Synodon Inc.
Financial Statements
October 31, 2008 and 2007

MANAGEMENT'S RESPONSIBILITY

The accompanying financial statements of Synodon Inc. are the responsibility of the management and have been approved by the Board of Directors on recommendation by the Audit Committee.

The financial statements have been prepared by management in accordance with generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has prepared financial information presented elsewhere in the accompanying management discussion and analysis and has ensured that it is consistent with that in the financial statements. In support of its responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility through its Audit Committee.

The Audit Committee is comprised of financially literate directors, appointed by the board. The Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting processes, auditing matters and financial reporting issues to satisfy itself that each party is properly discharging it responsibilities, and to review the financial statements and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the engagement or re-appointment of the external auditors.

Financial statements have been audited by Ernst & Young LLP, the external auditors, in accordance with generally accepted auditing standards on behalf of the shareholders. Ernst & Young LLP has full and free access to the Audit Committee.

(signed) "*Adrian Banica*"
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Adrian Banica, Director
Chief Executive Officer

(signed) "*Nimal Rodrigo*"
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Nimal Rodrigo
Chief Financial Officer

Synodon Inc.
(a development stage enterprise)
BALANCE SHEETS
[see note 1 – going concern communication]

As at October 31

	2008	2007
	$	$
ASSETS *[note 8]*		
Current		
Cash	**32,476**	4,943
Cash held in trust *[note 9]*	**111,683**	—
Accounts receivable *[note 11]*	**65,948**	114,827
Prepaid expenses and deposits	**39,675**	10,697
	249,782	130,467
Property and equipment *[note 3]*	**12,786**	15,970
Long-term deposits	**7,876**	18,786
	270,444	165,223
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	**1,313,303**	725,837
Deferred government assistance *[note 11]*	**128,799**	11,790
Notes payable *[note 4]*	**32,500**	5,000
Loans from Directors *[note 5]*	**2,700**	28,000
Current portion of obligations under capital lease *[note 8]*	**38,086**	30,569
Deposit on distribution rights option *[note 6]*	**65,875**	65,875
	1,581,263	867,071
Obligations under capital lease *[note 8]*	**1,456**	17,064
	1,582,719	884,135
Commitments and contingencies *[notes 6, 7 and 11]*		
Shareholders' deficiency		
Share capital *[note 9]*	**4,845,322**	4,239,464
Warrants on issue of units *[note 9]*	**528,743**	256,634
Contributed surplus *[note 9]*	**633,661**	538,248
Deficit	**(7,320,001)**	(5,753,258)
	(1,312,275)	(718,912)
	270,444	165,223

See accompanying notes

On behalf of the Board:

(signed) "*Adrian Banica*"
____
Adrian Banica, Director
Chief Executive Officer

(signed) "*John Pinsent*"
____
John Pinsent, Director
Audit Committee Chair

Synodon Inc.
(a development stage enterprise)
STATEMENTS OF LOSS AND DEFICIT

For the years ended October 31

	2008 $	2007 $
EXPENSES		
Research and development costs, net of government assistance *[notes 11 and 12]*	**599,469**	1,061,767
Amortization	**5,462**	5,920
Sales and marketing	**71,798**	4,800
Financing charges and interest *[notes 4 and 8]*	**82,604**	33,534
Foreign exchange losses (gains)	**90,806**	(38,197)
Stock-based compensation	**95,413**	131,619
Office and general administrative	**621,191**	629,024
	1,566,743	1,828,467
Loss from operations	**(1,566,743)**	(1,828,467)
Other income	—	22,279
Net loss and comprehensive loss for the year	**(1,566,743)**	(1,806,188)
Deficit, beginning of year	**(5,753,258)**	(3,947,070)
Deficit, end of year	**(7,320,001)**	(5,753,258)
Loss per share - basic and diluted	**(0.07)**	(0.09)
Weighted average number of shares outstanding	**20,952,962**	19,823,494

See accompanying notes

Synodon Inc.
(a development stage enterprise)

STATEMENTS OF CASH FLOWS

For the years ended October 31

	2008 $	2007 $
OPERATING ACTIVITIES		
Net loss for the year	**(1,566,743)**	(1,806,188)
Add charges to operations not requiring a current cash payment		
Stock-based compensation	**95,413**	131,619
Non-cash interest expense *[note 4]*	**5,560**	5,000
Amortization	**5,462**	5,920
Research and development costs, financed by obligations under capital lease	**—**	90,668
	(1,460,308)	(1,572,981)
Net change in non-cash working capital balances related to operations		
Accounts receivable	**48,879**	5,919
Investment tax credits recoverable	**—**	353,342
Prepaid expenses and deposits	**(18,068)**	(23,904)
Accounts payable and accrued liabilities	**637,466**	(103,661)
Deferred government assistance	**117,009**	(147,040)
Cash used in operating activities	**(675,022)**	(1,488,325)
INVESTING ACTIVITIES		
Proceeds on disposal of property and equipment	**—**	1,650
Purchase of property and equipment	**(2,278)**	(8,164)
Cash used in investing activities	**(2,278)**	(6,514)
FINANCING ACTIVITIES		
Repayment of notes payable	**—**	(52,000)
Issuance of notes payable	**134,600**	33,000
Repayment of obligations under capital lease	**(8,091)**	(23,610)
Issuance of shares and warrants	**683,034**	1,725,197
Payment of share issuance costs	**(25,127)**	(183,110)
Exercise of warrants	**32,100**	—
Cash provided by financing activities	**816,516**	1,499,477
Net increase in cash during the year	**139,216**	4,638
Cash, beginning of year	**4,943**	305
Cash, end of year	**144,159**	4,943

Cash is comprised of cash of $32,476 [2007 - $4,943] and cash held in trust of $111,683.

Supplemental cash flow information		
Interest paid	**73,134**	22,419

Other non-cash transactions *[notes 9 and 14]*
See accompanying notes

1. NATURE OF BUSINESS AND GOING CONCERN COMMUNICATION

Nature of business

Synodon Inc. (the "Company") is an advanced remote sensing technology company which has developed a proprietary platform technology called realSens™ that has been proven to be capable of measuring small ground-level gas concentrations from an aircraft flying up to 300 metres in altitude. The Company is in the final stages of completing the prototype manufacturing of the realSens™ instrument and developing its plan for commercialization and as such is considered a development stage company.

Going concern communication

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") 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 incurred significant losses since incorporation and as at October 31, 2008, the Company has an accumulated deficit of $7,320,001. At present, the Company does not have sufficient cash to continue its activities in the normal course of business. 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. Such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared by management in accordance with Canadian GAAP. 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. 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.

New accounting policies

Effective November 1, 2007, the Company adopted the following new accounting policies:

CICA 1506 – Accounting Changes

This new standard allows an entity to change an accounting policy only if the change is required by a primary source of GAAP or if the new policy results in more reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. This standard is effective for interim and annual periods related to fiscal years beginning on or after January 1, 2007. The adoption of this standard did not have any effect on the Company.

CICA 1535 – Capital Disclosures

This new standard requires an entity to provide disclosures related to its capital and how it is managed. The standard is effective for interim and annual periods relating to fiscal years beginning on or after October 1, 2007. These new disclosures are reflected in note 16.

CICA 3862 – Financial Instruments – Disclosures

This new standard establishes standards for disclosure about financial instruments and non-financial derivatives. The standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The adoption of this new standard did not have an effect on recorded amounts in the Company's financial statements. New disclosures related to this standard are included in note 15.

CICA 3863 – Financial Instruments – Presentation

This new standard supersedes and carries forward unchanged the presentation standards of CICA 3861 - Financial Instruments – Disclosure and Presentation. The standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. There was no effect on the Company of adopting this standard.

Financial instruments

Under CICA 3855, all financial instruments are classified as held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments, and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held for trading financial instruments are measured at fair value and changes in fair value are recognized in net loss. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive loss until the instrument is derecognized or impaired.

The Company has classified its cash as held for trading. Accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities, notes payable and obligations under capital lease are classified as other financial liabilities, all of which are measured at amortized cost. Financing costs incurred to issue long-term debt are applied to reduce the fair value of the associated debt and amortized to interest expense using the effective interest rate method.

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

Property and equipment

Property and equipment are 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 by which the carrying value of the asset exceeds its estimated fair value.

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

Leases

The Company records its lease obligations as either operating or capital. Capital leases are those where the Company is transferred substantially all of the benefits and risks of ownership, whereas under operating leases the Company is not transferred substantially all of the benefits and risks of ownership. Capital lease obligations are accounted for as the acquisition of property and equipment or development expenditure and a related obligation measured at the present value of future minimum lease payments. The related assets, if capitalized, are amortized over their estimated useful lives and imputed interest is recognized as a component of periodic lease payments. Operating leases are expensed as the payments are due.

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

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 9, 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 9.

Loss per share

Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the year after giving affect to potentially dilutive instruments. The dilutive effect of stock options and warrants is determined using the treasury stock method.

Recent accounting pronouncements issued but not yet adopted

CICA 3064 – Goodwill and Intangible Assets

In February 2008, the CICA issued CICA 3064 - Goodwill and Intangible Assets that supersedes CICA 3062 - Goodwill and Other Intangibles and CICA 3450 - Research and Development Costs. CICA 3064 provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. This new accounting standard is effective for interim or annual financial statements relating to fiscal years beginning on or after October 31, 2008. The Company will adopt this new standard for its fiscal year commencing November 1, 2008 and does not expect the adoption to have a material impact on its financial position or results of operations.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian public companies will be required to adopt International Financial Reporting Standards for years beginning on or after January 1, 2011. The Company is currently evaluating the effect of this change in standards on its financial statements.

3. PROPERTY AND EQUIPMENT

	2008		2007	
	Cost	**Accumulated amortization**	**Cost**	**Accumulated amortization**
	$	$	$	$
Computer equipment	**37,890**	**34,557**	36,735	31,692
Computer software	**6,867**	**6,695**	6,521	6,321
Laboratory equipment	**8,048**	**3,567**	7,271	2,544
Furniture and fixtures	**12,873**	**8,073**	12,873	6,873
	65,678	**52,892**	63,400	47,430
Net book value		**12,786**		15,970

4. NOTES PAYABLE

	2008	2007
	$	$
Demand promissory notes		
Notes, bearing interest at 8% per annum	**32,500**	5,000
	32,500	5,000

During the year ended October 31, 2008, the Company issued promissory notes with a face value of $134,600.

During the year ended October 31, 2008, promissory notes, including loans from Directors, with a face value of $132,400, plus accrued interest to October 8, 2008 totalling $5,560, were exchanged for 306,578 Class A common shares and 306,578 common share purchase warrants as part of the private placement described in note 9. Each common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of $0.75 until October 7, 2010.

During the year, interest expense of $9,357 [2007 - $5,155] was recorded on these notes, of which $8,179 [2007 - $3,848] was payable to related parties. At October 31, 2008, unpaid interest of $4,953 [2007 - $1,156] is included in accrued liabilities, of which $3,732 was payable to related parties [2007 - $1,113].

During the year ended October 31, 2007, promissory notes with a face value of $60,000, plus accrued interest to January 31, 2007 totalling $5,000, were exchanged for 130,000 Class A common shares and 65,000 common share purchase warrants. Each common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of $0.60 until December 28, 2007 and at a price of $0.75 for the subsequent 12-month period.

5. LOANS FROM DIRECTORS

The loans from Directors consist of the following:

	2008	2007
	$	$
Demand promissory notes		
Notes, bearing interest at 8% per annum	**2,700**	28,000
	2,700	28,000

6. 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 distribution rights option expired on July 31, 2007. However, both parties have agreed to extend the option until the realSens™ technology is commercialized. At that time, the third party must decide whether to exercise the option or convert the option to common shares. 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.

7. COMMITMENTS

The Company is committed to premises minimum lease payments to September 30, 2009 totalling $57,000.

The Company has entered into a procurement contract to take delivery of commercial grade detectors for the realSens™ instrument in 2009 with a value of $435,287 ($ U.S. 360,000). The Company has also entered into contracts for marketing services to be delivered in 2009 at a cost of up to $29,500.

8. OBLIGATIONS UNDER CAPITAL LEASE

	2008 $	2007 $
Vencore Solutions LLC, at 8.25%		
Lease contract #1, payable $1,976 monthly, due October 10, 2009	**25,669**	37,416
Lease contract #2, payable $600 monthly, due October 25, 2009	**7,796**	11,365
Lease contract #3, payable $1,267 monthly, due November 25, 2009	**20,652**	29,118
	54,117	77,899
Less amounts representing interest and lease arrangement costs	**(14,575)**	(30,266)
	39,542	47,633
Less current portion of obligations under capital lease	**(38,086)**	(30,569)
	1,456	17,064

During the year ended October 31, 2007, the Company signed a lease agreement with Vencore Solutions LLC ("Vencore") giving the Company the ability to borrow up to $ U.S. 385,000 in long-term lease financing. The amount was subsequently revised to $90,668 ($ U.S. 84,749). The funds were used to procure research and development materials necessary for field trials. As part of the terms of the lease agreement, the Company issued to Vencore 66,000 warrants, exercisable at $0.65 and with a term of two years. The fair value of these warrants of $18,945 has been applied to reduce the carrying value of the lease obligation and will be recorded as a component of interest expense over the term of the obligation.

Under the agreement with Vencore, security deposits representing 15% of amounts advanced are included in long-term deposits. In addition, the Vencore lease agreements are collateralized by a security interest in all property and equipment owned by the Company. The fair values of the capital leases approximate their carrying value.

Interest expense incurred on capital lease obligations for the year was $7,702 (2007 – $7,040).

9. SHARE CAPITAL

	2008 $	2007 $
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		
22,697,143 Class A common shares	**4,845,322**	—
20,746,571 Class A common shares	—	4,239,464

	Number of shares #	Total $
Balance, October 31, 2006	17,255,550	3,285,593
Issued in IPO, net of costs of issuance of $441,694 and net of fair value of warrants of $294,787	2,807,500	667,269
Issued in private placement, net of costs of issuance of $20,070 and net of fair value of warrants of $51,688	492,271	198,993
Issued for cash on the exercise of warrants	11,250	6,750
Issued for cash from exercise of options	50,000	25,000
Issued on conversion of notes payable and accrued interest *[note 4]*	130,000	51,350
Reclassified from contributed surplus on exercise of options	—	4,509
Balance, October 31, 2007	20,746,571	4,239,464
Issued in private placement, net of fair value of warrants of $284,589	1,517,853	398,445
Issued on exchange of notes payable and accrued interest *[note 4]*	306,578	137,960
Costs of issuance of private placement	—	(15,737)
Issued for cash on the exercise of warrants	62,038	32,100
Transfer from warrants issued on issue of units on exercise of warrants	—	3,840
Issued on conversion of debt, net of costs of issuance of $750 *[note 14]*	64,103	49,250
Balance, October 31, 2008	**22,697,143**	**4,845,322**

During the year ended October 31, 2008, the Company closed a private placement, issuing 1,824,431 units at a price of $0.45 per unit, each consisting of one Class A common share and one common share purchase warrant, for gross proceeds of $820,995. The private placement included an exchange of notes payable and accrued interest *[note 4]*. Each warrant entitles the holder to acquire one common share at an exercise price of $0.75 on or before October 7, 2010. The costs of issuance were $24,377.

At October 31, 2008, $111,683 from the proceeds was held in trust. Final amounts were disbursed to the Company in November, 2008 totalling $81,683 with the remaining $30,000 being paid for share issue and other legal costs.

On February 12, 2008, the Company issued 64,103 common shares to a supplier in satisfaction of a liability to that supplier incurred during December 2007.

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 Company has reserved up to 1,960,000 shares available for the settlement of options. The exercise price per share and the vesting period shall be determined at the time of grant by the Board of Directors. Except for the first grant, which vested when specific performance criteria were met, options granted prior to October 31, 2006 have vested immediately. Options granted subsequent to October 31, 2006 generally vest over a period of three years. The option period for options granted as compensation to Directors, officers and employees shall be a period of time fixed by the Board of Directors not to exceed five years. The option period for options granted in exchange

for services is specified by the Board of Directors 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 of Directors 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.

	2008		2007	
	Number of shares	**Weighted average exercise price** $	**Number of shares**	**Weighted average exercise price** $
Outstanding, beginning of year	1,540,000	0.4513	1,100,000	0.4182
Granted	600,000	0.7650	540,000	0.5000
Exercised	—	—	(50,000)	0.5000
Cancelled	(180,000)	0.5500	(50,000)	0.5000
Outstanding, end of year	1,960,000	0.5383	1,540,000	0.4513
Options exercisable at end of year	1,275,000	0.4451	1,230,000	0.4513

The following table summarizes information about share options outstanding at October 31, 2008:

Exercise price $	**Year of grant**	**Number outstanding and exercisable**	**Weighted average remaining contractual life** [years]	**Weighted average exercise price** $
0.45	2005	400,000	1.2	0.450
0.40	2006	550,000	1.2	0.400
0.50	2006	100,000	2.6	0.500
0.50	2007	410,000	3.2	0.500
0.75-0.78	2008	600,000	4.5	0.764
		2,060,000	2.6	0.5383

On February 12, 2008, the Company granted 300,000 options to purchase common shares to officers and employees which vest over a two-year period and are exercisable at $0.78 per option.

On August 1, 2008, the Company issued 300,000 options to CHF Investor Relations. The options are exercisable at $0.75 for a period of five years and vest in four equal tranches over a period of 12 months (75,000 options every three months).

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, 2008, $95,413 [2007 - $131,619] 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:

	2008	2007
Weighted average exercise price	$0.77	$0.36
Expected dividend yield	0.00%	0.00%
Weighted average risk-free interest rate	2.9%	4.5%
Expected volatility	94%	90%
Weighted average expected life	5.0 years	5.0 years

Warrants

At October 31, 2008, the Company had 3,946,776 (2007 – 2,795,315) common share purchase warrants outstanding, as follows:

Exercise price $	**Expiry date**	**Number outstanding and exercisable** $
0.65 US	December 31, 2009	98,500
0.60 - 0.75	December 28, 2008	1,367,000
0.75	December 28, 2008	65,000
0.50	December 28, 2008	276,750
0.65	May 15, 2009	66,000
0.80	September 13, 2009	246,134
0.45	October 7, 2010	2,961
0.75	October 7, 2010	1,824,431
		3,946,776

During the year ended October 31, 2008, the Company issued 1,824,431 common share purchase warrants from a private placement. The warrant holder is entitled to acquire one Class A common share at an exercise price of $0.75 on or before October 7, 2010. The warrants have an accelerated exercise provision under which, if the volume weighted average closing price of the shares equals or exceeds $1.05 per share, then the warrants must be exercised or will expire 30 calendar days after notice of such event is mailed to the warrantholders. The fair value of the warrants issued of $0.16 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 2.2%, a dividend yield of 0%, an expected volatility of 111% and an expected life of the warrants of two years. The resulting fair value of $284,589 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of $8,640.

In connection with the private placement, the agent received 2,961 Class A common share warrants at an exercise price of $0.45 for a period of 24 months, expiring October 8, 2010. The fair value of the warrants issued of $0.20 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 2.2%, a dividend yield of 0%, an expected volatility of 111% and an expected life of the warrants of two years. The resulting fair value of $586 is included in the private placement issuance costs.

Warrants on issue of units

The following table sets out the change in warrants on issue of units:

	2008 $	**2007** $
Balance, beginning of year	**256,634**	—
Warrants issued on private placement units, net of issuance costs of $8,640	**275,949**	—
Transfer to share capital on exercise of warrants	**(3,840)**	—
Warrants issued on IPO units, net of issuance costs of $98,755	—	196,032
Warrants issued on private placement units, net of issuance costs of $4,736	—	46,952
Warrants issued on conversion of promissory notes and accrued interest	—	13,650
Balance, end of year	**528,743**	256,634

The Company uses the treasury stock method to calculate loss per share and under this method options that are anti-dilutive are excluded from the calculation of diluted loss per share. For the years ended October 31, 2008 and 2007, all outstanding options are considered anti-dilutive when the Company has recorded a loss available to common shareholders.

Contributed surplus

The following table sets out the change in contributed surplus:

	2008 $	**2007** $
Balance, beginning of year	**538,248**	322,006
Stock-based compensation	**95,413**	131,619
Issuance of warrants	—	89,132
Transfer to share capital on exercise of options	—	(4,509)
Balance, end of year	**633,661**	538,248

10. INCOME TAXES

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

	2008 $	**2007** $
Combined statutory federal and provincial tax rate at 30.5% [2007 – 32.12%]	**(478,000)**	(580,200)
Adjusted for		
Stock-based compensation	**29,200**	42,300
Unrecognized losses	**447,300**	535,100
Other	**1,500**	2,800
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:

	2008	2007
	$	$
Non-capital loss carryforwards	**1,498,900**	1,172,000
SR&ED expense carryfowards	**243,400**	184,500
Equipment – differences in net book value and undepreciated capital costs	**10,000**	7,700
Cumulative eligible capital	**14,200**	13,000
Share issue costs	**91,500**	121,000
	1,858,000	1,498,200
Less valuation allowance	**(1,858,000)**	(1,498,200)
	—	—

At October 31, 2008, the Company has approximately $5,470,500 of non-capital losses available to reduce taxable income, expiring between 2008 and 2028. The Company also has investment tax credits of $175,800 available to reduce income taxes payable expiring between 2013 and 2028.

At October 31, 2008, the Company also has $888,300 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.

11. GOVERNMENT ASSISTANCE

SDTC funding

During fiscal 2008, 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 fund the lesser of $332,813 or 32.47% of the eligible project costs, less a 10% holdback. The Company has received an advance of $299,532 ($332,813 less 10% holdback) for the project. As at October 31, 2008, the Company had earned $170,733 of the project funding. The balance of $128,799 has been recorded as deferred government assistance. The completion of the project is scheduled for July 31, 2009. During the year ended October 31, 2008, $182,523 [2007 - $209,090] of SDTC funding has been included as a reduction of research and development costs, including $11,790 representing the final amount related to a similar program entered into in 2006.

At October 31, 2008, included in accounts receivable is a $65,000 holdback associated with the SDTC contract signed in 2006. The $33,281 holdback associated with the 2008 contract will be recorded as accounts receivable when the full amount of government assistance has been earned.

IERD funding

In 2004, the Company qualified for funding under the Industry Energy Research and Development Program ("IERD"). Under this government funding program, IERD advanced to the Company an amount equal to 28% of eligible costs incurred, up to a maximum of $600,000. The advances were non-interest bearing and only repayable at an amount of 3% of revenue earned in connection with the project. As at October 31, 2008, the project has been completed and all monies owing have been received by the Company, totalling $586,437. During the year ended October 31, 2008, $11,587 [2007 - $6,034] of IERD funding has been included as a reduction of research and development costs as a result of receiving payment for previously denied expense claims.

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.

12. RESEARCH AND DEVELOPMENT COSTS

Since inception the Company has incurred approximately $4,994,500 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:

	2008 $	**2007** $
Research and development expenditures	**793,579**	1,341,549
Less government assistance		
SDTC	**(182,523)**	(209,090)
IERD	**(11,587)**	(6,034)
Investment tax credits	—	(64,658)
	599,469	1,061,767

13. RELATED PARTY TRANSACTIONS

Officers, Directors and shareholders provided promissory notes *[note 4]* as well as services to the Company through 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 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 2008 were $4,500 [2007 - $5,500].
(b) The Company incurred interest on promissory notes in the amount of $8,179 [2007 - $3,848] to Directors of the Company as described in note 4.

14. NON-CASH TRANSACTIONS

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

Year ended October 31, 2008

(a) Issued 64,103 Class A common shares to satisfy a $50,000 supplier payable as described in note 9.
(b) Issued to the sponsor agent of the Company's private placement, 2,961 warrants at a price of $0.45 for a period expiring October 8, 2010 as described in note 9. These warrants were valued at $586.

15. MANAGEMENT OF RISKS

The Company manages various types of risk without the use of financial derivatives.

Credit risk

The amount recorded as accounts receivable on the Company's balance sheet represents its maximum exposure to credit risk. The Company's accounts receivable are primarily for government assistance holdbacks. These holdbacks are expected to be released upon the Company filing appropriate final reports including external auditors' reports on certain financial information of the related program *[note 10]*. Accordingly, the Company believes that there is a very low level of credit risk associated with these amounts.

Interest rate risk

The Company has fixed repayment terms on its obligations under capital lease and fixed interest rates on its notes payable and, accordingly, is not exposed to interest rate risk on its interest bearing obligations. The Company is exposed to interest rate price risk should interest rates fall while the Company is committed to a higher fixed rate.

Foreign exchange risk

The Company has capital lease obligations and accounts payable that are denominated in U.S. dollars. Accordingly, the Company is exposed to fluctuations in the Canadian/U.S. dollar exchange rate. The sensitivity of these liabilities to a 10% change in the exchange rate would result in a change in loss in the year of $38,249.

16. CAPITAL DISCLOSURES

The Company's objective in managing its capital is to ensure that it has appropriate financial resources to continue to further its technology toward commercialization. The Company's capital includes notes payable, obligations under capital lease and equity. The Company has been primarily dependent upon the issue of common shares and units comprising common shares and a common share purchase warrant as sources of capital as market conditions and the stage of the Company's technology development have allowed. During certain times when market conditions have not been suitable for issuing units or common shares, the Company has accessed lease financing and issued notes payable as short to medium term sources of capital.

The Company is not currently subject to any externally imposed capital requirements.

The Company does not have sufficient capital to fund operations; as such, it is in the process of raising sources of funds *[note 18]*.

17. RECLASSIFICATION OF COMPARATIVE FIGURES

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

18. SUBSEQUENT EVENTS

Warrants

On December 28, 2008, 1,708,750 warrants that were due to expire on that date expired. This will result in a reclassification of $196,032 from warrants issued on units to contributed surplus in the quarter ending January 31, 2009.

AVAC Ltd. contribution in the Company

On December 18, 2008, AVAC Ltd., through its Capacity Builder program, committed a $1.3 million investment to the realSens™ project. The funds will be dispersed on a completed milestone basis over the next 12 months. The investment will be used to support the deployment of the technology into the commercial marketplace. On December 23, 2008, the Company received $318,000 under this program.

The contribution is milestone based and is received upon successful completion of technical and marketing milestones. The contribution is repayable by way of a royalty based on 1.5% of revenue earned, beginning in October 2009 up to a maximum of two times the contribution.

SDTC contribution in the Company

On December 12, 2008, the Company signed a contribution agreement with SDTC to receive $110,000 of funding to be used towards the costs of Environmental Technology Verification Certification in Canada and the U.S. On December 19, 2008, the Company received the first advance on the contract of $38,000.

Stock option cancellations and grant

On November 15, 2008, the Company cancelled 100,000 share options previously granted to an employee.

On November 28, 2008, the Company issued to its Chief Financial Officer 300,000 share options to purchase common shares, exercisable at $0.30 per option. The options have been issued pursuant to the Company's Share Option Plan and will vest over a 13-month period.

Deposit on distribution rights

On November 15, 2008, the Company was notified that the holder of the distribution rights for Saudi Arabia declined to become a distributor and exercised the right to convert its deposit of $65,875 into shares of the Company, subject to regulatory approval.