750 | $0.65 | 4.38 |
| 2.95 | 240,000 | 2.95 | 1.52 | 240,000 | 2.95 | 1.52 |
| 3.00-3.90 | 2,800,000 | 3.34 | 5.62 | 2,035,900 | 3.34 | 5.49 |
| 4.52 | 225,000 | 4.52 | 0.40 | 225,000 | 4.52 | 0.40 |
| | 3,640,000 | 3.11 | 4.90 | 2,594,650 | 3.31 | 4.64 |

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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11. SHARE CAPITAL (continued)

Stock option activity for the three preceding years is as follows:

| | 2010 | | 2009 | | 2008 | |
|---|---|---|---|---|---|---|
| | Total # of Shares | Weighted average exercise price | Total # of Shares | Weighted average exercise price | Total # of Shares | Weighted average exercise price |
| Stock options outstanding, beginning of year | 4,005,000 | $3.74 | 4,207,500 | $3.73 | 2,225,500 | $4.59 |
| Granted | 500,000 | 0.68 | - | - | 2,775,000 | 3.35 |
| Forfeited | (740,000) | 5.28 | (202,500) | 3.53 | (766,750) | 4.91 |
| Exercised | (125,000) | 0.76 | - | - | (26,250) | 2.95 |
| Stock options outstanding, end of year | 3,640,000 | 3.11 | 4,005,000 | 3.74 | 4,207,500 | 3.73 |

(d) Beanstream acquisition additional contingent consideration

During the fiscal year ended March 31, 2009, the Corporation issued shares of its common stock pursuant to an earn-out provision in the Beanstream arrangement agreement. The issuance consisted of 774,576 of its common stock to the former Beanstream shareholders (see Note 9).

(e) Private Placement

In March, 2008, the Corporation completed a private placement of common stock. The private placement consisted of 4,000,000 common shares at a purchase price of $1.80 per common share, which realized the Corporation $7,200,000. The Corporation paid a financial advisor a 6.5% fee in cash as well as warrants to acquire 400,000 shares of the Corporation's common stock. The warrants are exercisable at $3.40 per share and are exercisable for a period of five years from March 26, 2008.

The fair value of the private placement warrants was calculated as $1.62 per share, based on the Black-Scholes fair value pricing model with the following assumptions:

- Risk-free interest rate of 3.825%;
- Expected volatility of 57.5%;
- Expected life of the warrants of 4 years; and
- No dividend yields.

The total fair value of approximately $649,500 is included in contributed surplus.  As of March 31, 2010, all warrants remain outstanding.

## 12. EMPLOYEE BENEFIT PLAN

The Corporation has a defined contribution 401(k) plan (the "Plan") for eligible employees. The Plan requires that the Corporation match 50% of eligible employees' contributions, up to 6% of their compensation. The Corporation recorded matching contribution expenses for the years ended March 31, 2010, 2009 and 2008 of $4,070, $2,769, and $22,327, respectively.

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## 13. INCOME TAXES

At March 31, 2010, the Corporation has Canadian non-capital loss carry-forwards for income tax purposes of approximately $3,300,642 and U.S. federal net operating loss carry-forwards of $7,677,379. Due to Canadian and U.S. tax "change of ownership" rules, the loss carry-forwards are restricted in their use. These losses expire as follows:

| Canadian non-capital loss-carry-forwards: | | U.S. federal net operating loss carry-forwards: | |
|---|---|---|---|
| 2015 | $1,000,785 | 2011 | $ 258,499 |
| 2025 to 2030 | 2,299,857 | 2017 to 2030 | 7,418,880 |
| | $3,300,642 | | $7,677,379 |

Future income taxes reflect the net 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 Corporation's future tax assets as of March 31, 2009 and 2008 are as follows:

| | 2010 | 2009 |
|---|---|---|
| Future tax assets: | | |
| Excess of tax value over the net book value for capital assets | $708,083 | $639,669 |
| Stock-based compensation | 1,180,357 | 1,180,357 |
| Canadian non-capital loss carry-forwards | 858,167 | 2,374,035 |
| U.S. federal net operating loss carry-forwards | 2,840,630 | 3,330,372 |
| U.S. alternative minimum tax carry-forwards | 92,418 | - |
| Total future tax assets | 5,679,655 | 7,524,433 |
| Valuation allowance for future tax assets | (1,992,322) | (2,256,280) |
| Net future tax assets | $3,687,333 | $5,268,153 |

A portion of potential income tax benefits related to future tax assets have not been recognized in the accounts as their realization did not meet the requirements of "more likely than not" under the liability method of tax allocation due to the Corporation's history of losses.

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expense (recovery), using a 29.63% statutory tax rate at March 31, 2010, 30.63% statutory tax rate at March 31, 2009 and a 31% statutory tax rate at March 31, 2008 is as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Income taxes at statutory rates | $186,266 | $316,566 | $(498,000 ) |
| State income taxes | 16,800 | 16,800 | 16,800 |
| Stock-based compensation – future income taxes | - | - | 11,185 |

| | | | |
|---|---|---|---|
| Stock-based compensation and other permanent differences | 333,806 | 489,341 | 544,000 |
| Effect of U.S. tax rates | 89,158 | 71,986 | 10,000 |
| Expiration of loss carry-forwards | (80,496) | 361,900 | 268,000 |
| Effect of foreign exchange translation of foreign currency denominated future tax assets | 531,811 | - | - |
| Effect of change in tax rates and other | 472,997 | (74,762) | 1,154,000 |
| Utilization of U.S. federal net operating losses | - | 590,587 | 88,000 |
| (Decrease) Increase in valuation allowance | (263,958) | (6,193,900) | (979,643) |
| | $1,286,384 | $(4,421,482) | $614,342 |

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## 13. INCOME TAXES (continued)

During the Corporation's 2010 assessment of the realizability of its future tax assets, the Corporation considered all available positive and negative evidence including its past operating results, the existence of cumulative losses and its forecast of future taxable income. In determining future taxable income, the Corporation is responsible for assumptions utilized including the amount of pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates it uses to manage the underlying businesses. Based upon this assessment, the Corporation decreased the valuation allowance for the fiscal year ended March 31, 2010 as the realization of future tax assets of $3,687,333 meet the requirements of "more likely than not" under the liability method of tax allocation.

## 14. COMMITMENTS AND CONTINGENCIES

(a) During the fiscal year ended March 31, 2007 a subsidiary of the Corporation received notification that it had been named in a class-action lawsuit filed in the United States District Court, Eastern District, Marshall Division, Texas, alleging that numerous defendants, including the subsidiary of the Corporation, violated the Driver's Privacy Protection Act regulating the use of personal information such as driver's license numbers and home addresses contained in motor vehicle records held by motor vehicle departments, by not having a permissible use in obtaining the State of Texas' entire database of names, addresses and other personal information. During the fiscal year ended March 31, 2009, the complaint was dismissed with prejudice. Also during the fiscal year ended March 31, 2009, the plaintiffs appealed this decision. On November 4, 2009 oral arguments were heard by the Fifth Circuit of appeals. While a ruling has not been received, the subsidiary of the Corporation believes it is likely the dismissal will be affirmed. The subsidiary of the Corporation believes that these allegations are without merit and does not expect them to have a material adverse effect on its results of operations, financial position or liquidity.

(b) During the fiscal year ended March 31, 2009, a subsidiary of the Corporation filed a patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against multiple financial institutions operating in the United States. In the suit, the subsidiary of the Corporation alleges that the defendants infringe U.S. Patent No. RE40,220. The subsidiary of the Corporation is seeking damages, injunctive and other relief for the alleged infringement of these patents.

During the fiscal year ended March 31, 2010, CitiBank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the Northern District of Illinois, Eastern Division against a subsidiary of the Corporation, in an action styled Citibank, N.A. as plaintiff vs. LML Payment Systems Corp. In the suit, Citibank, N.A. alleges that the subsidiary of the Corporation infringes U.S. Patent No. 7,020,639 and is seeking damages and injunctive and other relief. The subsidiary of the Corporation believes these allegations are without merit and intends to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminable and any amount likely to be payable is unknown.

During the fiscal year ended March 31, 2010, JP Morgan Chase Bank, N.A., an affiliate of one of the defendants in the LML Suit, filed a complaint for patent infringement in the U.S. District Court for the District of Delaware against two subsidiaries of the Corporation in an action styled JP Morgan Chase Bank N.A. as plaintiff vs. LML Payment Systems Corp. and Beanstream Internet Commerce Inc. In the suit, JP Morgan Chase Bank N.A. alleges that the services provided through the subsidiaries of the Corporation infringe U.S. Patent Nos. 5,917,965 and 6,341,724 and is seeking damages and injunctive and other relief. On May 13, 2009, the plaintiff in this suit filed an amended complaint alleging the same two subsidiaries of the Corporation provide services that infringe U.S. Patent Nos. 5,940,844 and 6,098,052. The subsidiaries of the Corporation believe these allegations are without merit and intend to vigorously defend against them. At this time, the likelihood of success of this suit is indeterminable and any amount likely to be payable is unknown.

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14. COMMITMENTS AND CONTINGENCIES (continued)

During the fiscal year ended March 31, 2010, a subsidiary of the Corporation filed another patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against six financial institutions operating in the United States. In the suit, the subsidiary of the Corporation alleges that the defendants infringe U.S. Patent No. RE40,220 and is seeking damages and injunctive and other relief for the alleged infringement of this patent.

Also during the fiscal year ended March 31, 2010 a subsidiary of the Corporation entered into a Settlement and License Agreement (the "License Agreement") with one of the defendants (the "Released Defendant") in the patent infringement lawsuit originally filed on November 19, 2008 in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40,220. The subsidiary of the Corporation sought damages, injunctive and other relief for the alleged infringement of this patent. The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to the subsidiary of the Corporation's patents for electronic check conversion transactions including "ARC", "WEB", "POP", "TEL" and "BOC". In connection with the License Agreement, the Released Defendant paid the subsidiary of the Corporation compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to a retention agreement with its legal firm, the subsidiary of the Corporation paid $307,754 in legal fees for the firm's services in connection with the License Agreement.

The License Agreement contained a number of elements for which revenue has been recognized in these consolidated financial statements under the guidance of EIC-175, which does not differ materially from the application required under the FASB issued authoritative guidance on revenue arrangements with multiple deliverables. Total consideration received under the License Agreement has been allocated to each of the following deliverables using the relative selling price method:

- Licenses –the Corporation has issued a license for the use of existing patents. This revenue has been recognized in the period.
- Release from litigation –the Corporation has agreed to release the Released Defendant from any claims or causes of action for patent infringement as of the effective date. This revenue has been recognized in the period.
- Covenant-not-to-sue provision –the Corporation has agreed to a covenant-not-to-sue provision for infringement of any patents for a specified period commencing on the effective date of the License Agreement. This revenue has been deferred and will be recognized ratably over the specified period.

(c) The Corporation is a party to additional ordinary litigation incidental to its business, none of which is expected to have a material adverse effect on results of operations, financial position or liquidity of the Corporation.

(d) Operating lease obligations

Future minimum lease payments for obligations under operating leases, including premises for the next five years and thereafter, are as follows:

| | |
|---|---|
| 2011 | $225,939 |

| | |
|---|---|
| 2012 | 254,465 |
| 2013 | 232,020 |
| 2014 | 113,898 |
| 2015 and thereafter | - |
| | $826,322 |

The Corporation's rent expense totaled $338,526 in 2010, $307,521 in 2009 and $443,420 in 2008.

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14. COMMITMENTS AND CONTINGENCIES (continued)

(e) Purchase obligations

Future minimum payments under all other contractual purchase obligations for the next five years and thereafter, are as follows:

| | |
|---|---|
| 2011 | $169,940 |
| 2012 | 28,800 |
| 2013 | - |
| 2014 | - |
| 2015 and thereafter | - |
| | $198,740 |

15. SUBSEQUENT EVENTS

Subsequent to the fiscal year ended March 31, 2010 a subsidiary of the Corporation entered into a Settlement and License Agreement (the "PNC License Agreement") with another of the defendants (the "Second Released Defendant") in the patent infringement lawsuit originally filed on November 19, 2008 in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40,220. The subsidiary of the Corporation sought damages, injunctive and other relief for the alleged infringement of this patent. The PNC License Agreement was effective June 2, 2010 and provided the Second Released Defendant with a fully paid-up license to the subsidiary of the Corporation's patents for electronic check conversion transactions including "ARC", "WEB", "POP", "TEL" and "BOC". In connection with the PNC License Agreement, the Second Releas Defendant paid the subsidiary of the Corporation compensation in the amount of $1,375,000 for releases, licenses, covenants and all other rights granted under the PNC License Agreement.

Also subsequent to the fiscal year ended March 31, 2001, four of the defendants in the Patent Litigation submitted a request for inter partes reexamination to the United States Patent and Trademark Office ("USPTO") regarding U.S. Patent RE40,220. The USPTO is evaluating the inter partes reexamination request and will make a determination as to whether it will order a re-examination. An inter partes re-examination is a USPTO administrative proceeding requested by a third party (the "Third Party Requester") to challenge the validity of patents that have already issued. In inter partes re-examination, a person challenges the patent by submitting a "request" to the USPTO. The request must supply prior art references and make proposed rejections of claims. The request is assigned to a patent Examiner in the Central Re-examination Unit of the Patent Office. The Examiner decides whether the request raises a "substantial new question of patentability", and if so, begins an inter partes re-examination proceeding.

In the event the re-examination is granted, the Examiner will typically issue a non-final office action rejecting one or more of the claims. We may file a response, which can amend the claims to avoid prior art, and, under certain circumstances, add new claims. Within one month of the service date of our response, the Third Party Requester may file comments. The Examiner will then consider the filings and issue an "Action Closing Prosecution". The Action Closing Prosecution is not final and may be appealed by either party. We may respond to the Action Closing

Prosecution and if we do so, the Third Party Requester may again file comments. A "Right of Appeal Notice" typically follows. The "Right of Appeal Notice" is a final but appealable office action. From there, either party may appeal the decision to the Patent Office Board of Appeals and Interferences ("Board") and then to the Court of Appeals for the Federal Circuit ("Federal Circuit"). Whether the Examiner will decide to order a re-examination and, if so, the results of such proceeding (including any appeals that may be made) are indeterminable at this time.

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## 16. CAPITAL MANAGEMENT DISCLOSURES

The Corporation's objectives when managing capital are to safeguard its ability to support its normal operating requirements on an ongoing basis, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and to provide an adequate return to shareholders by pricing products and services commensurately with the level of risk.

The capital structure of the Corporation consists of obligations under a capital lease and shareholders' equity. The Corporation manages its capital structure and makes adjustments to it in light of economic conditions. The Corporation, upon approval from its Board of Directors, will balance its overall capital structure through new share issues or by undertaking other activities as deemed appropriate under the specific circumstances.

The Corporation is not subject to any externally imposed capital requirements. The Corporation's overall strategy with respect to capital risk management remains unchanged from the year ended March 31, 2009.

## 17. INDUSTRY AND GEOGRAPHIC SEGMENTS

Based upon the way financial information is provided to the Corporation's Chief Executive Officer for use in evaluating allocation of resources and assessing performance of the business, the Corporation reports its operations in three distinct operating segments, described as follows:

TPP operations involve financial payment processing, authentication and risk management services provided by Beanstream. The services are accessible via the Internet and are offered in an application service provider (ASP) model.

IPL operations involve licensing an intellectual property estate, which includes five U.S. patents describing electronic check processing methods.

CP/SL operations involve primary and secondary check collection including electronic check re-presentment (RCK) and software licensing.

Within these segments, performance is measured based on revenue, factoring in interest income and expenses and amortization and depreciation as well as income before income taxes from each segment. There are no transactions between segments. The Corporation does not generally allocate corporate or centralized marketing and general and administrative expenses to its business unit segments because these activities are managed separately from the business units.

Financial information for each reportable segment for the fiscal years ended March 31, 2010, 2009 and 2008 was as follows:

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17 INDUSTRY AND GEOGRAPHIC SEGMENTS (continued)

| Fiscal Year Ended March 31, 2010 | TPP Canada | IPL U.S. | CP/SL U.S. | Reconciling Items | | Consolidated Total |
|---|---|---|---|---|---|---|
| Total Revenue | $9,639,219 | $2,871,753 | $2,314,695 | $- | | $ 14,825,667 |
| Revenue: major customers (Note 4) | 2,335,078 | 2,299,337 | 1,295,356 | - | | 5,929,771 |
| Cost of revenue | 5,625,000 | 447,773 | 1,434,550 | 148,228 | 1 | 7,655,551 |
| General and administrative | 912,233 | 13,472 | 552,163 | 2,860,046 | 2 | 4,337,914 |
| Sales and marketing | 391,059 | - | 22,533 | 3,025 | 1 | 416,617 |
| Product development and enhancement | 419,285 | - | - | 48,401 | 1 | 467,686 |
| Amortization and depreciation | 60,061 | 167,676 | 56,640 | 516,470 | 3 | 800,847 |
| Income (losses) before income taxes | 1,980,273 | 2,245,125 | 244,577 | (3,309,417) | 4 | 1,160,558 |
| Property and equipment | 94,591 | - | 101,190 | 23,799 | | 219,580 |
| Goodwill | 17,874,202 | - | - | - | | 17,874,202 |

| Fiscal Year Ended March 31, 2009 | TPP Canada | IPL U.S. | CP/SL U.S. | Reconciling Items | | Consolidated Total |
|---|---|---|---|---|---|---|
| Total Revenue | $7,848,819 | $1,703,977 | $2,826,052 | $- | | $ 12,378,848 |
| Revenue: major customers (Note 4) | 2,337,761 | 1,222,224 | 1,402,637 | - | | 4,962,622 |
| Cost of revenue | 4,278,214 | 2,247 | 1,627,640 | 149,716 | 1 | 6,057,817 |
| General and administrative | 643,471 | 18,724 | 639,078 | 3,039,886 | 2 | 4,341,159 |
| Sales and marketing | 293,961 | - | 26,109 | 3,033 | 1 | 323,103 |
| Product development and enhancement | 223,965 | - | - | 48,534 | 1 | 272,499 |
| Amortization and depreciation | 42,791 | 168,199 | 61,668 | 512,676 | 3 | 785,334 |
| Income (losses) before income taxes | 2,708,590 | 1,560,206 | 414,202 | (3,649,314) | 4 | 1,033,684 |
| Property and equipment | 95,454 | 249 | 88,200 | 43,421 | | 227,324 |
| Goodwill | 17,874,202 | - | - | - | | 17,874,202 |

| Fiscal Year Ended March 31, 2008 | TPP Canada | IPL U.S. | CP/SL U.S. | Reconciling Items | Consolidated Total |
|---|---|---|---|---|---|
| Total Revenue | $5,636,564 | $1,670,247 | $4,021,067 | $- | $ 11,327,878 |
| Revenue: major customers (Note 4) | 1,715,753 | 1,222,224 | 2,356,049 | - | 5,294,026 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Cost of revenue | 3,001,840 | - | 1,763,657 | 42,449 | 1 | 4,807,946 |
| General and administrative | 336,615 | 18,468 | 2,146,428 | 3,158,183 | 2 | 5,659,694 |
| Sales and marketing | 144,772 | - | 80,188 | 2,975 | 1 | 227,935 |
| Product development and enhancement | 153,902 | - | - | 23,802 | 1 | 177,704 |
| Amortization and depreciation | 19,161 | 167,122 | 338,053 | 381,152 | 3 | 905,488 |
| Income (losses) before income taxes | 2,203,221 | 1,613,249 | (1,348,273) | (4,074,683) | 4 | (1,606,486) |
| Property and equipment | 76,843 | 1,054 | 139,558 | 29,373 | | 246,828 |
| Goodwill | 15,903,077 | - | - | - | | 15,903,077 |

1 Represents stock-based compensation expense.

2 Represents stock-based compensation expense and other unallocated corporate or centralized marketing, general and administrative expenses

3 Represents amortization and depreciation included in the unallocated corporate or centralized marketing, general and administrative expenses.

4 Represents income (losses) included in the unallocated corporate or centralized marketing, general and administrative expenses.

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18. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

These consolidated financial statements are prepared using Canadian GAAP, which does not differ materially from U.S. GAAP with respect to the accounting policies and disclosures in these financial statements except as set out below:

(a) Under U.S. GAAP, the Corporation could not affect the reduction in deficit of $22,901,744 by reducing the stated capital of the shares of the Corporation's common stock.

(b) Income Taxes

In June 2006, the FASB issued authoritative guidance regarding accounting for uncertainty in income taxes. This guidance clarifies the recognition threshold and measurement of a tax position taken or expected to be taken on a tax return, and requires expanded disclosure with respect to the uncertainty in income taxes. The guidance also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. The guidance is effective for fiscal years beginning after December 15, 2006.

The Corporation adopted the provisions of the guidance on April 1, 2007. No cumulative effect adjustment to the April 1, 2007 balance of the Corporation's deficit was required upon the implementation. As of the date of adoption there were no unrecognized tax benefits. Under current conditions and expectations, management does not foresee any unrecognized tax benefits that would have a material impact on the Corporation's consolidated financial statements.

(c) Changes in U.S. GAAP

Recent accounting pronouncements affecting the Corporation's financial reporting under U.S. GAAP are summarized below:

(i) In June 2009, the FASB issued accounting standards related to its accounting standards codification of the hierarchy of generally accepted accounting principles. The new standard is the sole source of authoritative generally accepted accounting principles of the United States ("U.S. GAAP") to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification superseded non-SEC accounting and reporting standards. All accounting literature that is not in the Codification, not issued by the SEC and not otherwise grandfathered is non-authoritative. The new standard is effective for the Corporation's interim quarterly period beginning July 1, 2009. Applying the guidance in the accounting standards codification did not impact the Corporation's financial position or results of operations. The corporation has revised its references to post-Codification GAAP in its consolidated financial statements.

(ii) In September 2006, the FASB issued authoritative guidance which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Corporation has fully adopted this guidance in the first quarter of fiscal 2010. Adoption of this guidance had no impact on the consolidated financial statements except for note disclosure (see Note 5).

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18. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)

(iii) In December 2007, the FASB issued authoritative guidance regarding business combinations. This guidance is broader in scope than previous guidance that applied only to business combinations in which control was obtained by transferring consideration. The new guidance applies to all transactions and other events in which one entity obtains control over one or more other businesses. The new guidance is effective for fiscal years beginning after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance did not have an impact on the consolidated financial statements and the accompanying notes. The impact of this guidance will not be known until such time as the Corporation enters into a business combination, however, a difference between Canadian GAAP and U.S. GAAP would probably arise on business combinations entered into prior to April 1, 2011 due to the equivalent Canadian guidance not being adopted until April 1, 2011.

(iv) In December 2007, the FASB issued authoritative guidance regarding non-controlling interest in consolidated financial statements. The new guidance changes the accounting for, and the financial statement presentation of, non-controlling equity interests in a consolidated subsidiary. The new guidance establishes non-controlling interests as a component of the equity of a consolidated entity.

The underlying principle of the new guidance is that both the controlling interest and the non-controlling interests are part of the equity of a single economic entity: the consolidated reporting entity. Classifying non-controlling interests as a component of consolidated equity is a change from the previous FASB issued authoritative guidance of treating minority interests as a mezzanine item between liabilities and equity or as a liability. The change affects both the accounting and financial reporting for non-controlling interests in a consolidated subsidiary.

This guidance is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance has had no impact on the consolidated financial statements and the accompanying notes.

(v) In March 2008, the FASB changed its authoritative guidance regarding disclosures about derivative instruments and hedging activities. The changes in guidance require enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. This guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance has had no impact on the consolidated financial statements and the accompanying notes.

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18. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)

(vi) In April 2008, the FASB issued authoritative guidance regarding the determination of the useful life of intangible assets. This guidance removes the requirement to consider whether an intangible asset can be renewed without substantial cost of material modifications to the existing terms and conditions and, instead, requires an entity to consider its own historical experience in renewing similar arrangements. The guidance also requires expanded disclosure related to the determination of intangible asset useful lives. This guidance is effective for fiscal years beginning after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. The FASB issued authoritative guidance also requires that the Corporation perform tests for impairment of its goodwill annually and between annual tests in certain circumstances. As of March 31, 2010, the Corporation had recorded goodwill in connection with its acquisition of Beanstream in June 2007, with a carrying value of approximately $17.9 million. Significant judgments are required to evaluate goodwill for impairment including the determination of reporting units, estimating future cash flows, determining appropriate discount rates and other assumptions. The Corporation evaluates the goodwill related to the Beanstream acquisition on an annual basis as of March 31 or when indicators of impairment may exist. The Corporation did not record any goodwill or intangible asset impairment charges during fiscal 2010.

The FASB issued authoritative guidance also requires that the Corporation perform tests for impairment of its intangible assets subject to amortization annually and more frequently whenever events or circumstances suggest that its intangible assets may be impaired. The Corporation evaluates the intangible assets related to the Beanstream acquisition on an annual basis as of March 31 or when indicators of impairment may exist. As of March 31, 2010, the Corporation had recorded intangible assets in connection with its acquisition of Beanstream with a carrying value of approximately $4.7 million.

To evaluate potential impairment, the FASB issued authoritative guidance require the Corporation to assess whether the estimated fair value of its goodwill and intangible assets are greater than their respective carrying value at the time of the test. Accordingly, there could be significant judgment in determining the fair values attributable to goodwill and intangible assets, including the determination of reporting units, estimating future cash flows, determining appropriate discount rates and other assumptions.

(vii) In May 2008, the FASB issued authoritative guidance regarding debt with conversion and other options requiring issuers of convertible debt instruments that may be settled in cash to separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in periods subsequent to adoption. Upon adoption, the Corporation will allocate a portion of the proceeds received from the issuance of convertible notes between a liability and equity component by determining the fair value of the liability component using the Corporation's non-convertible debt borrowing rate. The difference between the proceeds of the notes and the fair value of the liability component will be recorded as a discount on the debt with a corresponding offset to paid-in-capital. The resulting discount will be accreted by recording additional non-cash interest expense over the expected life of the convertible notes using the effective interest rate method. The provisions of the FASB authoritative guidance on debt with conversion and other options are to be applied retrospectively to all periods presented upon adoption and are effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. The Corporation currently does not have any convertible debt instruments and, accordingly, the adoption of FASB authoritative guidance on debt with conversion and other options is not expected to have any impact on the Corporation's financial position or results of operations.

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18. RECONCILIATION OF CANADIAN TO UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (continued)

(viii) In April 2009, the FASB issued authoritative guidance regarding determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same, and provides additional guidance on when market level data should not be relied upon or should be adjusted in determining fair value. This guidance is effective for interim periods and fiscal years ending after June 15, 2009. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has not had a material impact on the consolidated financial statements and the accompanying notes.

(ix) In April 2009, the FASB issued authoritative guidance regarding interim disclosures about fair value of financial instruments. This guidance functions to require, on an interim basis, disclosures about the fair value of financial instruments for public entities. This guidance is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has had no material impact on the consolidated financial statements and the accompanying notes.

(x) In May 2009, the FASB issued authoritative guidance regarding subsequent events. The new statement provides additional guidance on what events that occur subsequent to the balance sheet date will be recognized and/or disclosed. It also provides guidance on the date through which subsequent events have to be evaluated. This statement shall be effective for interim and annual financial periods ending after June 15, 2009, and shall be applied prospectively. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has not had a material impact on the consolidated financial statements and the accompanying notes.

(xi) In October 2009, the FASB issued authoritative guidance on certain revenue arrangements that include software elements that is effective for fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. Under the new guidance, tangible products that contain software components and non-software components that function together to deliver the tangible product's essential functionality and undelivered elements that relate to software that is essential to the functionality of the tangible product are not within the scope of the software revenue recognition guidance. The Corporation has early adopted this guidance in the fiscal year ended March 31, 2010.

(xii) In October 2009, the FASB issued authoritative guidance on multiple-deliverable revenue arrangements that is effective for fiscal years on or after June 15, 2010, with earlier adoption permitted. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements including, but not limited to, significant judgments made in applying the guidance and how changes in the judgments or in the application of the guidance may significantly affect either the timing or amount of revenue recognition. The Corporation has early adopted this guidance in the fiscal year ended March 31, 2010. Under the previous revenue recognition guidance, some of the revenue related to the IPL segment may have been deferred.