

Financial Statements

Synodon Inc.
(a development stage enterprise)
October 31, 2006

AUDITORS' REPORT

To the Shareholders of
Synodon Inc.

We have audited the balance sheets of **Synodon Inc.** (a development stage enterprise) as at October 31, 2006 and 2005 and the statements of 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 financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2006 and 2005 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
February 6, 2007

Ernst + Young LLP

Chartered Accountants

Synodon Inc.
(a development stage enterprise)

BALANCE SHEET
[see note 1 – going concern communication]

As at October 31,

	2006	2005
	\$	\$
ASSETS		
Current		
Cash	305	26
Accounts receivable <i>[note 9]</i>	120,746	43,204
Investment tax credits recoverable	353,342	47,591
Prepaid expenses	5,579	6,475
	479,972	97,296
Property, plant and equipment <i>[note 3]</i>	15,376	19,626
Deferred transaction costs <i>[note 13]</i>	311,959	—
	807,307	116,922
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	810,073	750,696
Deferred government assistance <i>[note 9]</i>	158,830	—
Notes payable <i>[note 4]</i>	112,000	19,185
Deposit on share subscription <i>[note 7]</i>	—	20,000
Deposit on distribution rights <i>[note 5]</i>	65,875	65,875
	1,146,778	855,756
Commitments <i>[notes 5, 6 and 9]</i>		
Shareholders' deficiency		
Share capital <i>[note 7]</i>	3,285,593	1,776,483
Contributed surplus <i>[note 7]</i>	322,006	586,156
Deficit	(3,947,070)	(3,101,473)
	(339,471)	(738,834)
	807,307	116,922

See accompanying notes

On behalf of the Board:

Director

Director

Synodon Inc.
(a development stage enterprise)

STATEMENT OF LOSS AND DEFICIT

Year ended October 31

	2006	2005
	\$	\$
EXPENSES		
Research and development costs, net of government assistance [<i>notes 9 and 10</i>]	205,312	803,811
Amortization	9,840	12,923
Advertising and marketing	290	20,496
Financing charges and interest	26,187	174,098
Foreign exchange gains	(4,642)	(13,012)
Stock-based compensation	92,400	447,500
Office and general administrative	516,210	454,945
	845,597	1,900,761
Net loss for the year	(845,597)	(1,900,761)
Deficit, beginning of year	(3,101,473)	(1,200,712)
Deficit, end of year	(3,947,070)	(3,101,473)
Loss per share – basic and diluted	(0.05)	(0.18)
Weighted-average number of shares outstanding	16,074,357	10,467,389

See accompanying notes

Synodon Inc.
(a development stage enterprise)

STATEMENT OF CASH FLOWS

Year ended October 31

	2006	2005
	\$	\$
OPERATING ACTIVITIES		
Loss for the year	(845,597)	(1,900,761)
Add charges to operations not requiring a current cash payment		
Stock-based compensation	92,400	447,500
Non-cash payment for services <i>[note 7]</i>	69,966	17,000
Non-cash interest expense <i>[note 4]</i>	815	135,056
Amortization	9,840	12,923
	(672,576)	(1,288,282)
Net change in non-cash working capital balances related to operations		
Account receivable	(77,542)	23,253
Investment tax credits recoverable	(305,751)	57,768
Prepaid expenses	896	5,242
Accounts payable and accrued liabilities	47,119	635,372
Deferred government assistance	158,830	—
Cash used in operating activities	(849,024)	(566,647)
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(5,590)	(7,310)
Cash used in investing activities	(5,590)	(7,310)
FINANCING ACTIVITIES		
Deposit on share subscription	—	20,000
Repayment of notes payable	—	(11,000)
Issuance of notes payable	112,000	506,300
Issuance of shares	1,079,341	—
Payment of share issuance costs	(24,489)	—
Deferred transaction costs	(311,959)	—
Cash provided by financing activities	854,893	515,300
Net increase (decrease) in cash during the year	279	(58,657)
Cash, beginning of year	26	58,683
Cash, end of year	305	26
Supplemental cash flow information		
Interest paid	39,041	8,704
Other non-cash transactions <i>[notes 4, 7 and 12]</i>		
<i>See accompanying notes</i>		

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

1. NATURE OF BUSINESS AND GOING CONCERN COMMUNICATION

Nature of business

Synodon Inc. (the "Company") was incorporated under the laws of Alberta. The Company is a development stage enterprise that is developing an airborne survey leak detection system. At present, the Company anticipates completion of its instrument by spring of 2007

Going concern communication

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles 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 is in the development stage, has incurred significant losses since incorporation and as at October 31, 2006, the Company has a working capital deficiency of \$666,806 and an accumulated deficit of \$3,947,070. After considering the proceeds received on the Company's initial public offering [note 13] the Company believes it will require additional financing during its fiscal 2007 year in order to continue its operations. The Company's ability to continue as a going concern is dependant upon achieving profitable operations, the continued financial support of its lenders and the ability to obtain additional debt or equity financing. The outcome of these matters cannot be predicted at this time. These financial statements do not include any adjustment to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The precise determination of many assets and liabilities is dependent on future events. As a result, the preparation of financial statements for a period involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates and approximations. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

Property and equipment

Property and equipment is recorded at cost less accumulated amortization. Management assesses the carrying value of all property, and equipment using its best estimate of undiscounted future cash flows whenever conditions arise which could indicate a possible impairment. Any impairment is recognized when it is identified and is measured by the amount which the carrying value of the asset exceeds its estimated fair value.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Amortization is provided over the estimated useful lives of the assets using the following methods and rates with half-year amortization provided in the year of acquisition:

Computer equipment	3 years straight-line
Computer software	100%
Laboratory equipment	20% declining balance
Furniture and fixtures	20% declining balance

Revenue recognition

The Company's services are generally sold based upon purchase orders or contracts with customers that include fixed or determinable prices based upon kilometres surveyed. Revenue is recognized when services are rendered and only when collectibility is reasonably assured.

Translation of foreign currencies

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets are acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in expenses in the current period.

Research and development

Research costs are expensed as incurred. Development costs that meet specific criteria related to technical, market and financial feasibility are capitalized. To date, all development costs have been expensed.

Government assistance

Government assistance in connection with research activities is recognized as an expense reduction in the year that the related expenditure is incurred. Federal and provincial investment tax credits are accounted for as a reduction of expenditures in the year in which the credits are earned and when there is likely assurance of their recovery. Assistance related to future periods is deferred and recognized as an expense reduction as the related expenses are incurred.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. A valuation

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized.

Financial instruments

The carrying values of accounts receivable, investment tax credits recoverable, accounts payable and accrued liabilities, notes payable, deposit on share subscription and deposit on distribution rights approximate their fair values due to the relatively short periods to maturity of these instruments.

Stock based compensation

The Company utilizes the fair value method of accounting for stock based compensation. Under the fair-value based method, compensation cost is measured at fair value at the date of grant using the Black-Scholes option pricing model with assumptions as described in note 7, and is expensed over the award's vesting period. Any consideration paid by employees upon exercise of stock options is recorded as an increase to share capital. The Company's stock-based compensation plan is more fully described in note 7.

Loss per share

The calculation of loss per share is based on net loss divided by the weighted-average number of common shares outstanding during the year. Diluted loss per share reflects the assumed conversion of all dilutive securities using the treasury stock method. Under the treasury stock method, the weighted-average number of common shares outstanding is calculated assuming that the proceeds from the exercise of options and warrants are used to repurchase common shares at the average price during the year. For the current year, the calculation of loss per common share on a diluted basis excluded all potential common shares because the effect was anti-dilutive.

3. PROPERTY, PLANT AND EQUIPMENT

	<u>2006</u>		<u>2005</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Computer equipment	35,136	28,389	29,546	21,912
Computer software	6,120	6,120	6,120	4,914
Laboratory equipment	3,865	1,788	3,865	1,269
Furniture and fixtures	12,031	5,479	12,031	3,841
	<u>57,152</u>	<u>41,776</u>	<u>51,562</u>	<u>31,936</u>
Net book value		<u>15,376</u>		<u>19,626</u>

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

4. NOTES PAYABLE

	2006	2005
	\$	\$
Convertible promissory notes		
Notes, bearing interest at 8% per annum	60,000	—
Notes, bearing interest at 12% per annum	—	19,185
Demand promissory notes		
Notes, bearing interest at 8% per annum.	52,000	—
	112,000	19,185

The convertible promissory notes are either redeemable or convertible at the option of the holder.

During the year ended October 31, 2006, the Company issued convertible promissory notes with a face value of \$60,000. These notes are due on demand and are convertible into 150,000 Class A common shares. The fair value of the equity component of these notes was estimated to be \$Nil.

During the year ended October 31, 2006, the Company issued promissory notes with a face value of \$52,000. These notes are payable on demand and include \$49,000 payable to directors of the Company.

During the year ended October 31, 2005, the Company repaid notes with a face value of \$11,000 and renewed the balance of the notes with a face value of \$20,000 that matured during fiscal 2005 for a further one year under the same terms with \$10,000 maturing on each of April 10, 2006 and October 10, 2006. On February 15, 2006, these notes were converted into 50,000 Class A common shares [note 7].

The proceeds of the convertible promissory notes in the year ended October 31, 2005 were allocated to their debt and equity components upon issuance. The liability component was initially recorded during the year ended October 31, 2005 as \$18,850 which was calculated as the present value of the interest and principal amounts discounted at a rate approximating an interest rate applicable to non-convertible debt at the time the notes were issued. The residual amount of \$1,150 was recorded in contributed surplus during the year ended October 31, 2005. The liability component was accreted to its fair value over the term of the notes as a non-cash charge to interest expense.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

4. NOTES PAYABLE (CONTINUED)

On November 22, 2004 the Company borrowed funds from an officer of the Company under the terms of a convertible promissory note. Total funds advanced under this note were \$506,300. The proceeds were initially allocated into the debt and equity components on the same basis as the promissory notes above. The liability component was initially recorded as \$394,501 and the residual amount of \$111,799 was recorded as contributed surplus. The terms of the note included repayment of the principal sum plus interest at 8% per annum on or before May 31, 2007, unless sooner accelerated or otherwise converted in accordance with the terms of the note. On October 15, 2005, the Company called for the conversion of this note plus accrued interest calculated to May 31, 2007 in exchange for 2,759,800 Class A common shares. Upon conversion, the initial value of the note plus interest accreted during the period outstanding of \$40,993, interest payable of \$92,342 and the residual balance in contributed surplus of \$111,799, which totalled \$639,635, was recorded as the value of the Class A common shares issued.

During the year ended October 31, 2006 interest expense of \$2,840 [October 31, 2005 - \$138,002] was recorded on these notes. At October 31, 2006 unpaid interest of \$1,322 [October 31, 2005 - \$2,400] is included in accrued liabilities.

5. DEPOSIT ON DISTRIBUTION RIGHTS OPTION

During the year ended October 31, 2004, the Company granted a third party the right to purchase the distribution rights in the Saudi Arabian peninsula region in consideration for a fee of \$65,875. The option expires on July 31, 2007. Upon exercise of the option, the third party will have exclusive distribution rights over the designated area for a period of three years in conformance with specified terms. The third party will retain 30% of the service revenue generated from the region with the remainder of the revenue being retained by the Company. In the event that the third party does not exercise the right, the holder may elect to convert the deposit into Class A common shares of the Company at the per share value at the time of the last arm's length sale of Class A common shares by the Company prior to conversion.

6. COMMITMENTS

The Company is committed to pay base rent and condominium fees under the terms of a long-term operating lease for office premises until October 1, 2007. The payments committed over the next year total \$39,875.

The Company has also entered into agreements with various third party organizations whereby these parties will provide services or payments to the Company with a combined value of up to \$235,000. These services or payments are in support of the Company's research and development activities and are in exchange for the opportunity to either negotiate future distribution agreements or obtain discounted pricing for a period of time once the Company has commenced commercial operations. No payments or services have been provided or exchanged to date in connection with these agreements.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. SHARE CAPITAL

	2006	2005
	\$	\$
Authorized		
Unlimited number of Class A voting common shares		
Unlimited number of Class B voting common shares		
Unlimited number of Class C non-voting common shares		
Unlimited number of Class D non-voting common shares		
Unlimited number of Class E non-voting, redeemable, retractable preferred shares		
Issued and outstanding		
17,255,550 Class A common shares	3,285,593	—
13,134,815 Class A common shares	—	1,776,483

	Number of shares #	Total \$
Balance, October 31, 2004	10,295,015	1,119,848
Issued for services rendered	80,000	17,000
Issue on conversion of note payable	2,759,800	639,635
Balance, October 31, 2005	13,134,815	1,776,483
Issued in private placements, net of costs of issuance of \$44,475	2,741,499	1,054,751
Issued for services	174,916	69,966
Issued for commissions on private placement	11,820	4,728
Issued on conversion of note payable	50,000	21,150
Issued for cash from exercise of options	1,142,500	115
Reclassify from contributed surplus on exercise of options	—	358,400
Balance, October 31, 2006	17,255,550	3,285,593

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. SHARE CAPITAL (CONTINUED)

During the year ended October 31, 2006, the Company closed on two separate private placements, issuing 2,741,499 Units, each consisting of one Class A common share and one quarter common share purchase warrant, for gross proceeds of \$1,099,226. Under the first private placement, the Company issued 393,999 Units at an issue price of US \$0.35 per Unit for total proceeds of US \$137,900 (CAD \$160,226). Each whole warrant entitles the holder to subscribe for one Class A common share before December 31, 2009 at an exercise price of \$0.65 US. Under the first private placement, 98,500 common share purchase warrants were issued. Under the second private placement, the Company issued 2,347,500 Units at an issue price of \$0.40 per Unit for total proceeds of \$939,000. Each whole warrant entitles the holder to subscribe for one Class A common share at an exercise price of \$0.60 before December 31, 2006 and \$0.70 before December 31, 2007. Under the second private placement, 586,876 common share purchase warrants were issued. The Company applied the residual approach and allocated total net proceeds to the Class A common shares and \$Nil to the attached warrants.

The \$20,000 deposit on a share subscription, outstanding at October 31, 2005, was fulfilled with the issuance of 50,000 Units as part of the second private placement. Costs related to the private placements were recorded as a reduction of the gross proceeds and included \$24,489 paid in cash, \$12,258 accrued in accounts payable and \$3,000 representing the fair value of 25,000 common share purchase warrants issued to a third party for commissions. The Company applied the residual approach and allocated the total fair value of the Units to the Class A common shares and \$Nil to the attached warrants. In addition, the Company issued 11,820 Class A common shares at a fair value of \$0.40 per share, totalling \$4,728, as settlement for commissions payable on the private placements. The fair value of the Class A common shares issued was determined based on terms similar to the private placements during the period.

During the year ended October 31, 2006, the Company issued 174,916 Class A common shares to directors of the Company in exchange for services. The fair value of the Class A common shares issued was determined based on terms similar to the private placements during the period.

During the year ended October 31, 2005, the Company issued 80,000 Class A common shares to directors of the Company in exchange for services. The fair value of the shares issued was determined based on terms similar to the conversion of the note payable on October 15, 2005 [note 4].

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. SHARE CAPITAL (CONTINUED)

Warrants

At October 31, 2006 the Company had 744,931 (2005 – 34,555) common share purchase warrants outstanding, as follows:

Exercise price \$	Expiry date	Number outstanding and exercisable
0.60 - 0.70	December 31, 2007	586,876
0.65	January – October 2008	34,555
0.40	December 31, 2008	25,000
0.65 US	December 31, 2009	98,500
		<u>744,931</u>

During the year ended October 31, 2006, the Company issued 25,000 common share purchase warrants to a third party as commissions on the private placements. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.40 per common share, expiring on December 31, 2008. The fair value of the warrants issued of \$0.12 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 3.89%, a dividend yield of 0%, an expected volatility of 31.6% and an expected life of the warrants of three years. The resulting fair value of \$3,000 is included in the private placement issuance costs noted above. In addition, 685,376 common share purchase warrants were issued in connection with the two private placements during the year ended October 31, 2006. The Company applied the residual approach and allocated total net proceeds of the private placements to the Class A common shares and \$Nil to the attached warrants.

During the year ended October 31, 2005, the Company issued 4,188 warrants for \$Nil proceeds. The fair value of the warrants using the Black-Scholes option pricing model for warrants was \$Nil assuming a risk-free rate of 3.13%, a dividend yield of 0%, an expected volatility of 37.9% and an expected life of the warrants of three years.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. SHARE CAPITAL (CONTINUED)

Share options

Under the Company's share option policy, options to purchase common shares may be granted by the Board of Directors to directors, officers and employees. The exercise price per share and the vesting period shall be determined at the time of grant by the Board. Except for the first grant, which vested when specific performance criteria were met, all subsequent options granted have vested immediately. The option period for options granted as compensation to directors, officers and employees shall be a period of time fixed by the Board not to exceed five years. The option period for options granted in exchange for services is specified by the Board at the time of grant and ranged from three to ten years for options granted prior to April 30, 2006. If an option has lapsed, the board may grant new options covering the shares not purchased. If a participant ceases to be an employee or provider, the participant has 90 days to exercise his options or they are cancelled.

	2006		2005	
	Number of shares	Weighted-average exercise price \$	Number of shares	Weighted-average exercise price \$
Outstanding at beginning of year	1,772,500	0.1623	882,500	0.0455
Granted	720,000	0.3871	890,000	0.2781
Exercised	(1,142,500)	0.0001	—	—
Cancelled	(250,000)	0.4500	—	—
Outstanding at end of year	1,100,000	0.4182	1,772,500	0.1623
Options exercisable at end of year	1,100,000	0.4182	1,772,500	0.1623

The following table summarizes information about share options outstanding at October 31, 2006:

Exercise price \$	Year of grant	Number outstanding and exercisable	Weighted-average remaining contractual life [years]	Weighted-average exercise price \$
0.45	2005	400,000	3.2	0.45
0.40	2006	600,000	3.2	0.40
0.50	2006	100,000	4.6	0.50
\$0.40 – 0.50		1,100,000	3.3	0.4273

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

7. SHARE CAPITAL (CONTINUED)

The weighted-average fair value of share options, is determined at the date of grant using the Black-Scholes option pricing model. For the year ended October 31, 2006, \$92,400 [2005 - \$447,500] has been recorded as compensation expense with an equal amount reflected in contributed surplus. The compensation expense at each grant date was calculated using the following assumptions:

	2006	2005
Weighted average exercise price	\$0.41	\$0.40
Expected dividend yield	0.00%	0.00%
Weighted average risk-free interest rate	3.95%	3.89%
Expected volatility	31.60%	31.60%
Weighted average expected life	5.0 years	4.0 years

Future share options to be granted

Pursuant to options that qualified for distribution pursuant to the prospectus [note 13], the Company intends to grant 540,000 share options to officers, directors and employees of the Company at an exercise price of \$0.50, which will expire 5 years from granting of the option.

Contributed surplus

The following table sets out the change in contributed surplus:

	2006	2005
	\$	\$
Balance, beginning of year	586,156	137,506
Stock based compensation	92,400	447,500
Issuance of warrants	3,000	—
Equity component of convertible promissory notes	—	112,949
Transfer to share capital on conversion of convertible promissory notes [note 4]	(1,150)	(111,799)
Transfer to share capital on exercise of options	(358,400)	—
Balance, end of year	322,006	586,156

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

8. INCOME TAXES

The Company's income tax expense is determined as follows:

	2006	2005
	\$	\$
Combined statutory federal and provincial tax rate at 16.12 % [2005 – 16.12%]	(136,300)	(306,400)
Adjusted for		
Stock based compensation	14,900	72,100
Unrecognized losses	109,000	208,800
Other	12,400	25,500
Income tax expense	—	—

Future tax assets

The tax effects of temporary differences that give rise to significant portions of the future tax assets are presented below:

	2006	2005
	\$	\$
Non-capital loss carryforwards	428,900	310,000
SR&ED expense carryforwards	86,000	75,700
Equipment – differences in net book value and undepreciated capital costs	4,900	3,300
Cumulative eligible capital	8,400	8,400
Share issue costs	8,400	4,700
ITC carryforwards	500	500
	537,100	402,600
Less valuation allowance	(537,100)	(402,600)
	—	—

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

8. INCOME TAXES (CONTINUED)

At October 31, 2006 the Company has approximately \$2,660,600 of non-capital losses available to reduce future taxable income and \$3,300 of investment tax credits available to reduce income taxes payable. The losses and investment tax credits expire as follows:

	Non-capital loss carry forward \$	Investment tax credit \$
2008	13,500	—
2009	73,100	—
2010	317,300	—
2013	—	1,900
2014	490,700	700
2015	1,028,300	700
2016	737,700	—
	<u>2,660,600</u>	<u>3,300</u>

At October 31, 2006, the Company also has \$533,439 of SR&ED expenditures available to reduce net income for tax purposes in future periods. These expenditures may be carried forward indefinitely. The Company has provided a full valuation allowance against these potential future tax assets.

In assessing the realizability of future income tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will not be realized. The ultimate realization of future income tax assets is dependent upon the generation of future taxable income and tax planning strategies in making this assessment.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

9. GOVERNMENT ASSISTANCE

SDTC funding

During 2006 the Company entered into a funding agreement with Canada Foundation for Sustainable Development Technology ("SDTC") for the purpose of fostering the development and adoption of technologies that contribute to a sustainable development technology infrastructure in Canada by contributing to the rapid development, demonstration and pre-commercialization of technological solutions which address climate change and air quality. Upon the Company attaining pre-determined milestones, SDTC will advance non-repayable funds totalling the lesser of \$650,000 and 24.77% of the eligible project costs, less 10% holdbacks on each advance. As at October 31, 2006, Milestone #1 was earned and the Company received \$137,835 (\$153,150 less 10% holdback) for this milestone. The Company also received an advance of \$391,320 (\$434,800 less 10% holdback for Milestone #2. As at October 31, 2006, the Company had earned \$275,970 of the Milestone #2 funding. The balance of \$158,830 has been recorded as deferred government assistance. Milestone #3 for field testing, in the amount of up to \$62,050 is anticipated to be completed by May, 2007. During the year ended October 31, 2006, \$429,120 [2005 - \$Nil] of SDTC funding has been included as a reduction of research and development costs.

IERD funding

In 2004 the Company qualified for funding under the Industry Energy Research and Development Program (IERD). Under this government funding program, IERD committed to advance Synodon an amount equal to 28% of eligible costs incurred, up to a maximum of \$600,000. If any other government assistance is received, then an adjustment will be made to the total contribution. A 10% holdback is withheld until final approval of completion of the project and has been included in accounts receivable. The advances are non-interest bearing and are only repayable upon revenue earned, at an amount of 3% of revenue earned in connection with the project. As at October 31, 2006, a total of \$580,403 [2005 - \$385,740] was advanced to the Company from the IERD program, less a 10% holdback in each year. During the year ended October 31, 2006, \$194,663 [2005 - \$237,545] of IERD funding has been included as a reduction of research and development costs.

Investment tax credits

The Company claims research and development deductions and the related investment tax credits for income tax purposes based on management's interpretation of the applicable legislation under the Income Tax Act (Canada). These claims are subject to technical and expenditure review by the Canada Revenue Agency.

During fiscal 2006, the Company recorded the benefit related to refundable investment tax credits earned during the year of \$305,751 [2005 - \$47,591] as a reduction of research and development costs, of which \$145,551 related to the prior year's activities.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

10. RESEARCH AND DEVELOPMENT COSTS

Since inception the Company has incurred approximately \$2,859,433 of research and development expenditures in developing its technologies. Research and development costs and reductions due to government assistance in each of the past two years are summarized as follows:

	2006	2005
	\$	\$
Research and development expenditures	1,134,846	1,088,947
Less government assistance		
SDTC	(429,120)	—
IERD	(194,663)	(237,545)
Investment tax credits	(305,751)	(47,591)
	205,312	803,811

11. RELATED PARTY TRANSACTIONS

Officers, directors and shareholders provided promissory notes as well as services to the Company through consulting and rental agreements. The related party transactions occurred during the normal course of the Company's operations and are measured at their exchange amounts, which is the consideration amount established and agreed upon with the related parties.

- (a) The Company leased facilities from an officer who is also a shareholder. Total rental payments for fiscal 2006 were \$4,500 [2005 - \$6,000].
- (b) The Company paid \$nil during fiscal 2006 [2005 - \$66,700] to a director of the Company for consulting services.
- (c) The Company incurred interest on promissory notes in the amount of \$653 during fiscal 2006 [2005 - \$92,342] payable to an officer of the Company as noted in note 4.

Synodon Inc.

NOTES TO FINANCIAL STATEMENTS

October 31, 2006 and 2005

12. NON-CASH TRANSACTIONS

The corporation entered into the following non-cash transactions which are not reflected in the statements of cash flows:

Year ended October 31, 2006

- (a) Issued 50,000 Units on the conversion of notes payable [note 4].
- (b) Issued 25,000 common share purchase warrants for third party commissions payable on two private placements [note 7].
- (c) Issued 11,820 Units for third party commissions payable on two private placements [note 7].

Year ended October 31, 2005

- (d) Issued 2,759,800 Class A common shares on the conversion of a note payable plus accrued interest [note 7].

13. SUBSEQUENT EVENTS

Initial public offering

On December 29, 2006, the Company raised \$1,403,750 from an initial public offering of 2,807,500 Units at a price of \$0.50 per Unit net of offering costs of \$466,584. Each Unit consists of one Class A common share and one half of a common share purchase warrant. Each whole common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of \$0.60 for 12 months from the date of closing of the offering and at a price of \$0.75 for the period commencing 12 months and a day to 24 months from the date of closing of the offering. As at October 31, 2006, the costs associated with the initial public offering of \$311,959 have been deferred and will be reclassified to share capital as a reduction of the proceeds of the offering.

In connection with the offering the agent received 280,750 non-transferable compensation options entitling the holder to purchase up to 280,750 Units at a price of \$0.50 for a period of 24 months from the offering's closing date.

Issuance of promissory notes

Subsequent to October 31, 2006, two directors loaned the Company \$12,000. These promissory notes bear interest at 8%, and are repayable on demand.