Consolidated Financial Statements

Quest PharmaTech Inc.

January 31, 2012 and 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Quest PharmaTech Inc.

We have audited the accompanying consolidated financial statements of **Quest PharmaTech Inc.** (the "Company"), which comprise the consolidated statements of financial position as at January 31, 2012 and 2011, and February 1, 2010, and the consolidated statements of loss and comprehensive loss, changes in shareholders' deficiency and cash flows for the years ended January 31, 2012 and 2011, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Quest PharmaTech Inc. as at January 31, 2012 and 2011, and February 1, 2010, and its financial performance and its cash flows for the years ended January 31, 2012 and 2011 in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the financial statements which indicates that the Company incurred a net loss of $1,368,535 during the year ended January 31, 2012 and, as of that date, the Company's current liabilities exceeded its current assets by $2,454,876. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

Ernst & Young LLP

Edmonton, Canada
May 17, 2012

Chartered Accountants

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(see note 1 – going concern uncertainty)

As at

	January 31, 2012 $	January 31, 2011 $	February 1, 2010 $
ASSETS			
Current			
Cash	**74,975**	13,394	31,752
Accounts receivable	**3,051**	6,993	104,672
Marketable securities *[note 7]*	**—**	74,645	47,872
Prepaid expenses	**30,584**	17,445	6,575
	108,610	112,477	190,871
Property and equipment *[note 6]*	**86,130**	123,944	177,880
Intangible assets *[note 5]*	**81,010**	160,175	140,000
	275,750	396,596	508,751
LIABILITIES			
Current			
Accounts payable and accrued liabilities	**1,043,486**	624,130	315,512
Demand loans *[note 16]*	**1,020,000**	790,000	—
Convertible debenture *[note 8]*	**500,000**	500,000	500,000
Current portion of deferred revenue *[note 14]*	**—**	8,000	8,000
	2,563,486	1,922,130	823,512
Deferred revenue *[note 14]*	—	77,667	85,667
	2,563,486	1,999,797	909,179
Commitments and contingencies *[note 10]*			
SHAREHOLDERS' DEFICIENCY			
Common shares *[note 11]*	**24,598,875**	24,198,875	24,058,875
Shares to be issued *[note 5]*	**—**	—	60,000
Warrants	**200,000**	—	—
Equity portion of convertible debenture *[note 8]*	**60,000**	60,000	60,000
Contributed surplus *[note 11]*	**1,830,365**	1,746,365	1,675,365
Deficit	**(28,976,976)**	(27,608,441)	(26,254,668)
	(2,287,736)	(1,603,201)	(400,428)
	275,750	396,596	508,751

See accompanying notes

On behalf of the Board:

(signed)	(signed)
Ragupathy ("Madi") Madiyalakan	Ian McConnan
Director	Director

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

Years ended January 31

	2012 $	2011 $
REVENUE		
Market distribution rights *[notes 14 and 15]*	**85,667**	8,000
EXPENSES		
General and administrative	**549,568**	503,706
Research and development *[note 18]*	**767,433**	796,836
	1,317,001	1,300,542
Loss before the undernoted	**(1,231,334)**	(1,292,542)
Other income (expenses)		
Finance income	**203**	85
Finance expenses *[notes 8 and 16]*	**(126,989)**	(87,644)
Foreign exchange gain (loss)	**7,572**	(444)
Gain (loss) on fair value adjustment of marketable securities *[note 7]*	**(3,984)**	26,772
Loss on sale of marketable securities *[note 7]*	**(14,003)**	—
	(137,201)	(61,231)
Net and comprehensive loss for the year	**(1,368,535)**	(1,353,773)
Basic and diluted loss per share	**(0.02)**	(0.02)

See accompanying notes

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' DEFICIENCY

	Common Shares $	Equity Portion of Convertible Debenture $	Shares to be issued $	Warrants $	Contributed surplus $	Deficit $	Total Shareholders' Deficiency $
Balance, February 1, 2010	24,058,875	60,000	60,000	—	1,675,365	(26,254,668)	(400,428)
Shares issued	140,000	—	(60,000)	—	—	—	80,000
Share-based payments	—	—	—	—	71,000	—	71,000
Net loss for the year	—	—	—	—	—	(1,353,773)	(1,353,773)
Balance, January 31, 2011	24,198,875	60,000	—	—	1,746,365	(27,608,441)	(1,603,201)
Balance, February 1, 2011	24,198,875	60,000	—	—	1,746,365	(27,608,441)	(1,603,201)
Shares issued	400,000	—	—	—	—	—	400,000
Warrants issued	—	—	—	200,000	—	—	200,000
Share-based payments	—	—	—	—	84,000	—	84,000
Net loss for the year	—	—	—	—	—	(1,368,535)	(1,368,535)
Balance, January 31, 2012	24,598,875	60,000	—	200,000	1,830,365	(28,976,976)	(2,287,736)

See accompanying notes

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended January 31

	2012 $	2011 $
CASH FROM (USED IN) OPERATING ACTIVITIES		
Net loss for the year	**(1,368,535)**	(1,353,773)
Add (deduct) items not involving cash:		
Amortization	**116,981**	113,760
Share-based payments *[note 13]*	**84,000**	71,000
Loss on sale of marketable securities [*note 7*]	**14,003**	—
Loss (gain) on fair value adjustment of marketable securities *[note 7]*	**3,984**	(26,772)
Deferred revenue recognized in the year *[note 14]*	**(85,667)**	(8,000)
Net change in working capital *[note 17]*	**410,159**	395,427
Net cash flows used in operating activities	**(825,075)**	(808,358)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in demand loans *[note 16]*	**455,000**	790,000
Repayment of demand loans *[note 16]*	**(225,000)**	—
Private placement proceeds *[note 11]*	**600,000**	—
Net cash flows from financing activities	**830,000**	790,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of marketable securities *[note 7]*	**56,656**	—
Net cash flows from investing activities	**56,656**	—
Net increase (decrease) in cash and cash equivalents	**61,581**	(18,358)
Cash and cash equivalents, beginning of year	**13,394**	31,752
Cash and cash equivalents, end of year	**74,975**	13,394

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. CORPORATE INFORMATION AND GOING CONCERN UNCERTAINTY

Corporate information

Quest PharmaTech Inc. (the "Company") is a biotechnology company committed to the development and commercialization of oncology product candidates. It is developing a series of products for the treatment of cancer based on its pipeline of SonoLight compounds and monoclonal antibodies which target certain tumor antigens that are presented in a variety of cancers. The Company believes that by combining these antibodies with other cancer therapies such as chemotherapy, photodynamic therapy or radioimmuno therapy, it can potentially further complement and enhance treatment outcomes compared to antibody treatment alone.

The Company is domiciled in Alberta, Canada and incorporated under the Business Corporations Act (Alberta). The Company's functional currency is the Canadian dollar.

The Company is publicly traded on the TSX Venture Exchange under the symbol "QPT".

These consolidated financial statements have been authorized for issue in accordance with a resolution of the Company's Board of Directors on May 17, 2012.

Going concern uncertainty

The Company's consolidated financial statements have been prepared on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Company has experienced significant operating losses and cash outflows from operations since its inception.

The Company has incurred a net loss of $1,368,535 for the year ended January 31, 2012 and as at January 31, 2012 had a working capital deficiency of $2,454,876 (January 31, 2011 - $1,809,653; February 1, 2010 - $632,641) and a shareholders' deficiency of $2,287,736 (January 31, 2011 - $1,603,201; February 1, 2010 - $400,428). Accordingly, there is doubt regarding the Company's ability to continue as a going concern.

1. CORPORATE INFORMATION AND GOING CONCERN UNCERTAINTY (CONTINUED]

The Company's ability to continue as a going concern is uncertain and is dependent upon its ability to raise additional capital to successfully complete its research and development programs, commercialize its technologies, conduct clinical trials and receive regulatory approvals for its products. It is not possible at this time to predict the outcome of these matters. The Company's consolidated financial statements do not reflect any adjustments to the classifications and carrying values of assets and liabilities that may be required should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business. The Company intends to address this uncertainty through issuing new share capital through equity financing, licensing arrangements and/or strategic partnerships.

2. BASIS OF PREPARATION

These consolidated financial statements of the Company were prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Since this is the first year the Company is presenting its results and financial position under IFRS, these consolidated financial statements were prepared in accordance with IFRS 1, "First-Time Adoption of IFRS".

Subject to certain transition elections disclosed in note 4, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at February 1, 2010, and throughout all periods presented as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance, and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended January 31, 2011.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of May 17, 2012, the date the Board of Directors approved the consolidated statements.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention.

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries incorporated in Canada as at January 31, 2012:

- Sonolight Pharmaceuticals Corp. ("Sonolight")
- Steroidogenesis Inhibitors Canada Inc.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control and continue to be consolidated until the date such control ceases. The financial statements of the subsidiaries are prepared using accounting policies consistently applied. All inter-company transactions and balances have been eliminated in full.

Cash equivalents

Cash equivalents include highly liquid short-term investments with maturities of less than 90 days. Such investments are carried at fair value.

Intangible assets

Intangible assets include proprietary rights, intellectual property and patent rights which have been acquired from third parties. Intangible assets are recorded at historical cost less accumulated amortization. Following acquisition, the Company evaluates the prospective commercialization of the acquired intangible assets. Depending on the results of the evaluation, the Company generally commences amortization of the assets over a period of three to five years.

Proprietary rights and intellectual property
The Company's management evaluates the recoverability of the carrying cost of proprietary rights and intellectual property annually, based on expected utilization of the underlying technology and an assessment of whether estimated future cash flows exceed the carrying value of the proprietary rights and intellectual property. If the patent rights and intellectual property are not considered to be fully recoverable, a provision is recorded to recognize them at the recoverable amount.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Patent rights

Patent rights are recorded at historical cost less accumulated amortization. Amortization is calculated on a straight-line basis over a maximum period of five years from the time of acquisition. The Company's management evaluates the recoverability of the cost of such rights annually, based on the expected utilization of the underlying technology and an assessment as to whether estimated future net cash flows exceed the carrying value of the patent rights. If the rights are not considered to be fully recoverable, a provision is recorded to recognize them at the recoverable amount.

Property and equipment

Property and equipment are recorded at historical cost net of government assistance and accumulated amortization. Amortization of property and equipment is calculated over their estimated useful lives on a declining balance or straight-line basis at the following annual rates:

Computer equipment	Declining balance - 30%
Furniture and fixtures	Declining balance - 30%
Office equipment	Declining balance - 30%
Manufacturing and research and development equipment	Declining balance - 30%
Leasehold improvements	Straight-line - lease term

Leases

Leases that transfer substantially all the risks and benefits of assets to the Company are accounted for as capital leases. Assets under capital leases are recorded at the inception of the lease together with the long-term obligation to reflect the purchase and financing thereof. As at January 31, 2012 and 2011, the Company had no capital leases. Rental payments under operating leases are expensed evenly over the lease term.

Convertible debenture

On issuance of the debenture convertible into common shares of the Company, the fair value of the holders' conversion option is reflected as a component of shareholders' deficiency. The Company's obligation to debenture holders for future interest and principal payments is reflected as a liability and accreted to its maturity value over the term of the debenture using the effective interest method. If the holders exercise their conversion option, common shares issued on conversion will be recorded at an amount equal to the aggregate carrying value of the liabilities and the conversion option is extinguished with no gain or loss recognized.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Revenue recognition

Revenues associated with non-refundable up-front fees for the licensing of technology and products under agreements which require the Company to perform future performance obligations are recognized over the period of the contract as the performance obligation is satisfied. The portion related to future periods is recorded as deferred revenue.

Research and development

Research and development expenses are expensed as incurred. Upfront and milestone payments made to third parties in connection with specified research and development projects are expensed as incurred.

Investment tax credits

Investment tax credits relating to qualifying scientific research and experimental development expenditures that are recoverable in the current year are accounted for as a reduction in research and development expenditures. Investment tax credits are recognized when the related expenditures are incurred and there is reasonable assurance of their realization.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rates prevailing at year end. Revenue and expenses are translated at exchange rates in effect on the date of the transaction. Gains and losses arising from foreign currency transactions are included in income for the period.

Government assistance

Non-refundable government assistance towards current expenses is included in the determination of income for the period as a reduction of the expenses to which it relates. Amounts received for future expenditures are recorded as a current liability.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Financial instruments

All financial instruments are classified as either fair value through profit and loss, available-for-sale financial assets, loans and receivables, investments held to maturity or other financial liabilities. Financial assets classified as fair value through profit and loss and available-for-sale are measured on the consolidated statement of financial position at fair value. Subsequent changes in the fair value of held-for-trading financial assets are recognized in net loss immediately. Changes in the fair value of financial assets available-for-sale are recorded in comprehensive income until the investment is derecognized or impaired, at which time amounts would be recorded in net loss. Other comprehensive income and its components, when presented, are included directly in equity as accumulated other comprehensive income. Loans and receivables, investments held to maturity and other financial liabilities are measured on the consolidated statements of financial position at amortized cost.

The Company has designated cash and cash equivalents, and marketable securities as fair value through profit and loss, its accounts receivable as loans and receivables and its accounts payable and accrued liabilities, and the liability component of the convertible debenture as other financial liabilities. The Company has not recorded any financial instruments as available-for-sale or held to maturity investments.

For financial liabilities classified as other, transaction costs that are directly attributable to the issue of the financial liability are recorded as part of the fair value initially recognized for the financial instrument. These costs are expensed using the effective interest method and recorded in interest expense.

Impairment of long-lived assets

The Company assesses the carrying value of long lived assets, including property and equipment, intangible assets and other assets subject to amortization, for potential impairment when circumstances warrant a determination. Factors that are considered and which could lead to an impairment include significant changes in the manner of use of the asset or the overall strategy of the business.

Impairment of non-monetary long-lived assets is recognized when the carrying amount of an asset exceeds its recoverable amount. The impairment amount recorded will be the difference between the recoverable amount and the carrying value. The recoverable amount is the higher of fair value less costs to sell and value in use.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Borrowing costs

When the Company borrows funds to acquire qualified assets, the Company capitalizes borrowing costs incurred related to the purchase of the qualified assets.

Share-based payments

The Company accounts for share-based payment transactions granted to employees and non-employees using the fair value method. Fair value is calculated using the Black-Scholes option pricing model with the assumptions described in note 13 and is recognized for employees over the vesting period of the options granted, and for non-employees as goods are received or services rendered. The Company accounts for forfeitures when the forfeitures event occurs. Consideration paid on the exercise of share-based payments is credited to share capital and the amount in contributed surplus related to the share-based payments exercised is reclassified to share capital.

Under the fair value based method, share-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measured. The cost of share-based payments to non-employees is recognized over the vesting period. For fully vested and non-forfeitable share-based payments, the cost is measured and recognized at the grant date.

Income taxes

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and are accounted for using the liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Deferred income tax assets and liabilities are measured at the tax rates expected to apply in the period when the assets are realized or the liability is settled based on the tax rates that have been enacted or substantively enacted at the date of the consolidated statement of financial position. The carrying amount of the deferred tax asset is reviewed at each consolidated balance sheet date and reduced to the extent that it is not probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Basic and diluted loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed using the treasury stock method. Under this method, options, warrants and convertible securities are assumed to be exercised at the beginning of the period [or at the time of issuance, if later]. Proceeds from the exercise are assumed to be used to purchase common shares at the average market price during the period. Incremental shares [the difference between the number of shares assumed issued and the number of shares assumed purchased] are included in the denominator of the diluted loss per share computation.

Use of estimates

The measurement of certain assets and liabilities is dependent upon future events whose outcome will not be fully known until future periods. Therefore, the preparation of these consolidated financial statements requires the Company's management to make estimates and assumptions that affect the reported amounts of assets, liabilities and capital reserves. Actual results may vary from those estimated. The recoverable value of property and equipment of $86,130 and intangibles of $81,010 are the more significant items which reflect estimates made in the consolidated statement of financial position. Such estimates and assumptions have been made using careful judgments which, in management's opinion, are within reasonable limits of materiality and conform to the significant accounting policies summarized in these consolidated financial statements.

Accounting standards and amendments issued but not yet adopted

The listing below includes standards, amendments, and interpretations that the Company reasonably expects to be applicable at a future date and intends to adopt when they become effective. Unless otherwise noted, the effective date of each standard below is the first annual period beginning on or after January 1, 2013, with retrospective application required and early adoption permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

Financial Instruments
In November 2009, the IASB issued IFRS 9, "Financial Instruments" (IFRS 9), as part of the first of three phases to replace IAS 39, "Financial Instruments: Recognition and Measurement" (IAS 39). The first phase addressed the classification and measurement of financial assets. IFRS 9 replaces the multiple classification and measurement models of IAS 39 with a single model that has only two classification categories: amortized cost and fair value.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

In October 2010, the IASB reissued IFRS 9, incorporating new requirements on accounting for financial liabilities and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities and for classification and measurement of financial liabilities. The reissued IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability be presented in other comprehensive income, instead of in profit and loss.

In December 2011, the IASB issued amendments to IFRS 9 (the amendments). The amendments result in a deferred effective date for IFRS 9, from annual periods beginning on or after January 1, 2013 to January 1, 2015, with early adoption still permitted. This deferral makes it possible for all phases of the replacement of IAS 39 to have the same mandatory effective date. The amendments provide relief in restating prior periods, requiring instead that entities provide disclosures to allow financial statement users to understand the initial impact of applying IFRS 9.

Financial Instruments: Presentation
In December 2011, the IASB issued amendments to IAS 32, “Financial Instruments: Presentation” (the amendments). The amendments clarify when an entity has a legally enforceable right to set-off, as well as clarifying the application of offsetting criteria related to some settlement systems that may be considered the same as net settlement. The amendments to IAS 32 are applicable for annual periods beginning on or after January 1, 2014.

Financial Instruments: Disclosures
In October 2010, the IASB issued amendments to IFRS 7, “Financial Instruments: Disclosures” (the amendments). The amendments require additional qualitative and quantitative disclosure associated with the transfers of financial assets. Entities are required to apply the amendments for annual periods beginning on or after July 1, 2011. Early adoption is permitted. The new disclosure requirements are required to be applied prospectively. The adoption of the amendments is not expected to have a material impact on our consolidated financial statements.

In December 2011, the IASB issued further amendments to IFRS 7 related to the disclosures of offsetting financial assets and financial liabilities. These amendments require disclosure of information that will allow financial statement users to assess the impact of an entity’s netting arrangements, including rights of set-off associated with an entity’s recognized financial assets and liabilities, on the entity’s statement of financial position.

3. SIGNIFICANT ACCOUNTING POLICIES [CONTINUED]

Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, "Consolidated Financial Statements" (IFRS 10), which replaces Standing Interpretations Committee (SIC)-12, "Consolidation—Special Purpose Entities" and parts of IAS 27, "Consolidated and Separate Financial statements." The new standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included in a company's consolidated financial statements. The standard provides additional guidance to assist in the determination of control where it is difficult to assess.

Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12, "Disclosure of Interests in Other Entities" (IFRS 12). IFRS 12 combines the disclosure requirements for an entity's interests in subsidiaries, joint arrangements, associates, and structured entities into one comprehensive disclosure standard. Many of the disclosure requirements were previously included in IAS 27, IAS 28, IAS 31, and SIC-12 while others are new. IFRS 12 requires that an entity discloses the significant judgment and assumptions it has made in determining whether it controls an entity.

Fair Value Measurement

In May 2011, the IASB issued IFRS 13, "Fair Value Measurement" (IFRS 13). IFRS 13 provides guidance on how to measure fair value under IFRS when fair value is required or permitted by other standards. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. IFRS 13 requires enhanced disclosure for fair value. IFRS 13 is applied prospectively for annual periods beginning on or after January 1, 2013, and comparative disclosures for prior periods are not required.

Presentation of Financial Statements

In June 2011, the IASB issued amendments to IAS 1, "Presentation of Financial Statements" (IAS 1), to improve the consistency and clarity of items presented in Other Comprehensive Income (OCI). The amendments require that items presented in OCI be grouped into two categories: items that may be reclassified into profit or loss at a future date, and items that will never be reclassified into profit or loss. The amendments to IAS 1 are effective for annual periods beginning on or after July 1, 2012.

Employee Benefits

In June 2011, the IASB issued amendments to IAS 19 "Employee Benefits" (the amendments). Among other changes, the amendments impact the timing of the recognition of termination benefits. The revised standard requires termination benefits outside of a wider restructuring to be recognized only when the offer becomes legally binding and cannot be withdrawn. In the context of a wider restructuring, termination benefits are recognized at the same time as other restructuring costs.

4. TRANSITION TO IFRS

First time adoption of International Financial Reporting Standards

For all periods up to and including the year ended January 31, 2011, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles (GAAP). These consolidated financial statements for the year ended January 31, 2012, are prepared in accordance with IFRS.

Accordingly, the Company has prepared financial statements that comply with IFRS applicable for periods beginning on or after February 1, 2011, as described in the significant accounting policies (note 3). The Company prepared its opening statement of financial position as at February 1, 2010, its date of transition to IFRS. This note explains the principle adjustments the Company made in restating its Canadian GAAP statement of financial position as at February 1, 2010, and previously published Canadian GAAP financial statements for the year ended January 31, 2011.

Exemptions applied

IFRS 1 allows first-time adopters certain exemptions from the retrospective application of certain IFRS.

The Company has applied the following exemption:

- **Share-based payments.** IFRS 2, "Share-Based Payments", has not been applied to equity instruments in share-based payment transactions that were granted on or before November 7, 2002, or after November 7, 2002, that vested before February 1, 2010.

4. TRANSITION TO IFRS [CONTINUED]

Restatement of equity accounts from Canadian GAAP to IFRS:

Certain of the Company's equity accounts have been restated as a result of the transition from Canadian GAAP to IFRS as follows:

	Under Canadian GAAP ($)	Adjustments ($)	Under IFRS ($)
As at February 1, 2010:			
Common Shares	24,058,875	—	24,058,875
Shares to be Issued	60,000	—	60,000
Equity Portion of Convertible Debenture	60,000	—	60,000
Contributed Surplus	1,674,365	1,000	1,675,365
Deficit	(26,253,668)	(1,000)	(26,254,668)

	Under Cdn GAAP ($)	Adjustments ($)	Under IFRS ($)
As at January 31, 2011:			
Common Shares	24,198,875	—	24,198,875
Equity Portion of Convertible Debenture	60,000	—	60,000
Contributed Surplus	1,746,365	—	1,746,365
Deficit	(27,608,441)	—	(27,608,441)
For the year ended Jan 31, 2011:			
Comprehensive Income / (Loss)	(1,354,773)	1,000	(1,353,773)

Under IFRS, the Company accrues share-based payment transactions over the vesting period using the graded method of amortization rather than the straight-line method, which was the Company's policy under Canadian GAAP. This increased contributed surplus and deficit by $1,000 at the date of transition and decreased comprehensive loss by $1,000 for the year end January 31, 2011.

There were no forfeitures of the Company's share-based payment options during any of the above transition periods.

4. TRANSITION TO IFRS [CONTINUED]

As a result of the transition to IFRS, amortization of intangibles and property and equipment for the year ended January 31, 2012 and 2011 was allocated to general and administrative and research and development expenses as follows:

	2012 $	2011 $
General and administrative	**2,156**	3,080
Research and development	**114,825**	110,680
	116,981	113,760

There were no material adjustments to the Company's statements of cash flows for any of the above noted periods as a result of the transition from Canadian GAAP to IFRS.

5. INTANGIBLE ASSETS

	January 31, 2012		January 31, 2011		February 1, 2010	
	Cost $	**Accumulated amortization** $	**Cost** $	**Accumulated amortization** $	**Cost** $	**Accumulated amortization** $
Immunotherapy technology	**237,500**	**156,490**	237,500	77,325	157,500	17,500
Hypocrellin based technology and licenses	**2,476,822**	**2,476,822**	2,476,822	2,476,822	2,476,822	2,476,822
CDK technology	**225,000**	**225,000**	225,000	225,000	225,000	225,000
	2,939,322	**2,858,312**	2,939,322	2,779,147	2,859,322	2,719,322
Net book value	**81,010**		160,175		140,000	

During the year, amortization of intangible assets was $79,167 (2011 – $59,825). As at January 31, 2012, the Company performed a review of the carrying value of intangible assets and determined that no impairment charge was required (January 31, 2011 – nil, February 1, 2010 – nil).

5. INTANGIBLE ASSETS [CONTINUED]

CORE TECHNOLOGIES

Immunotherapy technology and licenses (“Immunotherapy technology”)
During September, 2009, the Company signed a technology purchase agreement with Paladin Labs Inc. (“Paladin”) to acquire the proprietary rights and intellectual property related to an antibody immunotherapy technology. Under this technology, the Company acquired product candidates consisting of five monoclonal antibodies targeting certain tumor antigens that are presented in a variety of cancers. Under the terms of the agreement, consideration for the purchase consisted of a cash payment of $37,500 and the issuance of 1,500,000 common shares upon the effective date of the purchase and an additional 1,500,000 common shares to be issued no later than December 31, 2010. The common shares issued on the effective date and those issued prior to December 31, 2010 were valued for accounting purposes at $0.04 per share which reflected the closing price of the common shares on the effective date of the purchase ($60,000 and $60,000 respectively). Under the terms of the agreement a further 2,000,000 common shares were contingently issuable upon successful future financing initiatives by the Company. On October 22, 2010, the Company decided to take control over the technology and issued the final 3,500,000 common shares under the agreement. The 2,000,000 common shares issued on October 22, 2010 reflecting the contingent consideration were valued for accounting purposes at $0.04 per share which reflected the closing price of the common shares at that date ($80,000). The agreement also requires the Company to make milestone and royalty payments to Paladin on future revenues. The Company is amortizing this asset on a straight-line basis over a three-year period.

Hypocrellin-based technology and licenses (proprietary rights)
The Company’s subsidiary, Sonolight, holds the exclusive worldwide license to develop, commercialize and exploit several proprietary inventions involving a class of sonosensitizers and their use in cancer and non-cancer therapies. Sonolight signed a licensing agreement dated March 6, 2001 with the University of Alberta. The license agreement is for a term of 25 years. The agreement requires royalty payments upon successful sales and marketing of products developed using the technology. The Company has amortized this asset on a straight-line basis over a three-year period that commenced August 1, 2001. This intangible asset is fully amortized. The Company has pledged this technology as collateral in connection with the convertible debenture (note 8).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended January 31, 2012 and 2011

5. INTANGIBLE ASSETS [CONTINUED]

NON-CORE TECHNOLOGIES (CDK technology (proprietary rights)

The Company owns the worldwide rights to develop, manufacture and sell the CDK technology, a novel immunomodulator with anti-cancer properties. As consideration for its acquisition of the technology, the Company must issue 400,000 common shares as certain milestones outlined in the technology purchase agreement are met. To date, the Company has issued 200,000 shares under the agreement: 100,000 shares issued in fiscal 2004 and 100,000 shares in fiscal 2003. These shares have been recorded at a value that represents the closing price of the common shares on the date the shares were issued. The Company amortized this asset on a straight-line basis over a three-year period, which commenced on August 1, 2002. This intangible asset is fully amortized. During fiscal 2009, the Company determined that it will not proceed with further development with respect to the CDK technology.

6. PROPERTY AND EQUIPMENT

	January 31, 2012		**January 31, 2011**		**February 1, 2010**	
	Cost $	**Accumulated amortization** $	**Cost** $	**Accumulated amortization** $	**Cost** $	**Accumulated amortization** $
Computer equipment	**80,744**	**75,241**	80,744	72,884	80,744	69,515
Furniture and fixtures	**12,114**	**11,636**	12,114	11,431	12,114	11,138
Office equipment	**31,494**	**30,722**	31,494	30,391	31,494	29,918
Manufacturing and research and development equipment	**456,084**	**376,707**	456,084	342,688	456,084	294,090
Leasehold improvements	**2,305**	**2,305**	2,305	1,403	2,305	200
	582,741	**496,611**	582,741	458,797	582,741	404,861
Net book value	**86,130**		123,944		177,880	

During the year, amortization of property and equipment was $37,814 (2011 - $53,935). As at January 31, 2012, the Company performed a review of the carrying value of property and equipment and determined that no impairment charge was required (January 31, 2011 – nil, February 1, 2010 – nil). .

7. MARKETABLE SECURITIES

The Company held the following marketable securities which were recorded as follows:

	January 31, 2012 $	**January 31 2011** $	**February 1 2010** $
Common shares of Brand Marvel Worldwide Consumer Products Corporation ("BMW.v")	—	74,312	47,289
Common shares of Samaritan Pharmaceuticals Inc. ("SPHC")	—	333	583
	—	74,645	47,872

At January 31, 2011, the Company held 1,351,111 common shares of BMW.v and 8,334 common shares of SPHC. During the year ended January 31, 2012, the Company sold all 1,351,111 common shares of BMW.v for net proceeds of $56,656. The shares of SPHC were written down to $nil.

Activity related to the Company's marketable securities is as follows:

	2012 $	**2011** $
Net sale proceeds	**56,656**	—
Loss on sale	**14,003**	—
Loss (gain) on fair value adjustment	**3,984**	(26,772)

8. CONVERTIBLE DEBENTURE

On March 23, 2005, the Company entered into an agreement to issue a $1,000,000 principal amount 8% convertible debenture with a one-year maturity to two arm's-length parties. The debenture is collateralized by the Company's Hypocrellin-based technology, one of its core technologies (note 5). The debenture was repayable in blended monthly installments of $6,667 with the balance, including accrued interest, due on March 22, 2006. The debenture had a conversion feature whereby it could be converted into common shares of the Company at a price of $0.45 per common share and could be redeemed at any time by the Company. The Company obtained extensions to the maturity date and as at October 31, 2011, the maturity date had been extended to March 22, 2012. In connection with the extensions the debenture interest rate was revised from 8% to 9% per annum and the debenture conversion price was amended from $0.45 to $0.25 per common share. During 2008, the Company made principal payments of $500,000 against the convertible debenture.

8. CONVERTIBLE DEBENTURE [CONTINUED]

During the year, the Company incurred $45,000 (2011 - $45,000) in interest under this convertible debenture.

9. INCOME TAXES

Details of the components of income taxes from operations are as follows:

	2012 $	2011 $
Loss from operations	**(1,368,535)**	(1,354,773)
Statutory tax rate	**26.37%**	27.87%
Income tax recovery at Canadian statutory tax rate	**(360,883)**	(377,610)
Adjustment in income taxes resulting from:		
Non-deductible share-based payments expense	**22,153**	20,068
Impact on future tax assets resulting from statutory rate reduction and expiry of loss carryforwards	**449,296**	673,436
Non-deductible expenses and other	**2,917**	(6,918)
Potential tax assets not recognized	**(113,483)**	(308,976)
Deferred tax recovery	**—**	—

Significant components of the Company's deferred tax balances are as follows:

	2012 $	2011 $	February 1, 2010 $
Deferred tax assets			
Non-capital loss carryforwards	**1,951,764**	2,068,506	2,560,639
Tax cost of property, plant and equipment in excess of book values	**218,025**	224,602	211,118
Tax cost of intangible assets in excess of book values	**97,965**	124,327	109,371
Scientific research and experimental development tax credits	**881,451**	836,108	677,794
Share issue costs deductible for tax purposes	**—**	3,595	7,135
Capital loss carryforwards	**836,318**	842,583	834,069
	3,985,523	4,099,721	4,400,126
Potential tax assets not recognized	**(3,985,523)**	(4,099,721)	(4,400,126)
	—	—	—

9. INCOME TAXES [CONTINUED]

The Company and its subsidiaries have non-capital losses for income tax purposes of approximately $7,807,000 at January 31, 2012 (January 31, 2011 - $8,109,000; February 1, 2010 - $10,083,000) that may be applied against future taxable income. In addition, the Company has scientific research and experimental development expenses of approximately $3,525,000 (2011 – $3,344,000). In total, approximately $7,807,000 (January 31, 2011 - $8,109,000; February 1, 2010 - $10,083,000) of non-capital losses and $4,800,000 (January 31, 2011 - $4,800,000; February 1, 2010 - $7,357,000) of deductible temporary differences for Canadian income tax purposes have not been recognized for accounting purposes. The non-capital losses and investment tax credits ("ITC") available for carry forward will expire as follows:

	Non-capital losses	**ITC**
	$	$
2013	—	9,600
2015	1,936,483	—
2026	2,440,630	—
2027	1,480,548	91,300
2028	614,914	98,900
2029	97	198,900
2030	122	90,400
2031	809,406	54,800
2032	524,855	—
	7,807,055	543,900

10. COMMITMENTS AND CONTINGENCIES

a) Lease obligations

The Company is committed to future minimum lease payments, including estimated operating costs, for its business premises as follows:

	$
2013	58,815
2014	58,212
2015	58,212
2016	59,983
2017 thereafter	81,158
	316,380

10. COMMITMENTS AND CONTINGENCIES [CONTINUED]

b) Research and development and other activities

Subject to successful completion of contractual milestones, the Company has commitments to fund various research and development and other activities in the normal course of business as follows:

	$
2013	564,424
2014	486,266
2015	223,802
2016	139,194
2017	139,194
	1,552,880

In fiscal 2008, the Company entered into a collaborative agreement for product development with the Alberta Research Council (the "ARC") whereby the ARC agreed to incur up to $200,000 of expenditures to develop a fermentation-based method to manufacture Hypocrellin B. Upon commercial sales of the developed product, the Company has committed to reimburse the ARC for its expenditures plus a 25% premium. This product development has not reached the commercialization stage and the outcome is not yet determinable.

In fiscal 2010, the Company entered into an assumption agreement (the "Assumption Agreement") with the Alberta Heritage Foundation for Medical Research (the "Foundation") in connection with the Company's September, 2009 purchase of the Immunotherapy Technology (note 5). This related to prior funding by the Foundation of $500,000 towards the development of the Immunotherapy Technology. Under the Assumption Agreement, upon the generation of revenues related to any developed product, the Company has committed to reimburse the Foundation for its $500,000 funding and to pay a royalty of $500,000 based on product revenues. This technology has not reached the commercialization stage and the outcome is not yet determinable.

11. SHARE CAPITAL

Authorized

Unlimited number of common shares without nominal or par value
Unlimited number of first preferred shares
Unlimited number of second preferred shares

The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

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Years ended January 31, 2012 and 2011

11. SHARE CAPITAL [CONTINUED]

Issued

	Number of common shares	Amount $
Common shares		
At February 1, 2010	69,697,580	24,058,875
Shares issued pursuant to a technology purchase (note 5)	3,500,000	140,000
At January 31, 2011	73,197,580	24,198,875
Shares issued pursuant to a private placement	10,000,000	400,000
At January 31, 2012	83,197,580	24,598,875

On October 25, 2011, the Company raised $600,000 through the issuance of 10,000,000 units at $0.06 per unit, each unit comprised of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase one common share at $0.10 per common share. The warrants expire on October 25, 2013.

On October 22, 2010, the Company issued 3,500,000 common shares to complete the purchase of the Immunotherapy technology. 1,500,000 of these shares were previously valued at $0.04 per share representing the price of the Company's common shares on the effective date of the purchase agreement. The remaining 2,000,000 common shares were valued at $0.04 per common share which represented the closing price of the common shares on October 22, 2010.

On October 15, 2006, the Company signed an exclusive agreement with KMH Co, Ltd ("KMH"), for the distribution rights of the SL017 topical gel variant of its Hypocrellin based technology in Asia for fifteen years or until the expiration of patents, whichever is longer. The agreement required an initial investment in the Company of $200,000 with additional investments of up to $1,300,000 upon the achievement of specified milestones as well as specified royalty payments on product sales. In addition, the Company also committed to issue up to 5,000,000 additional shares to KMH contingent on whether the product meets the clinical endpoints as outlined in the Health Canada approved clinical trial protocol.

Under the terms of the agreement, the Company issued 1,000,000 common shares to KMH. Of the $200,000 initial investment, $80,000 was applied to share capital based on the fair value of the shares at the date of the agreement with KMH. The remaining $120,000 was recorded as deferred revenue which was to be recognized in income over the fifteen-year term of the agreement. On August 31, 2011, the Company terminated the agreement with KMH with no further obligations required of the Company. Therefore, the remainder of deferred revenue was recognized in income during the year ended January 31, 2012 (2011 - $8,000).

11. SHARE CAPITAL [CONTINUED]

The following options to purchase common shares were outstanding as at January 31, 2012:

Exercise price $	Options outstanding #	Weighted average remaining life (years)	Options exercisable #
0.10	**4,700,000**	**6.24**	**4,700,000**
0.15	**525,000**	**0.12**	**525,000**
0.25	**1,250,000**	**0.15**	**1,250,000**
	6,475,000	**6.52**	**6,475,000**

The following schedule details the warrants and share-based payment transactions granted and expired:

	Shares issuable on exercise of			
	Warrants		Share options	
	Number of shares #	Weighted average exercise price $	Number of shares #	Weighted average exercise price $
Balance, February 1, 2010	—	—	4,331,000	0.26
Granted	—	—	1,700,000	0.10
Expired	—	—	(991,000)	0.43
Balance, January 31, 2011	—	—	5,040,000	0.16
Granted	10,000,000	0.10	2,150,000	0.10
Expired	—	—	(715,000)	0.25
Balance, January 31, 2012	**10,000,000**	0.10	**6,475,000**	**0.13**

Warrants

In October 2011, the Company issued 10,000,000 share purchase warrants exercisable at $0.10 per common share pursuant to a private placement of units. The warrants were valued at $0.02 per warrant using the Black-Scholes option valuation model with the following assumptions (dividend rate – 0.00%, volatility – 151.7%, risk-free interest rate – 1.20%, expected life – 2 years). The warrants are set to expire 24 months from the date of issue.

11. SHARE CAPITAL [CONTINUED]

Share options

For the year ended January 31, 2012, the Company granted 2,150,000 share options, as per the Company's Share Option Plan. Options vest immediately on date of grant. Out of this total, 200,000 share options, with exercise prices ranging from $0.10 to $0.15 were granted to non-employees and 1,950,000 share options, all with an exercise price of $0.10 were granted to employees (note 13).

For the year ended January 31, 2011, the Company granted 1,700,000 share options, as per the Company's Share Option Plan. Out of this total, 450,000 share options, all with an exercise price of $0.10 were granted to non-employees and 1,250,000 share options, all with an exercise price of $0.10 were granted to employees (note 13).

Under the Company's Share Option Plan the aggregate number of common shares eligible for issuance under the Share Option Plan shall not exceed 8,000,000. At January 31, 2012, 1,525,000 options are available for issue.

Basic and diluted loss per share

Basic loss per share has been calculated using the weighted average number of common shares outstanding during the year (2012 – 75,882,512; 2011 – 70,675,662). For the periods presented, the calculation of loss per common share on a diluted basis excluded all potential common shares because the effect was anti-dilutive.

12. CAPITAL DISCLOSURES

The Company is a biotechnology company and consistent with other companies in the industry, the Company's objectives when managing capital are to safeguard its accumulated capital in order to maintain its ability to continue as a going concern so that it can continue with its drug development program and strive to maximize shareholder value. Note 1 provides a discussion surrounding the Company's ability to continue as a going concern. Capital is defined by the Company as shareholders' deficiency (primarily comprised of share capital, contributed surplus and deficit) and current term debt consisting of a convertible debenture and demand loans. The Company manages its capital structures, and makes adjustments to it based on the needs of the Company's operations and the requirement for funding to continue with the Company's drug development program. The Company does this through new share or debt issuances, selling assets or licensing its technologies to third parties to fund operations. The Company is not subject to any externally imposed capital requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended January 31, 2012 and 2011

13. SHARE-BASED PAYMENTS

For the year ended January 31, 2012, the Company granted a total of 2,150,000 (2011 – 1,700,000) share options under the Company's Share Option Plan. Options vest immediately on date of grant. The fair value of options vesting in 2012 of $84,000 (2011 - $71,000) was recognized as a s share-based payment expense and credited to contributed surplus for the years ended January 31, 2012 and 2011. There were no forfeitures of Company's share options during the years ended January 31, 2012 and 2011.

The Company used the Black-Scholes option pricing model to estimate the fair value of these options. The Company considers historical volatility of its common shares in estimating future share price volatility. The following assumptions were used:

	2012 $	**2011** $
Dividend yield	**0.00%**	0.00%
Volatility	**135.2-166.8%**	129-226%
Risk-free interest rate	**0.81-3.20%**	1.98-3.60%
Expected life (years)	**2 - 10**	5 - 10
Fair value per option	**$0.02 - $0.04**	$0.04-$0.06

14. DEFERRED REVENUE

The Company recognized $85,667 of deferred revenue on the consolidated statements of loss and comprehensive loss during the year ended January 31, 2012 (2011 - $8,000) in connection with the Company's August 31, 2011 termination of the October, 2006 marketing distribution rights agreement with KMH (see note 11).

15. SEGMENT DISCLOSURES

The Company is managed as one operating segment – biopharmaceutical/pharmaceutical products. Management assesses performance and makes resource decisions based on the consolidated results of operations of this operating segment. Substantially all of the operations of the Company are directly engaged in or support this operating segment. The following table presents information on the Company's operating results for the years ended January 31, 2012 and 2011, by geographic area.

15. SEGMENT DISCLOSURES [CONTINUED]

Revenues by geographic area

	2012 $	2011 $
Asia	**85,667**	8,000

Revenues are attributed to countries based on location of customers or counterparties. Revenues represent market distribution rights recognized during the year.

16. DEMAND LOANS AND RELATED PARTY TRANSACTIONS

During the year ended January 31, 2011, the Company entered into a demand loan agreement with one of its officers to provide up to $1,000,000 bearing interest at 8% compounded annually to be used for the Company's operating expenditures. This financing is unsecured, has no fixed terms of repayment with interest payable monthly. As at January 31, 2012, the Company had drawn $739,154 on this financing, including accrued interest of $59,154. During the year ended January 31, 2012, the Company secured additional demand loan financing of $100,000 from a director of the Company. This demand loan financing bears interest at 8% per annum, interest payable monthly and is unsecured with principal repayment to be made 30 days after demand. During fiscal 2011 and 2012, the Company secured demand loan financing of $90,000 from an officer of the Company and $150,000 from an unrelated third party to the Company. These demand loan financings bear interest at 8% per annum, interest payable monthly and are unsecured with no fixed terms of repayment. During the year ended January 31, 2012, the Company incurred $77,043 (2011 – $40,368) in interest under the demand loan financing, $66,415 with related parties (2011 – $39,433) of which $29,298 was paid during the year and the remainder of $37,117 accrued at year end.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended January 31, 2012 and 2011

17. SUPPLEMENT CASH FLOW INFORMATION

NET CHANGE IN NON-CASH WORKING CAPITAL ITEMS RELATED TO OPERATING ACTIVITIES

	2012 $	2011 $
Accounts receivable	**3,942**	97,679
Prepaid expenses	**(13,139)**	(10,870)
Accounts payable and accrued liabilities	**419,356**	308,618
	410,159	395,427

During the year ended January 31, 2012, the Company paid $94,781 of interest (2011 - $64,345) and income taxes of nil (2011 - nil).

18. GOVERNMENT ASSISTANCE

During the year ended January 31, 2012, the Company recognized $39,839 (2011 - $30,466) from Alberta Finance related to scientific research and development claims made for research and development expenditures incurred in fiscal 2011 and 2010. This funding was treated as a reduction of research and development expenses.

	2012 $	2011 $
Gross research and development expenditures	**807,272**	827,302
Less government assistance	**(39,839)**	(30,466)
Research and development expenditures, net	**767,433**	796,836

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's financial instruments include cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities, and the convertible debenture and the demand loans.

a) Carrying value and fair value

The carrying values of cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities, the convertible debenture and the demand loans approximate their fair value due to the immediate or short term maturity of these financial instruments. The fair value of the Company's financial instruments of cash and cash equivalents and marketable securities are measured using the Level 1 classification of the fair value hierarchy.

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT [CONTINUED]

b) Risks

i) Foreign currency risk
The Company has certain assets and liabilities that are denominated in foreign currencies and are exposed to risks from changes in foreign exchange rates and the degree of volatility of these rates. Due to the limited number of transactions that are denominated in foreign currencies, the Company does not consider its exposure to foreign currency risk to be significant and currently does not use derivative instruments to reduce its exposure to this.

ii) Liquidity risk
Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's exposure to liquidity risk is dependent on its ability to raise funds to meet its commitments and sustain its operations. The Company controls liquidity risk by managing its working capital and by securing additional funds through equity, debt or partnering transactions (see Capital Disclosures, note 12). In fiscal 2011 and 2012, the Company secured debt financing from its officers and from unrelated third parties to provide demand loan financing for operational expenditures (note 8). On October 25, 2011, the Company secured equity financing of $600,000 through the issuance of common shares and share purchase warrants (see Share Capital, note 11). Subsequent to year end, the Company renegotiated the maturity of its convertible debenture to September 22, 2012.

iii) Credit risk
Financial instruments that subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. To minimize its exposure to credit risk for cash equivalents, the Company invests surplus cash in short-term deposits that are fully guaranteed by the Company's financial banker, a major Canadian chartered bank. As the Company is a research and development company, the Company's exposure to credit risk related to accounts receivable is not considered to be significant. At year end, 100% of accounts receivable was due from one federal government agency.

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT [CONTINUED]

iv) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents are comprised of highly liquid deposits or investments that earn interest at market rates. Interest on the convertible debenture and demand loans is at fixed rates. Consequently, the Company is exposed to fair value changes on long-term debt when the market interest rate changes. Accounts receivable, accounts payable and accrued liabilities bear no interest.

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company's policy limits the investing of excess funds to liquid government guaranteed deposits or guaranteed investment certificates.

20. LOSS PER SHARE

Basic and diluted net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the year. In determining diluted net loss and net loss per common share, the weighted average number of common shares outstanding is adjusted for share options and warrants eligible for exercise where the average market price of common shares for the year ended January 31, 2012 exceeds the exercise price. Common shares that could potentially dilute basic net loss and net loss per common share in the future that could be issued from the exercise of share options and warrants were not included in the computation of the diluted loss per common share for the year ended January 31, 2012 because to do so would be anti-dilutive.

The numerator and denominator used in the calculation of historical basic and diluted net loss amounts per common share are as follows:

	2012 $	**2011** $
Net loss	**($1,368,535)**	($1,353,773)
Number of weighted average common shares outstanding	**75,882,512**	70,675,662
Loss per share	**($0.02)**	($0.02)

20. LOSS PER SHARE [CONTINUED]

The following number and type of securities could potentially dilute basic earnings per common share in the future. These securities are not included in the computation of diluted earnings per share, because to so would have reduced the loss per common share (anti-dilutive) for the years presented:

	2012	2011
Share-based payment transactions	**6,475,000**	5,040,000
Warrants	**10,000,000**	—
	16,475,000	5,040,000

21. COMPENSATION OF KEY MANAGEMENT

Key management includes directors and executives of the Company. The compensation paid or payable (including share-based payments) to key management for services is shown below:

	2012 $	2011 $
Salaries and short term employee benefits	**400,906**	386,481
Director compensation	**18,000**	10,000
	418,906	396,481

During the year ended January 31, 2012, 1,950,000 share options (2011 – 1,250,000) were granted to executives and to independent directors.

22. SUBSEQUENT EVENTS

In March 2012, the Company signed an agreement with its convertible debenture holders to extend the date of maturity by six months. Under the agreement, the convertible debenture has a maturity date of September 22, 2012 with all other conditions remaining unchanged.

In May 2012, the Company closed a $500,000 private placement of 5,000,000 common shares at $0.10 per share. This transaction is subject to TSX Venture Exchange approval.