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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1

FORM 10-K/A

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

For the fiscal year ended December 31, 2006

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

For the transition period from _________ to _________

Commission File Number 000-28820

JONES SODA CO.

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

Washington	**91-1696175**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

234 Ninth Avenue North

Seattle, WA 98109

(Address of principal executive offices)

(206) 624-3357

(Issuer s telephone number)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	The NASDAQ Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act: None

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

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

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

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

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

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated Filer ¨

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

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

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

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

EXPLANATORY NOTE

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

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
Financial Statements are listed in the Index to Financial Statements and filed and included elsewhere herein as a part of this Annual Report on Form 10-K.

ITEM 9A. CONTROLS AND PROCEDURES.
Disclosure Control and Procedures

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

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

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

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

Management s Report on Internal Control Over Financial Reporting

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

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

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

/s/ PETER M. VAN STOLK	/s/ HASSAN N. NATHA
Peter M. van Stolk	**Hassan N. Natha**
Chief Executive Officer	**Chief Financial Officer**

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Management s Report on Internal Control Over Financial Reporting

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

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

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

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

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

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

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

/s/ KPMG LLP

Vancouver, Canada

March 13, 2007

SIGNATURES

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

JONES SODA CO.

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

President and Chief Executive Officer

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

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

JONES SODA CO.

FORM 10-K ANNUAL REPORT

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

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

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

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

/s/ KPMG LLP

Vancouver, Canada

March 13, 2007

JONES SODA CO. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

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

Commitments and contingencies (note 12)

See accompanying notes to consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31, 2006, 2005 and 2004

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

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

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

See accompanying notes to consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME

Years ended December 31, 2006, 2005 and 2004

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

See accompanying notes to consolidated financial statements.

JONES SODA CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2006, 2005 and 2004

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

See accompanying notes to consolidated financial statements.

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JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006 and 2005

1. Nature and continuance of operations:

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

2. Significant accounting policies:

(a) Basis of presentation:

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

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

(b) Use of estimates:

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

(c) Foreign currency translation:

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

(d) Cash and cash equivalents:

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

(e) Short term investments:

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

(f) Concentration of Risk

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

(g) Inventory:

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

(h) Capital assets:

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

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

(i) Intangible assets:

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

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

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

(k) Revenue recognition:

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

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

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

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

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

(l) Research and development:

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

(m) Stock-based compensation:

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

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

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

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

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

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

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

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

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

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

(n) Advertising:

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

(o) Income taxes:

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

(p) Earnings per share:

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

(q) Comprehensive income:

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

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

(r) Volume rebates from vendors:

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

(s) Seasonality

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

(t) Other Assets

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

(u) Recent accounting pronouncements:

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

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

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

(t) Reclassifications

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

3. Cash equivalents and short-term investments

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

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

JONES SODA CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2006 and 2005

4. Accounts receivable:

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

Supplementary information on the allowance for doubtful accounts:

	2006	2005
Allowance for doubtful accounts:		
Beginning of year	$ 107,406	