Consolidated Financial Statements

Quest PharmaTech Inc.

Nine Months ended October 31, 2010

(Unaudited)

Quest PharmaTech Inc.

National Instrument 51 – 102
Continuous Disclosure Obligations

Notice

Pursuant to Part 4.3 (3) of National Instrument 51 – 102, these unaudited interim consolidated financial statements of Quest PharmaTech Inc. for the nine month period ended October 31, 2010 have not been reviewed by the Company’s auditors.

Quest PharmaTech Inc.

CONSOLIDATED BALANCE SHEETS

(see note 1 – going concern uncertainty)

As at

	October 31, 2010 (Unaudited) $	January 31, 2010 (Audited) $
ASSETS		
Current		
Cash	**8,263**	31,752
Accounts receivable	**10,823**	104,672
Marketable securities *[note 5]*	**54,544**	47,872
Prepaid expenses	**9,570**	6,575
	83,200	190,871
Property and equipment *[note 4]*	**137,429**	177,880
Intangible assets *[note 3]*	**179,967**	140,000
	400,596	508,751
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	**471,778**	315,512
Demand loans *[note 13]*	**645,000**	—
Convertible debenture *[note 6]*	**500,000**	500,000
Deferred credit on adjustment to equity component of convertible debenture *[note 6]*	**7,863**	—
Current portion of deferred revenue *[note 11]*	**8,000**	8,000
	1,632,641	823,512
Deferred revenue *[note 11]*	**79,667**	85,667
	1,712,308	909,179
Shareholders' deficiency		
Share capital *[note 8]*	**24,198,875**	24,058,875
Shares to be issued *[note 3]*	—	60,000
Equity portion of convertible debenture *[note 6]*	**40,000**	60,000
Contributed surplus *[note 8]*	**1,692,365**	1,674,365
Deficit	**(27,242,952)**	(26,253,668)
	(1,311,712)	(400,428)
	400,596	508,751

See accompanying notes

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

	For the quarter ended October 31		For the nine months ended October 31	
	2010 $	2009 $	**2010** $	2009 $
REVENUE				
License fees and market distribution rights *[notes 7 and 11]*	**2,000**	**2,000**	**6,000**	**756,000**
EXPENSES				
General and administrative	**89,142**	**144,234**	**313,154**	**472,480**
Research and development, net *[note 15]*	**151,654**	**109,360**	**559,008**	**322,743**
Amortization	**27,266**	**17,665**	**80,484**	**52,575**
Bank charges and interest *[notes 6 and 13]*	**23,939**	**11,575**	**60,623**	**37,341**
	292,001	**282,834**	**1,013,269**	**885,139**
Loss before the undernoted	**(290,001)**	**(280,834)**	**(1,007,269)**	**(129,139)**
Other income (expenses):				
Interest income	**5,069**	**159**	**12,206**	**1,998**
Foreign exchange loss	**(634)**	**(235)**	**(893)**	**(4,403)**
Gain (loss) on fair value change in marketable securities *[note 5]*	**20,350**	**6,756**	**6,672**	**(18,440)**
	24,785	**6,680**	**17,985**	**(20,845)**
Net and comprehensive loss for the period	**(265,216)**	**(274,154)**	**(989,284)**	**(149,984)**
Deficit, beginning of period	**(26,977,736)**	**(25,611,699)**	**(26,253,668)**	**(25,735,869)**
Deficit, end of period	**(27,242,952)**	**(25,885,853)**	**(27,242,952)**	**(25,885,853)**
Basic and diluted loss per share	**($0.00)**	**($0.00)**	**($0.01)**	**($0.00)**

See accompanying notes

Quest PharmaTech Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the quarter ended October 31		For the nine months ended October 31	
	2010	2009	**2010**	2009
	$	$	**$**	$
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES				
Net loss for the period	**(265,216)**	**(274,154)**	**(989,284)**	**(149,984)**
Items that do not involve cash:				
Interest accreted on convertible debenture *[note 6]*	**(5,000)**	—	**(12,137)**	**2,863**
Amortization	**27,266**	**17,665**	**80,484**	**52,575**
Stock-based compensation *[notes 8 and 10]*	—	**15,000**	**18,000**	**19,250**
(Gain) loss on fair value change in marketable securities *[note 5]*	**(20,350)**	**(6,756)**	**(6,672)**	**18,440**
Deferred revenue recognized *[notes 7 and 11]*	**(2,000)**	**(2,000)**	**(6,000)**	**(756,000)**
Cash received on deferred licenses *[note 7]*	—	—	—	**500,000**
Changes in non-cash working capital items relating to operating activities *[note 14]*	**158,599**	**1,286**	**247,120**	**(95,614)**
	(106,701)	**(248,959)**	**(668,489)**	**(408,470)**
CASH PROVIDED BY FINANCING ACTIVITIES				
Increase in demand loans *[note 13]*	**95,000**	—	**645,000**	—
	95,000	—	**645,000**	—
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES				
Purchase of property, plant and equipment	—	**(39,805)**	—	**(45,671)**
	—	**(39,805)**	—	**(45,671)**
Decrease in cash and cash equivalents	**(11,701)**	**(288,764)**	**(23,489)**	**(454,141)**
Cash and cash equivalents, beginning of period	**19,964**	**429,449**	**31,752**	**594,826**
Cash and cash equivalents, end of period	**8,263**	**140,685**	**8,263**	**140,685**

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

1. DESCRIPTION OF BUSINESS AND GOING CONCERN UNCERTAINTY

Description of business

Quest PharmaTech Inc., (the "Company") is incorporated under the Business Corporations Act (Alberta). The Company's principal business activity is the research and development of pharmaceutical products. The Company is publicly traded on the TSX Venture Exchange under the symbol "QPT".

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'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 and 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.

2. SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim consolidated financial statements have been prepared by management in accordance with the accounting policies described in the Company's consolidated financial statements for the year ended January 31, 2010. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended January 31, 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

3. INTANGIBLE ASSETS

	October 31, 2010		January 31, 2010	
	Cost	**Accumulated amortization**	**Cost**	**Accumulated amortization**
	$	$	$	$
Immunotherapy technology	**237,500**	**57,533**	157,500	17,500
Hypocrellin based technology and Licenses	**2,476,822**	**2,476,822**	2,476,822	2,476,822
CDK technology	**225,000**	**225,000**	225,000	225,000
	2,939,322	**2,759,355**	2,859,322	2,719,322
Net book value	**179,967**		140,000	

During the three and nine month periods ended October 31, 2010, amortization of intangible assets was $13,783 and $40,033, respectively (during the three and nine month periods ended October 31, 2009 – $nil and $nil, respectively).

CORE TECHNOLOGIES

Immunotherapy technology and Licenses ("Immunotherapy Technology")
In 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 to be 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 determined to take complete control over the technology and issued the final 3,500,000 common shares under the agreement. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

3. INTANGIBLE ASSETS (CONTINUED)

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 6).

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 would not proceed with further development with respect to the CDK technology at this time.

4. PROPERTY AND EQUIPMENT

	at October 31, 2010		At January 31, 2010	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	$	$	$	$
Computer equipment	**80,744**	**72,040**	80,744	69,515
Furniture and fixtures	**12,114**	**11,358**	12,114	11,138
Office equipment	**31,494**	**30,273**	31,494	29,918
Manufacturing and R&D equipment	**456,084**	**330,539**	456,084	294,090
Leasehold improvements	**2,305**	**1,102**	2,305	200
	582,741	**445,312**	582,741	404,861
Net book value	**137,429**		177,880	

During the three and nine month periods ended October 31, 2010, amortization of property and equipment was $13,483 and $40,451, respectively (for the three and nine month periods ended October 31, 2009 - $17,665 and $52,575, respectively).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

5. MARKETABLE SECURITIES

The Company currently holds the following marketable securities which are recorded as follows:

	At October 31, 2010 $	At January 31, 2010 $
1,351,111 common shares of Brand Marvel Worldwide Consumer Products Corporation	**54,044**	47,289
8,334 common shares of Samaritan Pharmaceuticals Inc.	**500**	583
	54,544	47,872

During the three and nine month periods ended October 31, 2010, the Company recorded fair value adjustments of $20,350 and $6,672, respectively (during the three and nine month periods ended October 31, 2009 - $6,756 and ($18,440), respectively) in connection with the above noted shares.

6. 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 3). 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, 2010, the maturity date had been extended to March 22, 2011. 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.

On March 22, 2010, in connection with the one year extension of the maturity date of the convertible debenture, the Company used the residual value method to allocate the proceeds of $500,000 between the liability component and the equity component based on the Black-Scholes option pricing model assuming an expected life of one year, dividend yield of 0%, average expected volatility of 189.3% and an average risk-free interest rate of 0.28%. The equity component was calculated to be $40,000 (January 31, 2010 - $60,000). The resulting $20,000 reduction in the equity component is being treated as a deferred credit and is being amortized over a one year period with the amortized amount ($7,137 during the six month period ended July 31, 2010) accounted for as interest income. At October 31, 2010, the remaining unamortized portion of the deferred credit was calculated to be $7,863 ($20,000 less $12,137). At October 31, 2010, the liability component of the convertible debenture was calculated to be $500,000 (at January 31, 2010 - $500,000).

6. CONVERTIBLE DEBENTURE (CONTINUED)

During the three and nine month periods ended October 31, 2010, the Company incurred $11,250 and $22,500, respectively (2009 - $11,250 and $22,500, respectively) in interest under the convertible debenture. Also recorded was accreted interest income of $5,000 and $12,137, respectively, for the three and nine month periods ended October 31, 2010. The Company recorded accreted interest expense of $2,863 for the nine month period ended October 31, 2009.

7. LICENSE FEES

On December 14, 2007, the Company signed a license agreement to receive $3,000,000 to develop oncology products based on its SonoLight Technology. Under the terms of the agreement, the Company received $1,000,000 on execution of the agreement with an additional $1,500,000 received during fiscal 2009. During fiscal 2010, the Company received the final $500,000 license fee in connection with this agreement. The license agreement requires the Company to pay royalties on all future net revenue from the commercialization of the Company's SonoLight oncology products. Under the terms of the agreement, the Company was required to use commercially reasonable efforts to initiate a Phase 1 clinical trial for photodynamic therapy treatment of prostate cancer. The Company has recognized the license fee in relation to the costs incurred with these efforts and has recognized $nil and $750,000 of the license fee during the three and nine month periods ended October 31, 2009.

8. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

8. SHARE CAPITAL (CONTINUED)

Issued

	Number of common shares	Amount $
Common shares		
At January 31, 2010	**69,697,580**	24,058,875
Shares issued on Oct 22, 2010 for technology purchase	**3,500,000**	140,000
At October 31, 2010	**73,197,580**	24,198,875

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 has also committed to issuing 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, $120,000 was recorded as deferred revenue which will be recognized into income over the fifteen-year term of the agreement. During the nine month period ended October 31, 2010, the Company recognized $6,000 (2009 - $6,000) of the deferred amount into income. The remaining $80,000 was applied to share capital based on the fair value of the shares at the date of the agreement with KMH.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

8. SHARE CAPITAL (CONTINUED)

Stock options

The following options to purchase common shares were outstanding as at October 31, 2010.

Exercise price $	Options outstanding #	Weighted average remaining life (years)	Options exercisable #
0.10	**1,300,000**	**2.79**	**1,300,000**
0.15	**525,000**	**0.30**	**525,000**
0.25	**2,065,000**	**0.81**	**2,015,000**
	3,890,000	**3.90**	**3,840,000**

The following schedule details the stock options granted, exercised and expired:

	Stock options	
	Number of shares #	**Weighted average exercise price $**
Balance, January 31, 2010	4,331,000	0.26
Granted	350,000	0.10
Expired	(791,000)	0.49
Balance, October 31, 2010	**3,890,000**	**0.19**

For the three and nine month periods ended October 31, 2010, the Company granted nil and 350,000 stock options, respectively, as per the Company's Stock Option Plan. All of these options have an exercise price of $0.10 and were granted to non-employees (note 10).

For the three and nine month periods ended October 31, 2009, the Company granted 500,000 and 675,000 stock options, respectively, as per the Company's Stock Option Plan. These options have exercise prices ranging from $0.15 to $0.25 and were granted to non-employees (note 10).

On January 26, 2010, the Company received shareholder and regulatory approval to amend the Company's Stock Option Plan such that the aggregate number of common shares eligible for issuance under the Stock Option Plan shall not exceed 8,000,000. At October 31, 2010, 4,110,000 options are available for issue.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

8. SHARE CAPITAL (CONTINUED)

Contributed surplus

	2010	2009
	$	$
Contributed surplus, January 31	**1,674,365**	1,603,615
Stock-based compensation expense	**18,000**	19,250
Contributed surplus, October 31	**1,692,365**	1,622,865

9. 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) equity (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 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 and licensing its technologies to third parties to fund operations. The Company is not subject to externally imposed capital requirements.

10. STOCK-BASED COMPENSATION

For the three and nine month periods ended October 31, 2010, the Company granted a total of nil and 350,000 stock options, respectively (2009 – 500,000 and 675,000, respectively) under the Company's Stock Option Plan. The fair value of options vesting in the period of $nil and $18,000, respectively (2009 - $15,000 and $19,250, respectively) was recognized as an expense and credited to contributed surplus for the period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

10. STOCK-BASED COMPENSATION (CONTINUED)

The Company used the Black-Scholes option pricing model to estimate the fair value of these options. The following assumptions were used:

	October 31, 2010	**October 31, 2009**
Dividend yield	**0.00%**	0.00%
Volatility	**129 - 226%**	149 - 178%
Risk-free interest rate	**1.33 - 3.45%**	1.30 – 1.78%
Expected life (years)	**3 - 10**	2 - 5
Fair value per option	**$0.04 - $0.06**	$0.03 - $0.04

11. DEFERRED REVENUE

The Company has recorded deferred revenue in connection with market distribution rights received but not earned as follows:

	October 31, 2010	**Jan 31, 2010**
	$	$
Market distribution rights (*note 8*)	**87,667**	93,667
Less: current portion	**(8,000)**	(8,000)
Long term portion	**79,667**	85,667

The Company recognized $2,000 and $6,000, respectively of this deferred revenue on the statements of operations during the three and nine month periods ended October 31, 2010 and 2009.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

12. SEGMENT DISCLOSURES

The Company is managed as one operating segment – biopharmaceutical / pharmaceutical products. The following table presents information on the Company's operating results by geographic area.

Revenues by geographic area

	Three months ended Oct 31, 2010	Three months ended Oct 31, 2009	Nine months ended Oct 31, 2010	Nine months ended Oct 31, 2009
	$	$	$	$
Asia	**2,000**	2,000	**6,000**	756,000
	2,000	2,000	**6,000**	756,000

Revenues are attributed to countries based on location of customers or counterparties. Revenues represent market distribution rights and license fees earned during the period.

13. DEMAND LOANS AND RELATED PARTY TRANSACTIONS

During the nine month period ended October 31, 2010, 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 October 31, 2010, the Company had drawn $645,000 on this financing. During the three and nine month periods ended October 31, 2010, the Company incurred $12,108 and $25,391, respectively, in interest under the demand loan financing. Subsequent to October 31, 2010, the Company drew a further $145,000 on this financing (see Subsequent Events, note 17).

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

	3 Months Ended Oct 31 / 10	3 Months Ended Oct 31 / 09	9 Months Ended Oct 31/ 10	9 Months Ended Oct 31/ 09
	$	$	$	$
Accounts receivable	**(1,269)**	(953)	**93,849**	22,739
Prepaid expenses and other assets	**(4,397)**	1,724	**(2,995)**	31,919
Accounts payable and accrued liabilities	**164,265**	515	**156,266**	(150,272)
	158,599	1,286	**247,120**	(95,614)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

15. GOVERNMENT ASSISTANCE

In April, 2008, the Company obtained government assistance in the form of an IRAP grant to cover salaries and contractor fees related to the development of the Company's sonodynamic therapy for the treatment of peritoneal cancer. During the three and nine month periods ended October 31, 2010, the Company recognized $nil and $nil, respectively (2009 - $19,463 and $81,514, respectively) of funding as a reduction of research and development expenses.

During the three month period ended October 31, 2010, the Company received $30,466 from Alberta Finance related to scientific research and development claims made for research and development expenditures incurred in fiscal 2010. This funding was treated as a reduction of research and development expenses.

	3 Months Ended		9 Months Ended	
	Oct 31 / 10	**Oct 31 / 09**	**Oct 31/ 10**	**Oct 31/ 09**
	$	**$**	**$**	**$**
Gross R & D expenses	**182,120**	128,823	**589,474**	404,257
Less government assistance	**(30,466)**	(19,463)	**(30,466)**	(81,514)
R & D expenses, net	**151,654**	109,360	**559,008**	322,743

16. FINANCIAL INSTRUMENTS

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

a) Carrying value and fair value

The carrying values of cash and cash equivalents, accounts receivable, marketable securities, accounts payable and accrued liabilities and the convertible debenture approximate fair value due to the immediate or short term maturity of these financial instruments. The fair values of other financial instruments reflect the Company's best estimate based upon estimated interest rates at which the Company believes it could enter into with similar instruments at the consolidated balance sheet dates. The fair value of the Company's financial instruments is measured using a Level 1 classification.

16. FINANCIAL INSTRUMENTS (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 foreign currency risk.

At October 31, 2010, the Company's exposure to foreign currency risk is US$2,657 in cash and US$57,557 in accounts payable and accrued liabilities. The period end rate of conversion of U.S. to Canadian dollars is 1.0188. Based on the foreign currency exposures noted above, a 10 percent strengthening of the Canadian dollar would have decreased the net loss by $5,593 assuming that all other variables remain unchanged. A 10 percent weakening of the Canadian dollar would have an equal but opposite effect, assuming that all other variables remain unchanged.

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. During the nine month period ended October 31, 2010, the Company secured debt financing from one of its officers to provide up to $1,000,000 in demand ban financing for operational expenditures. In March 2010, the Company renegotiated the maturity of its convertible debenture to March 22, 2011.

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 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 period end, approximately 94% of accounts receivable were due from one federal government agency.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended October 31, 2010

16. FINANCIAL INSTRUMENTS (CONTINUED)

b) Risks (continued)

iv) Market risk

The Company owns investments in common shares of a publicly traded company that subject the Company to market risk. As market prices change, the Company's income and the value of its marketable securities are affected. The Company expects that its exposure to market risk will be short lived as the investments are viewed as temporary in nature. At period end, a 10 percent increase in the market price of those shares would have decreased the net loss by $5,454, assuming that all other variables remain unchanged. A 10 percent decrease in the market price would have increased the net loss by $5,454, assuming that all other variables remained unchanged.

v) Interest rate risk

Interest rate risk is the risk that the fair value of 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 long-term debt is at fixed rates. Consequently, the Company is exposed to fair value changes on long-term debt when the market rate of interest 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.

17. SUBSEQUENT EVENTS

Subsequent to period end, the Company drew $145,000 on its demand loan financing (see Demand Loans and Related Party Transactions, note 13). To date, the Company has drawn a total of $790,000 on this financing.