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## **FINANCIAL INFORMATION**

YEAR END REPORT

DECEMBER 31, 2014

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**VIRTRA SYSTEMS, INC.**

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# OTC PINK DISCLOSURE OBLIGATIONS

## I. NAME OF THE ISSUER AND ITS PREDECESSORS (IF ANY WITHIN PAST FIVE YEARS)

VirTra Systems, Inc.

## II. ADDRESS OF THE ISSUER'S PRINCIPAL EXECUTIVE OFFICES

### Company Headquarters

7970 S. Kyrene Rd. Tempe,  
AZ 85284  
Telephone (480) 968-1488  
www.virtra.com

### IR Contact

Financial Profiles, Inc.  
11601 Wilshire Boulevard  
Suite 1920  
Los Angeles, CA 90025  
Telephone (310) 478-2700  
vtsi@finprofiles.com

## III. SECURITY INFORMATION

Trading Symbol: **VTSI**

CUSIP: **92827K 10 3**

Exact title and class of securities outstanding: **VIRTRA SYSTEMS, INC. PREFERRED STOCK**

Par or Stated Value: **\$0.005**

Total shares authorized: **2,000,000**

as of: **December 31, 2014**

Total shares outstanding: **0**

as of: **December 31, 2014**

Exact title and class of securities outstanding: **VIRTRA SYSTEMS, INC. COMMON STOCK**

Par or Stated Value: **\$0.005**

Total shares authorized: **500,000,000**

as of: **December 31, 2014**

Total shares outstanding: **158,285,045**

as of: **December 31, 2014**

### Transfer Agent

Continental Stock and Transfer & Trust Company  
17 Battery Place, 8th Floor  
New York, NY 10004  
Telephone (212) 509-4000  
Fax (212) 616-7610

### Is the Transfer Agent registered under the Exchange Act?

Yes. Continental Stock and Transfer & Trust Company is registered under the Exchange Act. Its regulatory authority is the Securities and Exchange Commission and the Banking Commission of New York.

### List any restrictions on the transfer of security:

We previously were a shell company; therefore the exemption offered pursuant to Rule 144 is not available. Anyone who purchased securities directly or indirectly from us or any of our affiliates in a transaction or chain of transactions not involving a public offering cannot sell such securities in an open market transaction.

### Describe any trading suspension orders issued by the SEC in the past 12 months:

None.

## IV. ISSUANCE HISTORY

List below any events, in chronological order, that resulted in changes in total shares outstanding by the issuer in the past two fiscal years and any interim period. The list shall include all offerings of securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services, describing (1) the securities, (2) the persons or entities to whom such securities were issued and (3) the services provided by such persons or entities. The list shall indicate:

- The nature of each offering (e.g., Securities Act Rule 504, intrastate, etc.);
- Any jurisdictions where the offering was registered or qualified;
- The number of shares offered;
- The number of shares sold;
- The price at which the shares were offered, and the amount actually paid to the issuer;
- The trading status of the shares; and
- Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act.

<b>Date</b>	<b>Number of Shares</b>	<b>Price Offered/Paid</b>	<b>Issued To</b>	<b>Nature of Transaction</b>
	158,285,045		December 31, 2012;	Total number of shares outstanding
	-			No events
	158,285,045		December 31, 2014;	Total number of shares outstanding

## V. FINANCIAL STATEMENTS

SEMPLE, MARCHAL & COOPER, LLP  
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

SMC

2700 NORTH CENTRAL AVENUE, NINTH FLOOR, PHOENIX, ARIZONA 85004-1147

### Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
VirTra Systems, Inc.

We have audited the accompanying balance sheets of VirTra Systems, Inc. as of December 31, 2014 and 2013 and the related statements of operations, stockholders' equity, 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 based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits 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 Company'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 financial statements referred to above present fairly, in all material respects, the financial position of VirTra Systems, Inc. at December 31, 2014 and 2013, 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.

*Simple, Marchal & Cooper, LLP*

Certified Public Accountants

Phoenix, Arizona  
March 31, 2015

TEL 602-241-1500 • FAX 602-234-1867 • [WWW.SEMPLECPA.COM](http://WWW.SEMPLECPA.COM)

**VIRTRA SYSTEMS, INC.**  
**BALANCE SHEETS**  
as of **DECEMBER 31, 2014 and 2013**

	<b>2014</b>	<b>2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents.....	\$ 1,912,729	\$ 2,358,955
Accounts receivable.....	1,610,381	786,877
Inventory.....	702,829	407,434
Prepaid expenses and other current assets.....	58,124	44,902
Total current assets.....	4,284,063	3,598,168
Property and equipment, net.....	367,898	460,513
Total assets.....	<b>\$ 4,651,961</b>	<b>\$ 4,058,681</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable.....	\$ 339,373	\$ 289,820
Accrued compensation and related costs.....	394,920	588,097
Accrued expenses and other current liabilities.....	147,904	153,875
Deferred revenue.....	952,464	1,516,792
Total current liabilities.....	1,834,661	2,548,584
Long-term liabilities:		
Accrued rent liability - long-term.....	95,375	144,990
Total liabilities.....	1,930,036	2,693,574
Commitments and contingencies		
Stockholders' equity:		
Preferred stock \$0.005 par value; 2,000,000 shares authorized; no shares issued or outstanding as of December 31, 2014 and 2013.....	-	-
Common stock \$0.005 par value; 500,000,000 shares authorized; 158,328,245 shares issued and 158,285,045 shares outstanding as of December 31, 2014 and 2013, respectively.....	791,641	791,641
Additional paid-in capital.....	13,239,621	13,144,044
Treasury stock at cost, 43,200 common shares as of December 31, 2014 and 2013, respectively.....	(2,981)	(2,981)
Accumulated deficit.....	(11,306,356)	(12,567,597)
Total stockholders' equity.....	2,721,925	1,365,107
Total liabilities and stockholders' equity.....	<b>\$ 4,651,961</b>	<b>\$ 4,058,681</b>

The accompanying notes are an integral part of the financial statements.

**VIRTRA SYSTEMS, INC.**  
**STATEMENTS OF OPERATIONS**  
**For the Years Ended DECEMBER 31, 2014 and 2013**

	<b>2014</b>	<b>2013</b>
Net revenues.....	\$ 9,860,019	\$ 9,819,519
Cost of products sold.....	4,352,550	3,361,307
Gross profit.....	5,507,469	6,458,212
General and administrative expenses.....	4,243,826	4,864,056
Income from operations.....	1,263,643	1,594,156
Other income/(expense):		
Other income.....	2,343	847
Other expense.....	(4,745)	(14,227)
Net other income/(expense).....	(2,402)	(13,380)
Income before income taxes.....	1,261,241	1,580,776
Income tax expense/(benefit).....	-	-
Net income.....	\$ 1,261,241	\$ 1,580,776
Weighted average of common and common equivalent shares outstanding:		
-Basic.....	158,285,045	158,285,045
-Diluted.....	163,145,302	159,199,484
Net income per common and common equivalent share:		
-Basic.....	\$ 0.01	\$ 0.01
-Diluted.....	\$ 0.01	\$ 0.01

The accompanying notes are an integral part of the financial statements.

**VIRTRA SYSTEMS, INC.**  
**STATEMENTS OF STOCKHOLDERS' EQUITY**  
**For the Years Ended December 31, 2014 and 2013**

	<u>Common stock</u>		<u>Additional paid-in capital</u>	<u>Treasury Stock</u>	<u>Accumulated Deficit</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at January 1, 2013.....	158,285,045	\$ 791,641	\$ 13,032,498	\$ (2,981)	\$(14,148,373)	\$ (327,215)
Net income.....	-	-	-	-	1,580,776	1,580,776
Stock-based compensation.....	-	-	111,546	-	-	111,546
Balance at December 31, 2013.....	158,285,045	791,641	13,144,044	(2,981)	(12,567,597)	1,365,107
Net income.....	-	-	-	-	1,261,241	1,261,241
Stock-based compensation.....	-	-	95,577	-	-	95,577
Balance at December 31, 2014.....	<u>158,285,045</u>	<u>\$ 791,641</u>	<u>\$ 13,239,621</u>	<u>\$ (2,981)</u>	<u>\$(11,306,356)</u>	<u>\$2,721,925</u>

The accompanying notes are an integral part of the financial statements.



**VIRTRA SYSTEMS, INC.**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2014 and 2013**

	<b>2014</b>	<b>2013</b>
Cash flows from operating activities:		
Net income.....	\$ 1,261,241	\$ 1,580,776
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	192,153	218,059
Stock-based compensation.....	95,577	111,546
Changes in operating assets and liabilities:		
Accounts receivable.....	(823,504)	(323,935)
Inventory.....	(295,395)	(37,415)
Prepaid expenses and other current assets.....	(13,222)	20,656
Accounts payable and other accrued expenses.....	(199,210)	364,133
Deferred revenue.....	(564,328)	343,343
Net cash provided/(used) by operating activities.....	(346,688)	2,277,163
Cash flows from investing activities:		
Purchase of property and equipment.....	(99,538)	(66,192)
Net cash used in investing activities.....	(99,538)	(66,192)
Cash flows from financing activities:		
Draws on line of credit.....	-	150,000
Repayments of line of credit.....	-	(150,000)
Payments on term loan.....	-	(224,135)
Net cash used in financing activities.....	-	(224,135)
Increase/(decrease) in cash and cash equivalents.....	(446,226)	1,986,836
Cash and cash equivalents, beginning of period.....	2,358,955	372,119
Cash and cash equivalents, end of period.....	\$ 1,912,729	\$ 2,358,955
Cash paid during the period for:		
Interest.....	\$ -	\$ 7,738
Taxes.....	\$ -	\$ -

The accompanying notes are an integral part of the financial statements.

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

**1. Significant Accounting Policies**

***Organization and Business Operations***

VirTra Systems, Inc. (the “Company” or “VirTra”) is engaged in the sale and development of judgmental use of force training simulators and firearms training simulators for law enforcement, military and commercial uses. The Company sells simulators and related products worldwide through a direct sales force and international distribution partners. The original business started in 1993 as Ferris Productions, Inc. In September 2001, Ferris Productions, Inc. merged with GameCom, Inc. to ultimately become VirTra Systems, Inc., a Texas Corporation. The corporate office is located in Tempe, Arizona. All transactions are denominated in US dollars.

***Basis of Presentation and Use of Estimates***

The Company’s financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates in these financial statements include valuation assumptions for share-based payments, allowance for doubtful accounts receivable, inventory reserves, accrual for warranty reserves, the carrying value of long-lived assets, income tax valuation allowances and capitalization of labor and overhead to inventory for work in progress. Actual results could differ significantly from those estimates.

***Fair Value of Financial Instruments***

The fair value of financial instruments approximates their carrying values at December 31, 2014 and 2013 due to their short maturities. These financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments with a maturity of 90 days or less at the time of purchase to be cash equivalents.

***Accounts Receivable and Allowance for Doubtful Accounts***

The Company recognizes an allowance for losses on accounts receivable based on an analysis of historical bad debt experience, current receivables aging, and expected future write-offs, as well as an assessment of specific identifiable customer accounts considered at risk or uncollectible. Accounts receivable are charged off after all reasonable collection efforts have been taken. As of December 31, 2014 and 2013, management has determined all receivable balances to be fully collectible and accordingly, no allowance was recognized at such time. Accounts receivable are non-interest bearing and are generally unsecured.

***Inventories***

Inventories are stated at the lower of cost or market with cost being determined on the first-in, first-out method. Work in progress and finished goods inventory includes an allocation for capitalized labor and overhead. Capitalized labor and overhead included in inventory at December 31, 2014 and 2013 are \$40,236 and \$3,807, respectively. The Company routinely evaluates the carrying value of inventory and provides reserves when appropriate to reduce inventory to the lower of cost or market to reflect estimated net realizable value. As of December 31, 2014 and 2013, management has determined all inventory is salable at prices greater than cost and accordingly, no reserve has been recognized at December 31, 2014 or 2013.

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

***Property and Equipment***

Property and equipment are carried at cost, net of depreciation. Gains or losses related to retirements or disposition of fixed assets are recognized in operations in the period incurred. Costs of normal repairs and maintenance are charged to expense as incurred, while betterments or renewals are capitalized. Depreciation commences at the time the assets are placed in service. Depreciation is provided using the straight-line method over the estimated economic lives of the assets or for leasehold improvements, over the shorter of the estimated useful life or the remaining lease term, which are summarized as follows:

Computer equipment.....	3 - 5 years
Furniture and office equipment.....	5 - 7 years
Leasehold improvements.....	7 years

***Revenue Recognition and Deferred Revenue***

Net revenues include sales of products and services and are net of discounts. Product sales consist of simulators, upgrade components, scenarios, scenario software, recoil kits, Threat-Fire<sup>®</sup> and other accessories. Services include installation, limited warranties and related support. Certain of the Company's sales include multiple elements comprising of both products and services. These multiple elements consist of (i) the sale of the product, (ii) installation of the product and (iii) an extended warranty. Each element is considered a separate unit of accounting. The fair values of each unit of accounting are generally established based on the prices charged when sold separately by the Company or based upon estimated selling price. Revenue is allocated to each deliverable based on relative fair values.

The Company recognizes revenue for these products and services when it is realized or realizable and earned. Revenue is considered realized and earned when: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred and/or services have been rendered; (iii) the price is fixed and determinable; and (iv) collection of the resulting receivable is reasonably assured. Shipping fees are charged to customers and recorded as a component of net revenues. All sales and sales contracts, including international sales, have been denominated in US dollars.

***Products***

Revenue from the sale of products is recognized when title and risk of loss passes to the customer. Delivery is considered complete when products have been shipped to the customer, title and risk of loss has transferred to the customer. For customers other than United States federal agencies, the Company generally requires deposits in advance of shipment for customer sales orders. Customer deposits are recorded as a current liability under deferred revenue on the accompanying balance sheet and totaled \$136,779 and \$1,140,800 as of December 31, 2014 and 2013, respectively.

***Services***

Services include installation of product, separately priced extended limited warranties on parts and labor, and technical support. Revenue is recognized for service contracts as earned, which is generally upon completion of installation or, as it relates to the extended warranties, on a straight-line basis over the term of the contract. The Company does warranty its products from manufacturing defects on a limited basis for a period of one year after purchase, but also sells separately priced extended warranties for periods of up to four years after the expiration of the standard one year warranty. After the one year standard warranty expires and during the term of the extended warranty, if the device fails to operate properly from defects in materials and workmanship, the Company will fix or replace the defective product. Deferred revenue for separately priced extended warranties totaled \$815,685 and \$375,992 as of December 31, 2014 and 2013, respectively. The Company's accrual for the one-year manufacturer's warranty liability totaled \$77,400 as of December 31, 2014 and \$40,000 as of December 31, 2013.

***Milestone Method***

During 2013, the Company entered into a contract that consisted of multiple elements. The multiple elements consisted of the development and delivery of the product, the delivery of the spare parts and an extended warranty. The Company identified all goods and/or services that were to be delivered separately under the contract and allocated revenue to each deliverable based on relative fair values. Fair values are generally established based on the prices charged when sold separately by the Company or based upon estimated selling price.

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

The development and delivery of product (the “arrangement”) was accounted for under the Milestone Method. The arrangement consisted of five major milestones. The milestones were 1) Requirements Review, 2) Design Review, 3) Critical Design Review, 4) Factory Acceptance Testing, and 5) Final Acceptance. Each of the milestones was considered substantive as the consideration was commensurate with the Company’s anticipated efforts to achieve the milestone, the consideration for each milestone related solely to past performance and no portion of the milestone consideration was refundable or adjusted after the milestone had been reached. Further, the consideration was reasonable relative to all of the deliverables and payment terms within the arrangement. The arrangement has been completed as of December 31, 2014. Revenue recognized during the years ended December 31, 2014 and 2013 as a result of milestones completed is \$1,098,975 and \$974,472, respectively.

Revenue from the delivery of spare parts and the extended warranty was recognized upon delivery and acceptance of the parts by the customer and, proportionally over the warranty period, respectively.

***Cost of products sold***

Cost of products sold represents manufacturing costs, consisting of materials, labor and overhead related to finished goods and components. Shipping costs incurred related to product delivery are included in cost of products sold.

***Advertising Costs***

Costs associated with advertising are expensed as incurred. Advertising expense was approximately \$241,000 and \$156,000 for the years ended December 31, 2014 and 2013, respectively. These costs include domestic and international tradeshows, website, and sales promotional materials.

***Research and Development Costs***

Research and development costs are expensed as incurred. Research and development costs primarily include expenses directly related to research and development support. Research and development costs were approximately \$1,076,000 and \$1,512,000 for 2014 and 2013, respectively.

***Concentration of Credit Risk and Major Customers and Suppliers***

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Company’s cash and cash equivalents are maintained with financial institutions with high credit standings. The Company had uninsured cash and cash equivalents of \$1,730,948 and \$1,975,496 as of December 31, 2014 and 2013, respectively.

Sales are typically made on credit and the Company generally does not require collateral. Management performs ongoing credit evaluations of its customers’ financial condition and maintains an allowance for estimated losses. Historically, the Company has experienced minimal charges relative to doubtful accounts.

Historically, the Company sells its products primarily to federal and state agencies in the United States. In 2014 one international customer comprised 11.1% of total net sales. In 2013 two international customers comprised 23.5% and 11.1% of total net sales. No other single customer exceeded 10% of net sales for 2014 and 2013, respectively. As of December 31, 2014, the Company’s accounts receivable balances were with twelve customers. As of December 31, 2013, the Company’s accounts receivable balances were with eight customers.

The Company currently purchases small machined parts, custom cartridge assemblies and electronic components from suppliers located in the United States. Although the Company currently obtains many of these components from single source suppliers, the Company could seek to have the parts, customer cartridges and electronic components manufactured elsewhere. As a result, management believes it could obtain alternative suppliers in most cases without incurring significant production delays. The Company acquires its components on a purchase order basis and does not have long-term contracts with suppliers.

***Income Taxes***

Deferred tax assets and liabilities are recorded based on the difference between the financial statement and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company calculates a provision for income taxes using the asset and liability method, under which deferred tax assets and liabilities are recognized by identifying the temporary differences arising from the different treatment of items for tax and accounting purposes. In determining the

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

future tax consequences of events that have been recognized in the financial statements or tax returns, judgment and interpretation of statutes are required.

In assessing the realizability of deferred tax assets, management assesses the likelihood that deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not likely or there is insufficient operating history, a valuation allowance is established. The Company adjusts the valuation allowance in the period management determines it is more likely than not that net deferred tax assets will or will not be realized. As of December 31, 2014 and 2013, the Company has provided a valuation allowance for all net deferred tax assets due to the low volume/high dollar nature of sales.

As of December 31, 2014 and 2013, the Company did not recognize any assets or liabilities relative to uncertain tax positions. Interest or penalties, if any, will be recognized in income tax expense. Since there are no significant unrecognized tax benefits as a result of tax positions taken, there are no accrued penalties or interest. Tax positions are positions taken in a previously filed tax return or positions expected to be taken in a future tax return that are reflected in measuring current or deferred income tax assets and liabilities reported in the financial statements. Tax positions include, but are not limited to, the following:

- an allocation or shift of income between taxing jurisdictions;
- the characterization of income or a decision to exclude reportable taxable income in a tax return; or
- a decision to classify a transaction, entity or other position in a tax return as tax exempt.

The Company reflects tax benefits only if it is more likely than not that the Company will be able to sustain the tax return position, based on its technical merits. If a tax benefit meets this criterion, it is measured and recognized based on the largest amount of benefit that is cumulatively greater than 50% likely to be realized.

The Company is potentially subject to tax audits for its United States federal and Arizona state income tax returns for tax years ended 2012 to 2014 and 2011 to 2014, respectively; however, earlier years may be subject to audit under certain circumstances. Tax audits by their very nature are often complex and can require several years to complete.

***Impairment of Long-lived Assets***

Long lived assets, such as equipment, 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. Fair value is determined based on discounted cash flows or appraised values, depending on the nature of the asset. Assets to be disposed of, if any, would be separately presented in the balance sheet and reported at the lower of their carrying amounts or fair value less costs to sell, and are no longer depreciated. At December 31, 2014 and 2013, the Company concluded that there has been no indication of impairment to the carrying value of its long-lived assets. As such, no impairment has been recorded.

***Stock Based Compensation***

The Company calculates the fair value of stock-based awards using the Black-Scholes-Merton option pricing valuation model, which incorporates various assumptions including volatility, expected term and risk-free interest rates. The assumptions used for the years ended December 31, 2014 and 2013, and the resulting estimates of weighted-average fair value per share of options granted during those periods, are as follows:

	2014	2013
Volatility.....	112% to 116%	113% to 116%
Risk-free interest rate.....	2% to 3%	1% to 3%
Dividend rate.....	-	-
Expected term.....	7 years	7 years
Weighted average fair value of options granted.....	\$ 0.07	\$ 0.04

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on United States Treasury zero-coupon issues with an equivalent remaining term. The Company has not paid dividends in the past and does not plan to pay any dividends in the near future. The estimated fair value of stock-based compensation awards and other options is amortized to expense on a straight line basis over the relevant vesting period. As share-based compensation expense recognized is based on awards ultimately expected to vest, it is reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company's forfeiture rate was calculated based on its historical experience of awards which ultimately vested.

***Net income per common share***

The net income per common share is computed by dividing net income by the weighted average of common shares outstanding. Diluted net income per share reflects the potential dilution that would occur if outstanding stock options were exercised utilizing the treasury stock method. Dilutive shares consisted of the following as of December 31:

	2014	2013
Net income.....	\$ 1,261,241	\$ 1,580,776
Weighted average of common and common equivalent shares outstanding.....	158,285,045	158,285,045
Incremental shares from the assumed exercise of dilutive stock options.....	4,860,257	914,439
Dilutive potential common and common equivalent shares.....	163,145,302	159,199,484
Net income per common and common equivalent shares:		
-Basic.....	\$ 0.01	\$ 0.01
-Diluted.....	\$ 0.01	\$ 0.01

As a result of being considered anti-dilutive, 186,982 and 5,359,363 potentially dilutive options were not included in the incremental shares from the assumed exercise of dilutive stock options for the years ended December 31, 2014 and 2013, respectively.

***New Accounting Pronouncements***

With the exception of those discussed below, no recent accounting pronouncements or changes in accounting pronouncements during the year ended December 31, 2014 are of significance or potential significance to us.

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-15 – Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 defines management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and provides related footnote disclosure requirements. Under U.S. GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting establishes the fundamental basis for measuring and classifying assets and liabilities. The Update provides guidance on when there is substantial doubt about an organization's ability to continue as a going concern and how the underlying conditions and events should be disclosed in the footnotes. It is intended to reduce diversity that existed in footnote disclosures because of the lack of guidance about when substantial doubt existed. The amendments in this Update are effective beginning in the first quarter of 2017. Early application is permitted. The Company is currently evaluating the effect that the updated standard will have on the financial statements and related disclosures.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers" (ASU 2014-09). ASU 2014-09 supersedes nearly all existing revenue recognition guidance under U.S. GAAP and requires revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received

**VIRTRA SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**

for those goods or services. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This accounting guidance will become effective beginning in the first quarter of 2017 using one of two prescribed transition methods. Early adoption is not permitted. The Company is currently evaluating the effect that the updated standard will have on the financial statements and related disclosures.

**2. Inventory**

Inventory consisted of the following as of December 31,:

	<u>2014</u>	<u>2013</u>
Raw materials.....	\$ 603,905	\$ 393,830
Work-in-progress.....	<u>98,924</u>	<u>13,604</u>
Total inventory.....	<u>\$ 702,829</u>	<u>\$ 407,434</u>

**3. Property and Equipment**

Property and equipment consisted of the following as of December 31,:

	<u>2014</u>	<u>2013</u>
Computer equipment.....	\$ 457,283	\$ 382,967
Furniture and office equipment.....	554,214	545,704
Leasehold improvements.....	<u>307,583</u>	<u>259,366</u>
Total property and equipment in use.....	1,319,080	1,188,037
Less: Accumulated depreciation.....	<u>(951,182)</u>	<u>(759,029)</u>
Property and equipment in use, net.....	367,898	429,008
Construction-in-progress.....	<u>-</u>	<u>31,505</u>
Property and equipment, net.....	<u>\$ 367,898</u>	<u>\$ 460,513</u>

As of December 31, 2013 construction-in-progress includes leasehold improvements that were in-progress at year end. The leasehold improvement was completed in August, 2014. Depreciation expense was \$192,153 and \$218,059 for the years ended December 31, 2014 and 2013, respectively.

**4. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consisted of the following at December 31,:

	<u>2014</u>	<u>2013</u>
Standard one-year manufacturer's warranty.....	\$ 77,400	\$ 40,000
State and local taxes.....	55,504	98,875
Other.....	<u>15,000</u>	<u>15,000</u>
Total accrued expenses and other current liabilities.....	<u>\$ 147,904</u>	<u>\$ 153,875</u>

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**5. Related Party Transactions**

The Company reimburses its executive officers for business expenses charged to personal credit cards. The Company makes monthly payments directly to the card issuer for these business expenses incurred on behalf of the Company. As of December 31, 2014 and 2013 the balance payable by the Company for the use of these personal credit cards totaled \$2,016 and \$2,930, respectively, which is included in accounts payable on the balance sheet.

**6. Commitments and Contingencies**

***Operating Lease Obligations***

The Company's operating lease obligations primarily relate to a facility lease for the Company's corporate office space located at 7970 South Kyrene Road, Tempe, Arizona 85284, which expires in April, 2019, unless renewed. Future minimum lease payments under non-cancelable operating leases are as follows (years ended December 31.):

2015.....	193,172
2016.....	295,554
2017.....	304,421
2018.....	313,553
2019.....	<u>105,542</u>
Total.....	<u>\$ 1,212,242</u>

The Company has recognized a liability of \$95,375 and \$144,990 as of December 31, 2014 and 2013, respectively, relative to the increasing future minimum lease payments in the above table. Rent expense was \$271,649 and \$194,802 for the years ended December 31, 2014 and 2013, respectively.

***General or Threatened Litigation***

From time to time, the Company is notified of threatened litigation or that a claim is being made against it. The Company's policy is to not disclose the specifics of any claim or threatened lawsuit until such complaint is actually served on the Company. After consultation with appropriate legal counsel, if it is determined that the Company is not at fault, the Company will defend itself accordingly. Although we do not expect the outcome in any pending individual case to be material, the outcome of any litigation is inherently uncertain and there can be no assurance that any expense, liability or damages that may ultimately result from the resolution of these matters will be covered by our insurance or will not be in excess of amounts provided by insurance coverage and will not have a material adverse effect on our business, operating results or financial condition. As of December 31, 2014 and 2013, respectively, the Company has no accrual for general or threatened litigation and the Company believes its exposure to be de minimis in nature.

***Employment Agreements***

On April 2, 2012, the Company entered into three-year Employment Agreements with its Chief Executive Officer and Chief Operating Officer that call for base annual salaries of \$195,000 and \$175,000, respectively, subject to cost of living adjustments, and contain automatic one-year extension provisions. Capitalized terms in this note are defined in the Employment Agreements. If the Company's Chief Executive Officer or Chief Operating Officer are terminated by the Company for any reason other than for Cause, or if the Executive voluntarily terminates his own employment for Good Reason but not including a Change in Control, then the Company shall, subject to the terms of the Employment Agreements, be obligated to pay the Executive an amount equal to the product of the greater of (a) the Executive's annual base salary in effect on the day preceding the date of such termination or (b) the Executive's annual base salary during the twelve full calendar months preceding the date of such termination, times three. This payment shall be payable in 18 equal monthly payments commencing on the first day of the month following the month in which the termination occurs. If a Change of Control of the Company occurs while the Executive is an employee of the Company and within 36 months from the date of such Change in Control the Company terminates the Executive's employment for any reason (except for the death or disability of the Executive or for Cause) or the Executive terminates his employment for any reason, then the Company shall, subject to certain limitations, pay the Executive any earned and accrued but unpaid base salary through the date of termination plus an amount of severance



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pay equal to the product of the greater of (a) the Executive's annual base salary in effect on the day preceding the date on which the Change of Control occurred or (b) the Executive's annual base salary during the twelve full calendar months preceding the date on which the Change of Control occurred, times four.

**7. Income Taxes**

The Company accounts for its deferred tax assets and liabilities, including excess tax benefits of share-based payments, based on the tax ordering of deductions to be used on its tax returns. The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, are as follows:

	<u>2014</u>	<u>2013</u>
Deferred tax assets:		
Net operating loss carry forwards.....	\$ 2,671,000	\$ 2,752,000
Deferred revenue.....	381,000	607,000
Non-qualified stock option expense.....	420,000	382,000
Reserves, accruals and other.....	110,000	168,000
Accumulated depreciation and amortization.....	<u>1,807,000</u>	<u>1,992,000</u>
Net deferred tax assets.....	5,389,000	5,901,000
Less: Valuation allowance.....	<u>(5,389,000)</u>	<u>(5,901,000)</u>
Net deferred tax assets.....	<u>\$ -</u>	<u>\$ -</u>

Management has elected to provide a deferred tax asset valuation allowance equal to the potential benefit of the deferred tax assets.

Internal Revenue Code Section 382 limits the ability to utilize net operating losses if a 50% change in ownership occurs over a three year period. Such limitation of the net operating losses may have occurred but we have not analyzed it at this time as the deferred tax asset is fully reserved. We believe we have approximately \$7.8 million of federal and \$0.1 million state net operating loss carry-forwards that are available to offset future taxable income that expire in various years from 2021 to 2032.

Significant components of the (provision) benefit for income tax for the years ended December 31,:

	<u>2014</u>	<u>2013</u>
Current.....	\$ -	\$ -
Deferred.....	512,000	1,091,000
Change in valuation allowance.....	<u>(512,000)</u>	<u>(1,091,000)</u>
Provision (benefit) for income taxes.....	<u>\$ -</u>	<u>\$ -</u>

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The Company is subject to federal and state taxes. A reconciliation of the Company's effective income tax rate to the federal statutory rate for the years ended December 31, is as follows:

	2014	2013
Federal income tax benefit at the statutory rate.....	\$ 444,000	\$ 537,000
State income taxes, net of federal benefit.....	78,000	95,000
Permanent differences.....	(10,000)	(8,000)
Expiration of net operating loss carryforwards.....	-	467,000
Change in valuation allowance.....	(512,000)	(1,091,000)
Provision (benefit) for income taxes.....	\$ -	\$ -

**8. Line of Credit**

The Company has a line of credit agreement with a financial institution with maximum availability of \$750,000. The line of credit is secured by the Company's eligible accounts receivable and inventory and bears interest at varying rates, which at December 31, 2014 and 2013 was prime plus 1.5%, with a floor of 5.0%. Interest expense was approximately \$0 for the years ended December 31, 2014 and 2013. The effective rate of interest for the years ended December 31, 2014 and 2013 was 5.0%. The line of credit, which was amended and renewed in September 2014, primarily to include borrowing against received domestic purchase orders, matures in September 2015, and requires monthly payments of interest only. As of December 31, 2014 and 2013, there were no amounts outstanding under the line of credit.

**9. Stockholders' Equity**

*Authorized Capital*

The Company has authorized the issuance of two classes of stock designated as "common stock" and "preferred stock," each having a par value of \$0.005 per share. The Company is authorized to issue 500,000,000 shares of common stock and 2,000,000 shares of preferred stock.

*Treasury Stock*

The Company did not repurchase any stock in 2014 and 2013.

*Stock Options*

The Company periodically issues non-qualified incentive stock options to key employees, officers and directors under a plan approved by the Board of Directors in 2009. Terms of option grants are at the discretion of the Board of Directors. The Board of Directors has also approved a quarterly grant of a total of 100,000 stock options per quarter to the CEO, 75,000 stock options per quarter to the COO/Secretary, and 50,000 stock options per quarter to any board member not an employee of the Company. The following table summarizes stock options as of December 31,:

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	2014		2013	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options outstanding, beginning of year.....	15,499,340	\$ 0.05	13,599,340	\$ 0.05
Granted.....	900,000	0.07	1,900,000	0.04
Exercised.....	-	-	-	-
Expired / terminated.....	(270,000)	0.05	-	-
Options outstanding, end of year.....	<u>16,129,340</u>	0.05	<u>15,499,340</u>	0.05
Options exercisable, end of year.....	<u>14,196,007</u>	0.05	<u>12,566,007</u>	0.05
Weighted average fair value of options granted during the year.....		\$ 0.07		\$ 0.04

The following table summarizes the Company's non-vested stock options as of December 31:

	2014		2013	
	Number of Options	Weighted Average Grant Date Fair Value	Number of Options	Weighted Average Grant Date Fair Value
Non-vested options outstanding, beginning of year.....	2,933,333	\$ 0.07	3,500,000	\$ 0.05
Granted.....	-	-	1,000,000	0.04
Exercised.....	-	-	-	-
Expired / terminated.....	-	-	-	-
Vested.....	<u>(1,000,000)</u>	0.05	<u>(1,566,667)</u>	0.05
Non-vested options outstanding end of year.....	<u>1,933,333</u>	\$ 0.05	<u>2,933,333</u>	\$ 0.07

The following table summarizes information about stock options outstanding and exercisable as of December 31, 2014:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Options Exercisable	Weighted Average Exercise Price
\$0.03 - \$0.05.....	7,049,340	0.04	2.6	6,249,340	0.04
\$0.05 - \$0.07.....	5,355,000	0.06	4.0	4,638,334	0.06
\$0.07 - \$0.10.....	<u>3,725,000</u>	0.08	3.9	<u>3,308,333</u>	0.08
\$0.03 - \$0.10.....	<u>16,129,340</u>	0.05	3.4	<u>14,196,007</u>	0.05

**VIRTRA SYSTEMS, INC.**  
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The aggregate intrinsic value of options outstanding and options exercisable were \$1,055,512 and \$927,008 as of December 31, 2014, respectively. The aggregate intrinsic value of options outstanding and options exercisable were \$188,950 and \$160,338 as of December 31, 2013, respectively. The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying options and the fair value of the Company's common stock, for those stock options that have an exercise price lower than the fair value of the Company's common stock. Options with an exercise price above the fair value of the Company's common stock are considered to have no intrinsic value. The total fair value of shares vested during the years ended December 31, 2014 and 2013 is \$106,100 and \$111,546, respectively. As of December 31, 2014, total unrecognized stock-based compensation expense related to non-vested stock options is \$87,010, which is expected to be recognized in the next four years.

**11. Subsequent Events**

The Company has evaluated subsequent events through the date the accompanying financial statements were issued, which was March 31, 2015. On January 21, 2015, the Company entered into a Co-Venture Agreement with Modern Round, a privately-held company, to develop a simulator-based shooting lounge, where customers may enjoy a fun and safe entertainment experience. The Company's role is focused on the shooting simulator portion both at store opening and with ongoing, regular updates and maintenance. The Company received a 5 percent ownership stake in Modern Round and will have the right to purchase up to an additional 5 percent of Modern Round stock, if certain conditions are met in the future, for a potential total ownership of 10 percent. Modern Round affiliates will have the right to purchase up to a 10 percent ownership interest in the Company if certain conditions are met in the future. As part of the agreement, the Company will receive ongoing royalty payments from each Modern Round location.

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## **VI. ISSUER'S BUSINESS, PRODUCTS AND SERVICES**

### **DESCRIPTION OF THE BUSINESS OPERATIONS**

VirTra develops, sells and supports use-of-force training and marksmanship firearms training systems and accessories for law enforcement, military, or civilian use. VirTra's simulators use software, hardware, and content to create uniquely effective and realistic training that does not require live ammunition or less-than-lethal munitions, which can both save money and provide certain training capabilities unavailable to live fire exercises. VirTra has developed a higher standard in simulation training with several exclusive capabilities, including multi-screen video based scenarios, unique scenario authoring ability, superior training scenarios, the patented Threat-Fire™ shoot-back system, powerful gas-powered simulated recoil weapons, and more.

### **DATE AND STATE OF INCORPORATION**

The original business started in 1993 as Ferris Productions, Inc. In September 2001, Ferris Productions, Inc. merged with GameCom, Inc. to ultimately become VirTra Systems, Inc., a Texas Corporation. The corporate name was changed to VirTra Systems, Inc. (VirTra) on April 30, 2002.

### **PRIMARY AND SECONDARY SIC CODES**

The issuer's primary SIC Code is: 3699-0300 Electronic Training Devices.

The issuer's secondary SIC Code is: 7373 Computer Integrated Systems Design

### **FISCAL YEAR END DATE IS DECEMBER 31**

### **PRINCIPAL PRODUCTS OR SERVICES, AND THEIR MARKETS**

VirTra's principal products include the following:

- V-300™ Simulator – a 300° wrap-around screen with video capability is the higher standard for simulation training
- V-180™ Simulator – a 180° screen with video capability is for smaller spaces or smaller budgets
- V-100™ Simulator – a single-screen based simulator system
- V-ST™ Simulator – a highly-realistic simulated shooting range simulator
- Top SME Content – content supplied with our simulators is approved by top Subject Matter Experts (SME)
- V-Author™ Software – allows users to create, edit, and train with content specific to agency's objectives
- Simulated Recoil – a wide range of highly realistic and reliable simulated recoil kits/weapons
- Return Fire Device – the patented Threat-Fire™ device which applies real-world stress on the trainees during simulation training

VirTra's principal markets include both domestic and international:

- Law Enforcement judgmental use-of-force simulation training
- Military firearms simulation training
- Civilian simulation shooting market

VirTra considers some or all of the markets listed above could experience growth in the future, but such expansion is not guaranteed. Some reasons as to why simulation training markets might expand include:

- Simulation training can save money as compared with live fire and in times of constricting budgets, money savings are often prioritized.
- Live fire training raises environmental, noise and accessibility concerns.

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- Realistic training that is too dangerous for live fire (threats from any direction while interacting with photorealistic humans in complex 360° environments).
- As technology improves, simulator training capabilities and effectiveness continue to grow.

***Market Penetration***

VirTra has hundreds of simulators installed at this time in the US and worldwide. However, VirTra's management thinks VirTra is in the early stages of market penetration for all three markets.

***Distribution Channels***

VirTra directly markets and sells its products throughout the United States. VirTra also works with various companies throughout the world to distribute its products or serve as prime contractor on particular programs. For product sales outside the United States, VirTra relies on carefully selected professional distributors or agents to sell its products into the territories they know best.

***Suppliers***

VirTra produces some of their own products as well as relies on a variety of suppliers. VirTra does not expect to encounter delays with its suppliers in the future that would have a material impact on the Company, but supplier delays could occur in the future and could adversely affect the Company.

***The Need for Realistic Training***

The world can be a very dangerous place. Both warfighters and law enforcement officers are expected to make the correct decision, with excellent marksmanship, in split-second life-and-death situations. The better and more realistic the training, the greater the chance the trainee will succeed when lives hang in the balance and threats are real. Customers buy VirTra's simulator for high quality and realistic training.

***Return Fire***

One overwhelming factor in a real engagement is the fact that threats can cause harm or even death; this weighs heavily upon the trainee and certainly affects their responses. VirTra invented the patented Threat-Fire™ device, which simulates return fire with a split-second electric shock. VirTra and many instructors consider this ability to safely simulate return fire enhances the effectiveness of any simulation and forces trainees to take the training more seriously.

***Licensing***

VirTra licenses its software or other intellectual property to other companies from time to time, when such licensing makes business sense to VirTra and would enhance training effectiveness.

***Service and Support***

VirTra is committed to providing exceptional service and support for its customers. If a problem is encountered, VirTra service and engineering employees go the extra mile to ensure the issue is resolved quickly and efficiently. VirTra has a long tradition of standing behind its products.

***Competition***

Competitors include, but are not limited to, the following: Cubic Defense Applications, FAAC, Laser Shot, Meggitt, and Ti Training.

**VIRTRA SYSTEMS, INC.**  
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## **VII. ISSUER'S FACILITIES**

VirTra's headquarters is located at: 7970 S. Kyrene Road, Tempe, AZ 85284. The building is leased with the agreement expiring April, 2019, unless renewed. The stand-alone building is approximately 40,000 square feet with 80 parking spaces. Approximately 50% of the building is production space and warehouse. The other 50% is office space. It is fully air-conditioned.

## **VIII. OFFICERS, DIRECTORS, AND CONTROL PERSONS**

**A.** Names of Officers, Directors, and Control Persons. Provided are the names of each of the issuer's executive officers, directors, general partners and control persons (control persons are beneficial owners of more than five percent (5%) of any class of the issuer's equity securities), as of the date of this information statement.

<b>Name</b>	<b>Position(s)</b>	<b>Date of Appointment</b>
Bob Ferris	Chief Executive Officer and Chairman of the Board of Directors	05/13/08
Matt Burlend	Chief Operating Officer and Secretary	12/30/08
Jeff Brown	Board of Directors Member	08/10/11

**B.** Legal/Disciplinary History. The list below identifies if any of the foregoing persons have, in the last five years, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);  
**None**
2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;  
**None**
3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated;  
**None**
4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.  
**None**

**C.** Beneficial Shareholders. Provided is a list of the name, address and shareholdings or the percentage of shares owned by all persons beneficially owning more than ten percent (10%) of any class of the issuer's equity securities. If any of the beneficial shareholders are corporate shareholders, the name and address of the person(s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders is provided.

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<b>Name and Address of Beneficial Owner</b>	<b>Officer or Director</b>	<b>Amount of Beneficial Ownership</b>	<b>Percent of Class</b>
Robert Ferris 7970 S. Kyrene Rd. Tempe, AZ 85284	CEO & Director	15,989,915	10.1%

## **IX. THIRD PARTY PROVIDERS**

Listed below are the name, address, telephone number, and e-mail address of each outside provider that advises the issuer on matters relating to operations, business development and disclosure:

### **Intellectual Property and Business Counsel**

Mark F. Wright  
Wright Law Group, PLLC  
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Telephone (480) 499-3584  
Telecopier (866) 687-6019  
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### **Public Relations**

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### **Auditor**

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2700 North Central Avenue, Ninth Floor  
Phoenix, AZ 85004  
Telephone (602) 241-1500  
rms@semplecpa.com

## **X. ISSUER CERTIFICATION**

I, **Robert D. Ferris**, certify that:

1. I have reviewed this annual disclosure statement of VirTra Systems, Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: March 31, 2015

/s/ Robert D. Ferris

**CEO/Chairman**