ZEROREZ FRANCHISING SYSTEMS, INC.

Audited Financial Statements

December 31, 2004 and 2003

Zerorez Franchising Systems, Inc.

Financial Statements

December 31, 2004 and 2003

Contents

Child, Sullivan & Company

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Independent Accountants' Report

To the Board of Directors and Shareholders
Zerorez Franchising Systems, Inc.

We have audited the balance sheets of Zerorez Franchising Systems, Inc. (the Company) as of December 31, 2004 and 2003, and the related statements of operations, changes in stockholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements are based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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Zerorez Franchising Systems, Inc.
Balance Sheets

	December 31, 2004	December 31, 2003 (restated – note 6)
Assets		
Current assets:		
Cash	$ 78,152	$ 14,533
Accounts receivable	185,437	173,085
Accounts receivable - related entities (Note 2)	66,071	9,282
Total current assets	329,660	196,900
Fixed Assets:		
Vehicles	133,320	-
Furniture and equipment	6,126	-
Less: accumulated depreciation	(5,652)	-
Net fixed assets	133,794	-
Total assets	$ 463,454	$ 196,900
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Accounts payable	$ 8,916	$ 30,328
Accounts payable - related entities (Note 2)	54,027	131,027
Advances payable - related entities (Note 2)	-	193,613
Accrued liabilities	12,800	-
Warranty reserve	8,000	8,000
Current portion of long-term debt	23,489	-
Total current liabilities	107,232	362,968
Long-term liabilities:		
Notes payable-less current portion	104,237	-
Stockholders' equity (deficit) (Note 4):		
Common stock; .0001 par value, 50,000,000 shares authorized, 12,646,114 and 12,406,529 shares issued and outstanding, respectively	1,264	1,240
Additional paid-in-capital	548,583	159,993
Accumulated deficit	(297,862)	(327,301)
Total stockholders' equity (deficit)	251,985	(166,068)
Total liabilities and stockholders' equity (deficit)	$ 463,454	$ 196,900

See accompanying notes to financial statements.

Zerorez Franchising Systems, Inc.
Statements of Operations

	Years ended December 31, 2004	2003
Revenues		
Sales	$ 1,780,129	$ 997,969
Sales - related entities (Note 2)	6,639	33,383
Franchise fees	315,365	22,029
Total revenues	2,102,133	1,053,381
Cost of goods sold	(1,330,581)	(843,502)
Cost of goods sold - related entities (Note 2)	(2,695)	(31,988)
Total cost of goods sold	(1,333,276)	(875,490)
Gross Profit	768,857	177,891
Other Expenses		
Other general and administrative	296,097	55,665
Advertising	91,534	3,709
Management, legal and consulting fees	28,100	30,192
Management, legal, engineering and professional fees - related entities (Note 2)	306,424	70,264
Depreciation	5,652	8,353
Rent-related entities (Note 2)	9,500	-
Total other expenses	737,307	168,183
Net operating income before other income (expense) and income taxes	31,550	9,708
Other income (expense)		
Miscellaneous	216	1,287
Interest expense	(2,327)	-
Loss on disposal of fixed assets	-	(8,500)
Total other income (expense)	(2,111)	(7,213)
Net income (loss) before income taxes	29,439	2,495
Income taxes (Note 7)	-	-
Net income (loss)	$ 29,439	$ 2,495

See accompanying notes to financial statements.

Zerorez Franchising Systems, Inc.
Statements of Changes in Stockholders' Equity (Deficit)

	Common Stock		Additional Paid in Capital	Accumulated deficit	Total
	Shares	Amount			
Balance at January 1, 2003 (restated – note 6)	12,406,529	$ 1,240	$ 159,993	$ (329,796)	$ (168,563)
Net income	-	-		2,495	2,495
Balance at December 31, 2003	12,406,529	1,240	159,993	(327,301)	(166,068)
Common stock issued for cash, net of offering costs	100,000	10	169,990	-	170,000
Common stock issued for cash-related entities	30,278	3	60,552	-	60,555
Common stock issued for extinguishment of debt-related entities	109,307	11	218,603	-	218,614
Notes payable issued for return of capital-related entities (note 2)	-	-	(60,555)	-	(60,555)
Net income	-	-	-	29,439	29,439
Balance at December 31, 2004	12,646,114	$ 1,264	$ 548,583	$ (297,862)	$ 251,985

See accompanying notes to financial statements.

Zerorez Franchising Systems, Inc.
Statements of Cash Flows

	Years ended December 31, 2004	2003 (restated–note 6)
Operating activities		
Net income	$ 29,439	$ 2,495
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	5,652	8,353
Loss on disposal of fixed assets	-	8,500
Changes in operating assets and liabilities:		
Accounts receivable	(12,352)	(173,085)
Accounts receivable - related entities	(56,789)	(9,282)
Accounts payable	(21,411)	15,328
Accounts payable - related entities	(52,000)	87,497
Accrued liabilities	12,800	-
Warranty reserve	-	8,000
Net cash used in operating activities	(94,661)	(52,194)
Investing activities		
Purchase of fixed assets	(139,446)	-
Net cash used in investing activities	(139,446)	-
Financing activities		
Proceeds from advances payable - related entities	-	68,027
Payments on advances payable - related entities	-	(4,639)
Payments on notes payable - related entities	(60,555)	-
Proceeds from long-term debt	133,320	-
Principal payments on long-term debt	(5,594)	-
Proceeds from issuance of common stock, net of offering costs	230,555	-
Net cash provided by financing activities	297,726	63,388
Net increase in cash	63,619	11,194
Cash at beginning of year	14,533	3,339
Cash at end of year	$ 78,152	$ 14,533
Supplemental disclosures:		
Income taxes paid	$ -	$ -
Interest paid in cash	$ 2,327	$ -
Non-cash investing and financing activities:		
Notes payable issued for return of capital - related entities	$ 60,555	$ -
Common stock issued for extinguishment of debt - related entities	$ 218,614	$ -

See accompanying notes to financial statements.

Zerorez Franchising Systems, Inc.
Notes to Financial Statements
December 31, 2004 and 2003

1. Organization and Summary of Significant Accounting Policies

This summary of significant accounting policies of Zerorez Franchising Systems, Inc. (the Company) is presented to assist in understanding the Company's financial statements. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the accompanying financial statements.

Business activity
Zerorez Franchising Systems, Inc., formerly H2O AquaCare Franchising Systems, Inc., was organized in January 2002, and incorporated in Nevada in February 2002. The Company engages in the business of operating and franchising complete floor and fabric care and cleaning services, and licensing franchises to operate a "Zerorez" business in certain markets. The Company also manufactures, sells, and distributes equipment, accessories, and supplies to potential franchisees.

Income taxes
The Company recognizes the tax effects of transactions in the year in which such transactions enter into the determination of net income, regardless of when reported for tax purposes. Deferred taxes are provided in the financial statements under Financial Accounting Standards Board Statement No. 109 to give effect to the resulting temporary differences which may arise from differences in the bases of fixed assets, depreciation methods, allowances, and start-up costs based on the income taxes expected to be payable in future years. Deferred tax assets arising as a result of net operating loss carry forwards have been offset completely by a valuation allowance due to the uncertainty of their utilization in future periods. Operating loss carryforwards generated through the periods ending December 31, 2004 of approximately $220,000 will begin to expire in 2021.

Estimates
Preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates. Actual amounts may differ from those reported.

Fixed Assets
Fixed assets as of December 31, 2004 and 2003 are recorded at cost and have been depreciated using the straight-line method over estimated useful lives of five (5) years. During 2003, the Company disposed of fixed assets previously used for demonstration purposes. These assets had a net book value of $8,500 at the time of disposal and are considered obsolete. Therefore, a loss on the disposal of fixed assets was recorded.

Advertising Costs
The Company generally expenses advertising costs as incurred. Advertising expenses were $91,534 and $3,709 for 2004 and 2003, respectively.

1. Organization and Summary of Significant Accounting Policies (continued)

Credit Risk and Concentrations

The Company's customers may be affected by changing economic conditions. Management believes that its credit review procedures, and loss reserves (if any) have adequately provided for usual and customary credit-related losses. The carrying amount of trade receivables and other receivables approximates fair value. The Company's policy for charging off trade receivables is to consider write-down of receivables extending beyond 120 days after significant collection efforts have been made or when the financial condition of debtors warrant charge-off. Trade receivables are determined to be past due after 90 days regardless of whether partial payments have been received. To date, sales have all been to Zerorez franchisees scattered throughout the country.

Revenue recognition

The Company recognizes revenues from the installation and retrofit of specialized carpet cleaning equipment onto trucks built for use by carpet cleaning companies. Generally, revenue is separated as accessory sales, truck sales, and machine sales. Accessory sales consist of wands, pumps, and kits required for cleaning carpets and furniture. Truck sales consist of a truck chassis retrofitted with a truck box, tanks, and related parts. Machine sales consist of the proprietary equipment developed by Electric Aquagenics Unlimited, Inc. (EAU), an affiliated entity from which the Company's franchisees are required to purchase products for use in its carpet cleaning businesses. Revenue related to accessory and truck sales is recognized upon delivery of a retrofitted truck, including any accessories that have been ordered for that truck. Machine sales are recognized upon delivery of the machine itself and do not necessarily coincide with accessory or truck sales. In addition, the Company had no inventory of accessories, trucks or machines to be installed under purchase orders still in progress at December 31, 2004 or 2003.

The Company also recognizes revenues from franchise fees. The minimum initial franchise fee, due upon the completion of initial training and the commencement of operations, entitles the franchisee to one exclusive operating territory. In addition to the initial franchise fee, the franchisee must purchase a proprietary cleaning system package (components of the package are described in the preceding paragraph) from the Company before the start of operations. Delivery of the completed proprietary cleaning system package constitutes the extent of services to be performed by the Company as required by the franchise agreement. Other fees include a royalty fee and an advertising contribution that are based on percentages of the franchisees' gross receipts, both due on a monthly basis. Of the $315,365 and $22,029 in franchise fees recognized as revenue during 2004 and 2003, respectively, $182,500 and $20,000 is for initial franchise fees and $132,865 and $2,029 is for monthly royalty fees, respectively. As of December 31, 2004, the Company recorded accounts receivable of $62,819 for initial franchise fees and $23,725 for monthly royalty fees that are due but not yet collected. As of December 31, 2003, the Company recorded accounts receivable of $14,444 for initial franchise fees.

1. Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

For the purpose of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents. The Company had no cash equivalents other than cash at December 31, 2004 and 2003.

Reclassifications

Certain 2003 amounts have been reclassified to conform to the 2004 presentation.

2. Related Party Transactions

The Company sold products to affiliates or shareholders. Total sales to these entities and cost of sales for the periods ended December 31, 2004 and 2003 are as follows:

	2004	2003
Sales	$ 6,639	$ 33,383
Cost of sales	2,695	31,988
Gross profit	$ 3,944	$ 1,395

Accounts receivable from related entities for advances and product sales were $66,071 and $9,282 at December 31, 2004 and 2003, respectively.

The Company incurred $306,424 and $70,264 in management, legal, engineering and consulting fees with stockholders or other affiliates during 2004 and 2003, respectively. Also, the Company reimbursed related entities $17,681 for the payment of operating expenses.

Some of the Company's operating expenses were funded by EAU. As of December 31, 2003, the Company had received advances made to support operations in the normal course of business totaling $193,613 due at December 31, 2003. During 2004, the Company extinguished $218,614, including the balance due at December 31, 2003, for 109,307 shares of common stock valued at $2 a share. In addition, the Company purchased $200,000 and $252,500 in machines during 2004 and 2003, respectively, to be included in the sale of accessories, trucks, and machines to various franchisees. As of December 31, 2004 and 2003, the Company owed EAU $25,000 and $100,000 for those machines. Also, the Company has entered into a facilities lease agreement with an affiliate, which has been accounted for as an operating lease. The contract rent amount is $1,000 per month, with rent expense of $9,500 and $0 charged to operations for 2004 and 2003, respectively. The landlord did not charge the Company rent in 2003 due to cash flow considerations and since rent in 2003 was considered nominal. There are no minimum lease commitments, as the contract is a year-to-year contract. Rent in the amount of $29,027 and $31,027 was outstanding at December 31, 2004 and 2003, respectively.

2. Related Party Transactions (continued)

The Company issued non-interest bearing notes payable during 2004 to certain related entities in return for originally issued paid in capital in the amount of $60,555. The Company paid these individuals in full for the the amount of $60,555 during 2004.

3. Long-Term Debt

Long-term debt consists of the following at December 31, 2004:

Note payable to a bank, secured by vehicles, payable in monthly installments of $2,640, including interest of 7%, due September 2009.	$ 127,726
Less current portion	23,489
	$ 104,237

Future maturities of long-term debt for the five years succeeding December 31, 2004 are as follows:

2005	$	23,489
2006		25,187
2007		27,008
2008		28,956
2009		23,086
Thereafter		-
	$	127,726

Management estimates the fair values of debt financing instruments are equal to or less than carrying amounts due to the terms of their repayment.

4. Shareholders' Equity

In 2001, the Company issued 443,611 warrants to purchase the Company's common stock at a price of $0.55 per share, exercisable for five years. The warrants were issued for advisory and consulting services and were valued at $.12 per share using the Black-Scholl's method for a total consideration of $53,233. No new warrants were issued during 2003 or 2004. Also in 2001, the Company issued 20,000 warrants to an unrelated entity for services rendered. The warrants are exercisable for five years at a strike price of $ .55 per share. As permitted under FAS 123, "*Accounting for Stock-Based Compensation,*" these warrants were valued at $.12 per share using the Black-Scholls method, resulting in fees valued at $2,400. No new warrants were issued during 2003 or 2004.

4. Shareholders' Equity (continued)

During 2004, the Company commenced a private placement for the sale of 100,000 shares at $2.00 per share. After the successful completion of the offering, the Company paid $30,000 in offering costs which were offset against the proceeds from the offering.

The Company also issued $30,278 shares to an existing shareholder (EAU) for $60,555, and an additional 109,307 shares to EAU to extinguish debt totaling $215,614 (see note 2).

The Company is authorized to issue 5,000,000 shares of $ .0001 par value preferred stock, none of which has been issued as of December 31, 2004.

5. Income Taxes

Income tax expense for the years ended December 31, 2004 and 2003 consists of the following:

	2004	2003
Current-federal	$ -	$ -
Current-state	-	-
	-	-
Deferred-federal	$ -	$ -
Deferred-state	-	-
	-	-
Total	$ -	$ -

A reconciliation of income tax expense to amounts using statutory rates applied to pre-tax income is as follows for the years ended December 31, 2004 and 2003:

	2004	2003
Pretax income, at federal statutory rate of 35%	$ 10,304	$ 873
Expected state taxes on net income	1,472	125
Effect of graduated rates on federal taxes	(7,088)	(1,998)
Redetermination of prior year taxes	(6,481)	-
Change in valuation allowance	(14,800)	1,000
	$ -	$ -

Zerorez Franchising Systems, Inc.
Notes to Financial Statements
December 31, 2004 and 2003

5. Income Taxes (continued)

Deferred income tax (assets) liabilities consist of the tax effect differences in financial reporting assets and liabilities and the related tax bases as follows:

	2004	2003
Warranty reserve	$ (3,200)	$ (3,200)
Depreciation	400	(400)
Net operating losses	(87,800)	(101,800)
Valuation allowance	90,600	105,400
	$ -	$ -

6. Restatement of previously issued financial statements

Certain amounts owed to EAU by predecessor entities of the Company were assumed by the Company under agreements that were finalized in the current year. Because the amounts were incurred in prior years and since the Company had not recorded the obligations of these predecessor entities in previous years, the financial statements have been restated to reflect these obligations. The effect of the restatements on the 2003 financial statements was to increase advances payable – related entities and decrease retained earnings by $63,919.