

Consolidated Financial Statements

**Quest PharmaTech Inc.**

January 31, 2008 and 2007

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## AUDITORS' REPORT

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To the Shareholders of  
**Quest PharmaTech Inc.**

We have audited the consolidated balance sheets of **Quest PharmaTech Inc.** as at January 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada,  
April 10, 2008.

*Ernst + Young LLP*

Chartered Accountants

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**Quest PharmaTech Inc.****CONSOLIDATED BALANCE SHEETS****(see note 1 - going concern uncertainty)**

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As at January 31

	2008	2007
	\$	\$
		<i>(restated - note 17)</i>
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	1,305,802	123,022
Accounts receivable	168,893	23,513
Prepaid expenses and other assets	32,240	16,595
	<b>1,506,935</b>	163,130
Property, plant and equipment <i>[note 4]</i>	66,665	96,966
Assets held for sale - intangible <i>[note 5]</i>	37,500	—
	<b>1,611,100</b>	260,096
<b>LIABILITIES AND SHAREHOLDERS'</b>		
<b>EQUITY (DEFICIENCY)</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	161,265	582,581
Deposit on share subscription	—	183,000
Demand notes <i>[note 13]</i>	—	230,000
Convertible debenture <i>[note 6]</i>	500,000	991,434
Current portion of deferred revenue <i>[notes 7 and 10]</i>	758,000	—
	<b>1,419,265</b>	1,987,015
Deferred revenue <i>[notes 7 and 10]</i>	101,667	117,667
	<b>1,520,932</b>	2,104,682
Commitments and contingencies <i>[note 9]</i>		
<b>Shareholders' equity (deficiency)</b>		
Share capital <i>[note 10]</i>	23,998,875	21,048,675
Equity portion of convertible debenture <i>[note 6]</i>	40,000	80,000
Warrants <i>[note 10]</i>	144,000	—
Contributed surplus <i>[note 10]</i>	1,439,115	1,240,115
Deficit	(25,531,822)	(24,213,376)
	<b>90,168</b>	(1,844,586)
	<b>1,611,100</b>	260,096

*See accompanying notes*

On behalf of the Board:

(signed)  
Ragupathy (“Madi”) Madiyalakan  
Director

(signed)  
Ian McConnan  
Director



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**Quest PharmaTech Inc.****CONSOLIDATED STATEMENTS OF OPERATIONS,  
COMPREHENSIVE LOSS AND DEFICIT**

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Years ended January 31

	2008	2007
	\$	\$
		<i>(restated - note 17)</i>
<b>REVENUE</b>		
License fees and market distribution rights <i>[note 7]</i>	<b>574,575</b>	2,333
<b>EXPENSES</b>		
General and administrative	<b>869,593</b>	640,718
Research and development, net <i>[note 15]</i>	<b>901,530</b>	861,954
Amortization	<b>28,571</b>	60,715
Bank charges and interest <i>[notes 6 and 13]</i>	<b>98,662</b>	119,876
	<b>1,898,356</b>	1,683,263
<b>Loss before the undernoted</b>	<b>(1,323,781)</b>	(1,680,930)
<b>Other income (expenses)</b>		
Interest income	<b>17,338</b>	267
Foreign exchange gain (loss)	<b>(13,803)</b>	5,252
Gain (loss) on sale of property, plant and equipment and other assets	<b>(7,462)</b>	21,307
	<b>(3,927)</b>	26,826
<b>Loss from continuing operations</b>	<b>(1,327,708)</b>	(1,654,104)
Income from discontinued operations <i>[note 5]</i>	<b>9,262</b>	200,027
<b>Net and comprehensive loss for the year</b>	<b>(1,318,446)</b>	(1,454,077)
Deficit, beginning of year	<b>(24,213,376)</b>	(22,759,299)
<b>Deficit, end of year</b>	<b>(25,531,822)</b>	(24,213,376)
<b>Basic and diluted income (loss) per share</b>		
Continuing operations	<b>\$(0.02)</b>	\$(0.04)
Discontinued operations	<b>\$0.00</b>	\$0.01
	<b>\$(0.02)</b>	\$(0.03)

*See accompanying notes*

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**Quest PharmaTech Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years ended January 31

	2008	2007
	\$	\$
<b>CASH USED IN OPERATING ACTIVITIES</b>		
Net loss for the year	(1,318,446)	(1,454,077)
Income from discontinued operations	(9,262)	(200,027)
	<u>(1,327,708)</u>	<u>(1,654,104)</u>
Items that do not involve cash:		
Interest accreted on convertible debenture <i>[note 6]</i>	8,566	15,879
Amortization	28,571	60,715
Stock-based compensation <i>[note 11]</i>	159,000	109,630
Loss (gain) on sale of property, plant and equipment and other assets	7,462	(21,307)
Deferred revenue recognized in the year	(8,000)	(2,333)
Cash received on sale of market distribution rights	—	120,000
Cash received on deferred license fees <i>[note 7]</i>	750,000	—
Net change in non-cash working capital items related to continuing operating activities <i>[note 14]</i>	(582,341)	408,532
	<u>(964,450)</u>	<u>(962,988)</u>
<b>CASH PROVIDED BY FINANCING ACTIVITIES</b>		
Shares issued on private placement <i>[note 10]</i>	2,875,200	80,000
Increase in demand notes	—	343,300
Repayment of demand notes	(230,000)	(113,300)
Repayment of convertible debenture	(500,000)	—
Deposit on share subscription	—	183,000
	<u>2,145,200</u>	<u>493,000</u>
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>		
Purchase of property, plant and equipment	(1,500)	(8,095)
Proceeds from sale of property, plant and equipment and other assets	1,365	72,079
	<u>(135)</u>	<u>63,984</u>
Foreign exchange loss on cash held in foreign currency	(7,097)	—
<b>Cash provided by (used in) continuing operations</b>	<u>1,173,518</u>	<u>(406,004)</u>
<b>Cash provided by discontinued operations</b>		
Operating activities	4,262	24,309
Investing activities	5,000	389,212
	<u>9,262</u>	<u>413,521</u>
<b>Net increase in cash and cash equivalents</b>	<u>1,182,780</u>	<u>7,517</u>
Cash and cash equivalents, beginning of year	123,022	115,505
<b>Cash and cash equivalents, end of year</b>	<u>1,305,802</u>	<u>123,022</u>

*See accompanying notes*

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**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.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES**

The Company's consolidated financial statements have been prepared following Canadian generally accepted accounting principles ("GAAP"). 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, revenues and expenses. Actual results may vary from those estimated. The recoverable value of property, plant and equipment of \$66,665, and assets held for sale of \$37,500, are the more significant items which reflect estimates in these consolidated financial statements. 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 below.

#### **Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries:

Altachem Pharma Inc.  
Danamedix Inc.  
Sonolight Pharmaceuticals Corp. ("Sonolight")  
Steroidogenesis Inhibitors Canada Inc. ("SI Canada")

Altachem Pharma Inc. and Danamedix Inc. were dissolved during the year ended January 31, 2008.

All significant intercompany transactions and balances are eliminated in the preparation of these consolidated financial statements.

#### **Cash and cash equivalents**

Cash and cash equivalents includes balances with banks, net of outstanding cheques, and short-term liquid investments with maturities of less than 90 days. Such investments are carried at fair value.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Intangible assets**

Intangible assets include proprietary rights, intellectual property and patent rights which have been acquired from third parties. Intangible assets are recorded at 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 the expected utilization of the underlying technology and an assessment as to whether estimated future net cash flows exceed the carrying value of the proprietary rights and intellectual property. If the rights and intellectual property are not considered to be fully recoverable, a provision is recognized for the unrecoverable amount.

*Patent rights*

Patent rights are recorded at 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 recognized for the unrecoverable amount.

**Property, plant and equipment**

Property, plant and equipment is recorded at cost less accumulated amortization. Amortization of property, plant and equipment is calculated over the estimated useful life on a declining balance basis at the following annual rates:

Computer hardware and software	30%
Furniture and fixtures	30%
Office equipment	30%
Manufacturing and R&D equipment	30%

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **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, 2008 and 2007, 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' equity (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.

#### **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.

#### **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 translation of assets and liabilities are included in income for the period.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Government assistance**

Government assistance, which is non-refundable, 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. Government assistance towards the acquisition of property, plant and equipment is deducted from the cost of the related property, plant and equipment.

#### **Stock-based compensation**

The Company accounts for stock options 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 10 and is recognized over the vesting period of the options granted. Consideration paid on the exercise of stock options is credited to share capital.

Under the fair value based method, stock-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 stock-based payments to non-employees are recognized over the vesting period. For fully vested and non-forfeitable stock based payments, the cost is measured and recognized at the grant date.

#### **Income taxes**

The Company uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. A valuation allowance is recorded for the portion of the future tax assets for which the realization of any value is not more likely than not to occur. As at January 31, 2008 and 2007, the Company recognized a valuation allowance of \$4,887,655 and \$5,133,506, respectively.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### **Basic and diluted income (loss) per share**

Basic income (loss) per share is calculated using the weighted average number of common shares outstanding during the period. Diluted income (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 income (loss) per share computation.

Basic income (loss) per share has been calculated using the weighted-average number of common shares outstanding during the year [2008 – 58,500,119; 2007 – 42,500,594]. For the periods presented, the calculation of income (loss) per common share on a diluted basis excluded all potential common shares because the effect was anti-dilutive.

#### **Changes in significant accounting policies**

##### *Accounting changes*

Effective February 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) Section 1506, *Accounting Changes*. The new standard allows for voluntary changes in an accounting policy only when the changes result in the financial statements providing reliable and more relevant information. This standard also requires a change in accounting policy to be applied retroactively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. It includes the disclosure, on an interim and annual basis, of a description and the impact on the Company’s financial results of any new primary source of GAAP that has been issued but is not yet effective. The adoption of the new standard did not have an impact on the Company’s financial position or its results of operations.

##### *Financial instruments, equity and comprehensive income*

Effective February 1, 2007, the Company adopted CICA Section 3855, *Financial Instruments – Recognition and Measurement*; Section 1530, *Comprehensive Income*; and Section 3251, *Equity*, prospectively without restatement of prior periods.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### *Financial instruments, equity and comprehensive income (continued)*

Section 1530 provides guidance on the reporting and presentation of comprehensive income. Comprehensive income is the change in equity of an enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by shareholders and distributions to shareholders. Other comprehensive income comprises revenues, expenses, gains and losses that are recognized in comprehensive income, but are excluded from net loss calculated in accordance with GAAP. The adoption of this standard had no impact on the Company's deficit as of February 1, 2007.

Under Section 3855, financial assets and liabilities are classified as either held for trading, available-for-sale, loans and receivables, investments held to maturity, and other financial liabilities. Financial assets classified as held for trading and available-for-sale are measured on the consolidated balance sheets 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. Loans and receivables, investments held to maturity and other financial liabilities are measured on the consolidated balance sheets at amortized cost.

On adopting Section 3855, the Company designated cash and cash equivalents as held for trading. The Company classified 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. The adoption of the new standards did not have a material impact on the presentation of the consolidated financial statements.

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 within interest expense.

Prior to the adoption of the new standards, derivatives embedded in other financial instruments were not accounted for separately from the host instrument. On adopting the new standards, the Company performed a review of its contracts to identify any embedded derivatives. No significant embedded derivatives were identified.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

#### *Financial instruments, equity and comprehensive income (continued)*

Section 3251 requires separate presentation of changes in equity for the period from net income, other comprehensive income, retained earnings, contributed surplus, share capital and reserves and separate presentation of the components of equity, including retained earnings, accumulated other comprehensive income, contributed surplus, share capital and reserves. The adoption of the new standard did not have a material impact on the presentation of equity of the Company.

#### **Recent accounting pronouncements**

In October 2006, the CICA issued Section 1535, *Capital Disclosures*. The new standard requires disclosure of qualitative and quantitative information that enables users of financial statements to evaluate an entity's objectives, policies and processes for managing capital. These recommendations are effective for the Company's interim and annual reporting periods beginning February 1, 2008. The Company is currently determining the impact of these additional disclosure requirements but expects that there will be incremental disclosures required regarding the Company's capital and how it is managed.

The CICA also issued Section 3862, *Financial Instruments – Disclosure* and Section 3863, *Financial Instruments – Presentation* in October 2006. These Sections will effectively replace existing Section 3861, *Financial Instruments – Disclosure and Presentation* effective for the Company's interim and annual reporting periods beginning February 1, 2008. Section 3862 requires disclosures by class of financial instruments that enable users to evaluate the significance of financial instruments for the Company's financial position and performance. Disclosures are also required of qualitative and quantitative information that enables users of financial statements to evaluate the nature and extent of the Company's exposure to the risks arising from financial instruments, specifically credit risk, liquidity risk and market risk. Quantitative disclosures must also include a sensitivity analysis for each type of market risk the Company is exposed to and how net income and other comprehensive income would be affected. Section 3863 carries forward the presentation requirements of Section 3861 already adopted by the Company. As a result, the Company expects the only effect of the new standards will be additional disclosures regarding the significance of financial instruments for the Company's financial position and performance and the nature, extent and management of risks arising from financial instruments to which the Company is exposed.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**3. INTANGIBLE ASSETS**

	2008		2007	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
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
<b>Net book value</b>	<b>2,701,822</b>	<b>2,701,822</b>	<b>2,701,822</b>	<b>2,701,822</b>

During the year, amortization of intangible assets related to continuing operations was nil [2007 – \$11,833].

**CORE TECHNOLOGIES:**

**Hypocrellin based technology and licenses (“SonoLight Technology”)**

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].

**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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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January 31, 2008 and 2007

### 4. PROPERTY, PLANT AND EQUIPMENT

	2008		2007	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Computer hardware and software	79,670	65,316	79,670	59,288
Furniture and fixtures	12,114	10,122	12,114	9,269
Office equipment	31,494	28,278	36,943	31,388
Manufacturing and R&D equipment	306,217	259,114	306,217	238,033
	<b>429,495</b>	<b>362,830</b>	434,944	337,978
<b>Net book value</b>	<b>66,665</b>		96,966	

During the year, amortization of property, plant and equipment related to continuing operations was \$28,571 [2007 - \$48,882].

### 5. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

During 2006, the Company announced that it had approved initiatives to divest itself of certain non-core technologies and operations as a part of a plan to focus on core technologies and refinancing the Company.

Accordingly, the results of operations and financial position of these non-core technologies and operations have been segregated and presented separately as discontinued operations and assets held for sale in the consolidated financial statements. The values of these non-core technologies and operations have been measured and presented at the lower of the carrying amount or estimated fair value less estimated costs to sell. These non-core technologies and operations are as follows:

Intangible assets held for sale:

	2008		2007	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Bionex technology and license	407,100	369,600	369,600	369,600
<b>Net book value</b>	<b>37,500</b>		—	

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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January 31, 2008 and 2007

### 5. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE (CONTINUED)

During the year, amortization of intangible assets held for sale was nil [2007 - \$5,464] and is included in discontinued operations, net of income taxes.

#### **Bionex technology and license (proprietary rights)**

The Company owns the exclusive worldwide rights to develop, manufacture and sell Bionex, a family of novel disinfectants used for multiple applications. As consideration for its acquisition of the technology, the Company was required to issue 400,000 common shares as certain milestones outlined in the technology purchase agreement are met. To date, 400,000 common shares have been issued pursuant to this agreement, of which 240,000 were issued in 2008 and 160,000 were issued in 2003. The shares issued in 2008 were recorded at a value of \$36,000 that represents the closing price of the common shares on the date the shares were issued. In 2008, the Company also capitalized \$1,500 worth of consulting costs to get the Bionex asset ready for sale. On December 21, 2007, and amended on April 18, 2008 [note 19], the Company signed a technology transfer agreement with a third party to sell its interest in the Bionex technology. Under the terms of the agreement, the Company will receive cash of \$50,000, certain share consideration and certain future royalties upon the successful commercialization of Bionex related products. The agreement is contingent upon TSX Venture Exchange approval of the pending transaction between the purchaser and another unrelated company.

#### **Business license – China**

The Company, through Shanghai Hua Gao Pharmaceutical Pellet Core Ltd. (“SHGP”), held a business license issued by State Administration for Industry and Commerce of the People’s Republic of China. The Company sold all its interest in SHGP to the Gaojing Government in July, 2006.

#### **Accu-MAb™ license (proprietary rights)**

The Company had acquired the inventory and associated rights to produce and distribute a diagnostic test kit (“Accu-MAb”) for the detection of whooping cough. The assets and technology related to Accu-MAb were sold for gross proceeds of \$200,000 on June 9, 2006.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**5. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE  
(CONTINUED)**

**ACP-HIP (patent rights)**

The Company had the worldwide patent rights over compounds with anti-Kaposi's Sarcoma and HIV treatment described as the ACP-HIP molecule, to make, have made, use, lease, sell, import and export technology products and processes, and practice the technology processes. This intangible asset was sold on January 30, 2006 to the original inventor for \$60,000 plus future payments on successful milestones and sales royalties.

**Anticort™ license (proprietary rights)**

The Company owned the exclusive renewable rights to market and distribute the product Anticort™ ("Anticort") in Canada. On July 21, 2006 the Company sold its Anticort rights for gross proceeds of U.S. \$50,000 and certain share consideration.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**5. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE  
(CONTINUED)**

The following table shows revenue and net after-tax income (loss) from the discontinued operations for the years ended January 31, 2008 and 2007:

	<b>2008</b>				
	<b>SHGP (China)</b>	<b>Accu- MAb (Canada)</b>	<b>ACP- HIP (Canada)</b>	<b>Anticort (Canada)</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Revenue</b>	—	—	—	—	—
<b>Income from operating activities</b>	—	—	—	—	—
Disposal gain	—	<b>4,262</b>	<b>5,000</b>	—	<b>9,262</b>
<b>Income for the year, net of income taxes</b>	—	<b>4,262</b>	<b>5,000</b>	—	<b>9,262</b>

	<b>2007</b>				
	<b>SHGP (China)</b>	<b>Accu- MAb (Canada)</b>	<b>ACP- HIP (Canada)</b>	<b>Anticort (Canada)</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Revenue</b>	—	24,787	—	—	24,787
<b>Income from operating activities</b>	—	18,074	—	—	18,074
Disposal gain (loss)	(70,349)	174,696	—	77,606	181,953
<b>Income (loss) for the year, net of income taxes</b>	(70,349)	192,770	—	77,606	200,027

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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January 31, 2008 and 2007

### 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 SonoLight 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 January 31, 2008, the maturity date had been extended to March 22, 2008. Subsequent to year end, the debenture holders agreed to extend the maturity date to March 22, 2009. 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.

The Company has used the residual value method to allocate the proceeds of \$500,000 between the liability component and the equity component based on a Black-Scholes option pricing model assuming an expected life of one year, dividend yield of 0%, average expected volatility of 115.1% and an average risk-free interest rate of 3.13%. The equity component was calculated to be \$40,000. The liability component was accreted to the face value of the debenture over its term and the accretion charge was accounted for as interest expense.

During the year ended January 31, 2008, the Company incurred \$85,516 [2007 - \$99,212] in interest under this convertible debenture, of which \$8,566 [2007 - \$15,879] was in the form of accreted interest.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **7. LICENSE FEES**

On April 30, 2007, the Company signed a license agreement granting an exclusive license for multinational rights to the Company's proprietary SonoLight Technology for dermatology applications (excluding cosmetic hair removal applications in Asia and acne applications in Korea). Under the terms of the agreement, the purchaser is responsible for dermatology related development and commercialization activities outside of Canada. Under the terms of the license agreement, the Company will receive license fees and the right to royalties on future sales and certain payments on the achievement of specified milestones defined in the agreement. During the year ended January 31, 2008, the Company recognized US\$300,000 (Cdn \$316,575) of license fees related to this agreement.

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 \$2,000,000 to be received within twelve months of execution. The license agreement requires the Company to pay royalties on all future net revenue from the commercialization of the Company's oncology products. Under the terms of the agreement, the Company is required to use commercially reasonable efforts to initiate a Phase 1 clinical trial for photodynamic therapy treatment of prostate cancer. The Company is recognizing the license fee in relation to the costs incurred with these efforts and has recognized \$250,000 of the license fee as at January 31, 2008.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**8. INCOME TAXES**

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

	<b>2008</b>	<b>2007</b>
	\$	\$
Loss from continuing operations	<b>(1,327,708)</b>	(1,654,104)
Statutory tax rate	<b>31.9%</b>	32.37%
Tax recovery at Canadian statutory rate	<b>(423,539)</b>	(535,433)
Adjustment in income taxes resulting from:		
Non-deductible stock-based compensation expense	<b>50,721</b>	35,487
Impact on future tax assets resulting from statutory rate reduction	<b>615,226</b>	681,747
Non-taxable portion of capital gain	—	(4,847)
Non-deductible expenses and other	<b>3,443</b>	9,005
Valuation allowance	<b>(245,851)</b>	(185,959)
Future tax recovery	—	—

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

	<b>2008</b>	<b>2007</b>
	\$	\$
<b>Future tax assets</b>		
Non-capital loss carryforwards	<b>3,650,811</b>	4,011,969
Tax cost of property, plant and equipment in excess of book values	<b>180,457</b>	202,123
Tax cost of intangible assets in excess of book values	<b>128,850</b>	149,466
Scientific research and experimental development tax credits	<b>92,321</b>	107,092
Share issue costs deductible for tax purposes	<b>15,147</b>	—
Capital loss carryforwards	<b>820,069</b>	662,856
	<b>4,887,655</b>	5,133,506
Valuation allowance	<b>(4,887,655)</b>	(5,133,506)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**8. INCOME TAXES (CONTINUED)**

The Company and its subsidiaries have non-capital losses for income tax purposes of approximately \$13,940,000 at January 31, 2008 [2007 - \$13,743,000] that may be applied against future taxable income. In addition, the Company has scientific research and experimental development expenses of \$369,000, which expire in 2023. In total, approximately \$13,940,000 [2007 - \$13,743,000] of non-capital losses and \$4,939,300 [2007 - \$3,867,000] 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:

	<b>Non-capital losses</b>	<b>ITC</b>
	\$	\$
2009	1,252,200	—
2010	2,543,900	—
2011	2,682,200	—
2012	—	64,000
2013	—	9,600
2015	1,936,500	—
2026	2,443,500	—
2027	1,951,700	—
2028	1,130,000	—
	<u>13,940,000</u>	<u>73,600</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**9. COMMITMENTS AND CONTINGENCIES**

**a) Lease obligations**

The Company is committed to lease payments, including estimated operating costs, for its business premises as follows to August 31, 2011:

	<b>Continuing operations</b>
	\$
2009	37,364
2010	37,364
2011	37,364
2012	21,801
	<u>133,893</u>

Operating lease expense of \$32,488 was incurred during 2008 [2007 - \$59,333] (general and administrative expense of \$9,728 [2007 - \$15,960]; and research and development expense of \$22,760 [2007 - \$43,373]).

**b) Research and development**

The Company has commitments to fund various research and development activities in the normal course of its business. Subject to successful completion of contractual milestones, the Company is committed to approximately \$364,609 of research and development expenditures for fiscal 2009.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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January 31, 2008 and 2007

### 10. 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.

#### Issued

	<b>Number of common shares</b>	<b>Amount \$</b>
<b>Common shares</b>		
<b>At January 31, 2006</b>	42,237,580	20,968,675
Shares issued pursuant to a private placement	1,000,000	80,000
<b>At January 31, 2007</b>	43,237,580	21,048,675
Shares issued pursuant to a private placement	9,600,000	816,000
Shares issued pursuant to a private placement	3,000,000	300,000
Shares issued pursuant to a private placement	5,733,333	860,000
Shares issued pursuant to private placements	6,386,667	938,200
Shares issued pursuant to intangible asset purchase <i>[note 5]</i>	240,000	36,000
<b>At January 31, 2008</b>	68,197,580	23,998,875

At January 31, 2008, the Company holds 125,000 common shares for cancellation.

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.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **10. SHARE CAPITAL (CONTINUED)**

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. In 2008, the Company recognized \$8,000 [2007 - \$2,333] 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.

In March, 2007, the Company closed a non-brokered private placement with the sale of 9,600,000 units for gross proceeds of \$960,000, including \$167,000 raised from Officers and Directors of the Company. Each unit consisted of one common share and one half of one non-transferable share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$0.20 at any time within one year of issuance. The fair value of \$144,000 for these warrants was estimated at the grant date utilizing the Black-Scholes option pricing model assuming an expected life of one year, a dividend yield of 0%, average expected volatility of 128.4% and an average risk free interest rate of 2.83%.

In May, 2007, under the KMH agreement, the Company closed a non-brokered private placement with the sale of 3,000,000 common shares for gross proceeds of \$300,000.

In May and July, 2007, the Company closed a non-brokered private placement with the sale of 5,733,333 common shares for gross proceeds of \$860,000, including \$55,000 raised from Officers and Directors of the Company.

In December, 2007, the Company closed two non-brokered private placements with the sale of 6,386,667 common shares for proceeds of \$938,200 (net of share issue costs of \$69,800), including \$7,500 raised from an Officer of the Company.

In December, 2007, the Company completed an issuance of 240,000 common shares from treasury related to a September, 2001 technology purchase agreement for Bionex. The common shares were valued at the closing price of the shares on the day of issue of the shares of \$0.15 per share.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

January 31, 2008 and 2007

**10. SHARE CAPITAL (CONTINUED)**

The following options to purchase common shares were outstanding as at January 31, 2008.

Exercise price \$	Options outstanding #	Weighted average remaining life (years)	Options exercisable #
0.25	3,181,000	2.99	3,181,000
0.31	171,000	1.91	171,000
0.52	200,000	1.17	200,000
0.64	50,000	1.10	50,000
0.67	50,000	0.85	50,000
1.00	250,000	2.05	250,000
	<b>3,902,000</b>	<b>2.74</b>	<b>3,902,000</b>

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

	Shares issuable on exercise of			
	Warrants		Stock options	
	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$
<b>Balance, January 31, 2006</b>	2,986,000	0.45	3,730,000	0.79
Granted	—	—	1,250,000	0.25
Expired	(2,986,000)	0.45	(887,000)	0.35
<b>Balance, January 31, 2007</b>	—	—	4,093,000	0.72
Granted	4,800,000	0.20	1,663,000	0.25
Expired	—	—	(1,854,000)	1.14
<b>Balance, January 31, 2008</b>	<b>4,800,000</b>	<b>0.20</b>	<b>3,902,000</b>	<b>0.32</b>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**10. SHARE CAPITAL (CONTINUED)**

**Warrants**

In March, 2007, the Company issued 4,800,000 share purchase warrants exercisable at \$0.20 per common share pursuant to a private placement of units. These warrants were set to expire 12 months from the date of issue. In March, 2008, the Company received approval from the TSX Venture Exchange to extend the expiry date of the warrants to September 19, 2008 [note 19].

During the year ended January 31, 2007, 2,986,000 warrants issued in 2006 and exercisable at \$0.45 per common share expired without exercise. The recorded value of these warrants of \$98,740 was reflected in contributed surplus on the expiry of the warrants.

**Stock options**

For the year ended January 31, 2008, the Company granted 1,663,000 stock options, as per the Company's Stock Option Plan. Out of this total, 1,163,000 stock options were granted to non-employees and 500,000 were granted to employees. All of these stock options have an exercise price of \$0.25 [note 11].

For the year ended January 31, 2007, the Company granted 1,250,000 stock options, as per the Company's Stock Option Plan. Out of this total, 613,000 stock options were granted to non-employees and 637,000 were granted to employees. All of these stock options have an exercise price of \$0.25 [note 11].

On September 15, 2005, 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 is equal to 10% of the number of the Company's issued and outstanding common shares at that date. The aggregate number of common shares reserved for issuance under the Company's Stock Option Plan shall not exceed 6,819,758. At January 31, 2008, 2,917,758 options are available for issue.

**Escrowed shares**

As at January 31, 2008, the Company's transfer agent held 1,207,155 [2007 - 1,810,733] common shares pursuant to a time-based escrow agreement (prior to October 31, 2004, these shares were subject to a TSX Venture Exchange performance-based escrow agreement). These shares will be automatically released over time through to October 30, 2009.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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January 31, 2008 and 2007

### 10. SHARE CAPITAL (CONTINUED)

#### Contributed surplus

	2008	2007
	\$	\$
Contributed surplus, beginning of year	1,240,115	1,031,745
Stock-based compensation expense	159,000	109,630
Change in equity component of convertible debenture	40,000	—
Expiration of warrants	—	98,740
Contributed surplus, end of year	<u>1,439,115</u>	<u>1,240,115</u>

### 11. STOCK-BASED COMPENSATION

For the year ended January 31, 2008, the Company granted a total of 1,663,000 [2007 – 1,250,000] stock options under the Company's Stock Option Plan. The fair value of options vesting in 2008 of \$159,000 [2007 - \$109,630] was recognized as an expense and credited to contributed surplus for the year ended January 31, 2008.

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

	2008	2007
	\$	\$
Dividend yield	0.00%	0.00%
Volatility	49.2 – 118%	95.9 - 118%
Risk-free interest rate	2.96 – 4.75%	2.93 - 3.13%
Expected life (years)	0.25 – 5.00	2.90 – 5.00
Fair value per option	<u>\$0.00 - \$0.11</u>	<u>\$0.03 - \$0.06</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**12. 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, 2008 and 2007, by geographic area.

**Revenues by geographic area**

	<b>2008</b>		<b>2007</b>	
	<b>Continuing operations</b>	<b>Discontinued operations</b>	<b>Continuing operations</b>	<b>Discontinued operations</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Canada	—	—	—	426
United States	<b>316,575</b>	—	—	22,336
Other	<b>258,000</b>	—	2,333	2,025
	<b>574,575</b>	—	2,333	24,787

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

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **13. DEMAND NOTES AND RELATED PARTY TRANSACTIONS**

- a) In June, 2007, the Company repaid the \$50,000 demand note held by a company controlled by a Director of the Company. This demand note was obtained in fiscal 2007, was unsecured, had no fixed terms of repayment and bore interest at 6% per annum, payable monthly. Interest of \$1,044 was incurred on this note in fiscal 2008.
- b) In December, 2007, the Company repaid \$180,000 worth of demand notes held by a company controlled by a Director of the Company. These demand notes were obtained in fiscal 2007, were unsecured, had no fixed terms of repayment and bore interest at 6% per annum, payable monthly. Interest of \$9,883 was incurred on these notes in fiscal 2008.
- c) Of the Company's private placements closed during the year, \$229,500 was raised from Officers and Directors of the Company.
- d) During fiscal 2007, the Company obtained bridge financing from related parties, including Officers and Directors of the Company in the amount of \$41,800. This bridge financing was unsecured, had no fixed terms of repayment and was non-interest bearing. This bridge financing was repaid in full in fiscal 2007.
- e) During fiscal 2007, the Company obtained bridge financing from third parties in the amount of \$71,500. This bridge financing was unsecured and had no fixed terms of repayment. Of the amounts borrowed, \$60,000 bore interest at 8% per annum, payable monthly and the remainder was non-interest bearing. The \$71,500 was repaid in full in fiscal 2007.
- f) On August 8, 2005, the Company entered into an agreement with a company controlled by a director of the Company to provide consulting services. The consulting agreement required the Company to make monthly payments of \$7,500 plus reimbursable out-of-pocket expenses, was for a term of 12 months and the amounts were recorded at the exchange amount agreed to by the parties. This consulting agreement expired August 31, 2006. In March, 2007, the Company paid \$15,975 related to consulting services provided in fiscal 2007. The amounts were accrued but unpaid at the end of fiscal 2007.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

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

	<b>2008</b>	<b>2007</b>
	\$	\$
Accounts receivable	<b>(145,380)</b>	143,408
Prepaid expenses and other assets	<b>(15,645)</b>	16,869
Accounts payable and accrued liabilities	<b>(421,316)</b>	248,255
	<b>(582,341)</b>	408,532

During the year ended January 31, 2008, the Company paid approximately \$90,096 of interest [2007 - \$96,000] and income taxes of nil [2007 – nil].

**15. GOVERNMENT ASSISTANCE**

During the year ended January 31, 2006, the Company was awarded a grant from the Alberta Ingenuity Fund to cover salary expenditures related to the development of the Company's photodynamic therapy for prostate cancer. The \$110,000 grant is being paid over a 24-month period. During the year ended January 31, 2008, the Company received \$12,583 [2007 - \$55,000] under this grant which was recorded as a reduction to research and development expenses.

In August, 2006, the Company obtained federal government assistance in the form of a grant from the National Research Council's Industrial Research Assistance Program ("NRC-IRAP") to cover salaries and contractor fees related to the development of the Company's photodynamic therapy for the treatment of acne. During the year ended January 31, 2008, the Company recognized \$13,339 [2007 - \$36,160] of funding as a reduction of research and development expenses. This funding was part of a \$49,500 grant the Company was eligible to receive for the period to March 31, 2007.

In May, 2007, the Company obtained federal government assistance in the form of an NRC-IRAP grant to cover salaries and contractor fees related to the development of a prototype LED device for the Company's photodynamic therapy for hair removal. During the year ended January 31, 2008, the Company recognized \$26,500 of funding as a reduction of research and development expenses.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

**15. GOVERNMENT ASSISTANCE (CONTINUED)**

	<b>2008</b>	<b>2007</b>
	\$	\$
Gross research and development expenses	<b>953,952</b>	970,714
Less government assistance	<b>(52,422)</b>	(108,760)
<b>Research and development expenses, net</b>	<b>901,530</b>	861,954

**16. FINANCIAL INSTRUMENTS**

**a) Fair value**

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and the convertible debenture. The fair value of financial instruments represents the amounts that would have been received from or paid to counterparties, calculated at the reporting date, to settle these instruments. Transaction costs on financial instruments are expensed when incurred. Purchases and sales of financial assets are accounted for at trade dates. Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and the convertible debenture are assets and liabilities that have short periods to maturity and the carrying values contained in the consolidated balance sheets approximate their estimated fair value. 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.

**b) 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. The Company does not currently use derivative instruments to reduce its exposure to foreign currency risk.

**c) Credit risk**

Financial instruments that subject the Company to credit risk consist primarily of accounts receivable. At January 31, 2008 approximately 89% of accounts receivable were due from one organization.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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January 31, 2008 and 2007

### **17. PRIOR PERIOD RESTATEMENT**

The 2007 accounts payable and accrued liabilities and opening deficit figures have been restated to reflect an overstatement of the balance as at January 31, 2007. The impact of the restatement was to reduce accounts payable and accrued liabilities and the deficit at the beginning of the year by \$47,442.

### **18. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

### **19. SUBSEQUENT EVENTS**

On March 1, 2008, the Company signed an agreement with its convertible debenture holders to extend the date of maturity by one year. Under the agreement, the convertible debenture has a maturity date of March 22, 2009, with all other conditions remaining unchanged. The impact on the consolidated financial statements will be a decrease in the convertible debenture and an increase to the equity component of the convertible debenture of \$20,000.

On March 5, 2008, the Company received TSX Venture Exchange approval to a six-month extension of the expiry date of the Company's share purchase warrants. The warrants will now expire on September 19, 2008. The impact on the consolidated financial statements will be a decrease in the warrants and increase to contributed surplus of \$96,000.

On April 22, 2008, the Company announced that it had obtained approval for Federal government assistance in connection with an NRC-IRAP grant of up to \$198,362 to cover salaries and contractor fees related to the development of the Company's Sonodynamic therapy for ultrasound for oncology applications.

On May 7, 2008, the Company announced that it had signed a technology transfer agreement, as amended, with a third party to sell its interest in the Bionex technology. Under the terms of the agreement, the Company will receive cash of \$50,000, 1,351,111 common shares of Toba Industries Ltd. ("Toba") and \$200,000 of future royalties upon the successful commercialization of Bionex related products. The agreement is contingent upon TSX Venture Exchange approval of the pending transaction between Toba and the third party.

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