Lorus Therapeutics Inc.

Annual Report

May 31, 2008

Letter to Shareholders

Dear Shareholder:

I am pleased to have the opportunity to share with you the highlights of 2008 and our plans for 2009. Lorus has continued to make significant progress over the past year that continues to bring us closer to our goal in the fight against cancer.

Over the past two years Lorus has made important strategic and operational changes to better position the Company for success while our underlying philosophy and mandate remains the same: focus on innovation and quality. By repositioning our product portfolio and strategic focus, Lorus continues to achieve milestones on our path to success.

Our strength is in our people and the dedicated research expertise they have brought. We are fortunate to have a team as dedicated to increasing stakeholder value as they are to our most passionate pursuit – discovering and developing drugs with high safety profiles that will provide cancer patients with an extended, high quality of life that is both rewarding and productive. The near and long-term success of Lorus is based on the quality of our science and we take pride in our abilities to discover and develop novel products and technologies for the management of cancer.

Key Accomplishments in 2008

Product Development

We are very excited about the progress during the year in our promising small molecule drug program. We initiated GLP toxicology studies for our lead anticancer small molecule drug candidate LOR-253. The toxicology studies now completed but awaiting final results are designed to support the filing of an Investigational New Drug (IND) application with the U.S. FDA for LOR-253 to initiate a Phase I clinical study in cancer indications. Lorus intends to submit an IND for LOR-253 during the first quarter of calendar 2009, following successful completion of the toxicology program.

We continue to progress in the development of our lead clinical-stage drug LOR-2040. During the year we announced the completion of a proof-of-concept clinical trial in Acute Myeloid Leukemia (AML), and expansion of our LOR-2040 development program in this indication, with initiation of a more advanced Phase II clinical trial with LOR-2040 and high dose Ara-C in refractory and relapsed AML. The advanced Phase II clinical trial underway includes both an efficacy study and a novel additional study to measure intracellular target activities and pharmacological synergies between the two agents.

In order to increase the commercial opportunity of LOR-2040, Lorus commenced a development program aimed at expanding the therapeutic application of LOR-2040 for the treatment of superficial bladder cancer. We believe local administration into the bladder provides the opportunity to expose the bladder tumor to higher levels of drugs, with the objective to prevent tumor cells from becoming invasive and spreading to other organs, and represents a novel route of delivery for this compound. In August 2008 we announced the successful completion of GLP toxicology studies with LOR-2040. Two studies were conducted to assess toxicity of LOR-2040 when administered by intravesical (direct) administration into the bladder. In both studies, no evidence of toxicity was seen following single or repeated doses of LOR-2040 given with this method of administration. Toxicity was evaluated based on a wide range of observations including detailed examination of urinary tract tissues.

Corporate Developments

In April 2008 Lorus signed an exclusive multinational license agreement with Zor Pharmaceuticals LLC ("ZOR") formed as a subsidiary of Zoticon Bioventures Inc., to further develop and commercialize Virulizin® for human therapeutic applications. ZOR is responsible for the cost of all the clinical development, regulatory submissions and commercialization of Virulizin® in North and South America, Europe and Israel. Under the terms of the licensing agreement, we are entitled to receive payments in

excess of US$10 million in upfront and various clinical and regulatory milestones payments as well as royalties that vary from 10-20% depending on achieving of sales of Virulizin®. Lorus also received 25% of the initial equity in ZOR. In addition, Lorus entered into a Service Agreement with ZOR to assist in the transfer of knowledge for moving forward with the clinical development program for Virulizin®.

In July 2007 Lorus completed a corporate reorganization resulting in approximately $6.9 million in additional cash for Lorus without diluting the equity interests of existing securityholders.

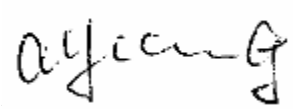
In August 2008 we successfully completed a rights offering to Lorus shareholders to raise gross proceeds of $3.71 million. Each shareholder received one right for each common share and 4 rights entitled the holder to purchase one unit. Each unit consisted of a common share and ½ purchase warrant priced at $0.18 expiring on August 7, 2010.

Building a Solid Foundation for 2009

Lorus is engaged in the discovery and development of novel and targeted cancer therapies. In fiscal 2009 we will continue to focus on the development of our small molecule drug platform, as we are optimistic that additional product candidates could be selected for clinical development. As part of our ongoing strategic development Lorus will continue to evaluate our strategic options with respect to partnerships and merger and acquisition opportunities. Developing new drug candidates with novel mechanisms of action takes many years and requires extensive experience and resources. Our business model for drug development involves advancing selected programs through our own efforts and simultaneously entering into partnerships with corporate partners that can provide drug development expertise and resources to late-stage programs.

We believe that we have set difficult, yet attainable, goals for 2009 and achievement of those goals will increase the value of Lorus as a partnership candidate and for our shareholders. We remain committed to building Lorus, the leading company engaged in the development of targeted therapies for the treatment of cancer. I truly appreciate your continued support and look forward to keeping you updated on our progress.

Sincerely yours,



President and Chief Executive Officer

Management's Discussion and Analysis

August 28, 2008

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This management discussion and analysis may contain forward-looking statements within the meaning of Canadian and U.S. securities laws. Such statements include, but are not limited to, statements relating to:

- *our expectations regarding future financings;*
- *our plans to conduct clinical trials;*
- *our expectations regarding the progress and the successful and timely completion of the various stages of our drug discovery, pre-clinical and clinical studies and the regulatory approval process;*
- *our plans to obtain partners to assist in the further development of our product candidates;*
- *our expectations with respect to existing and future corporate alliances and licensing transactions with third parties, and the receipt and timing of any payments to be made by us or to us in respect of such arrangements, and*

the Company's plans, objectives, expectations and intentions and other statements including words such as "anticipate", "contemplate", "continue", "believe", "plan", "estimate", "expect", "intend", "will", "should", "may", and other similar expressions.

Such statements reflect our current views with respect to future events and are subject to risks and uncertainties and are necessarily based upon a number of estimates and assumptions that, while considered reasonable by us are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements, including, among others:

- *our ability to obtain the substantial capital required to fund research and operations;*
- *our lack of product revenues and history of operating losses;*
- *our early stage of development, particularly the inherent risks and uncertainties associated with (i) developing new drug candidates generally, (ii) demonstrating the safety and efficacy of these drug candidates in clinical studies in humans, and (iii) obtaining regulatory approval to commercialize these drug candidates;*
- *the progress of our clinical trials;*
- *our ability to repay or refinance the convertible debentures at maturity;*
- *our ability to maintain compliance with the operational covenants of the convertible debenture agreement that could result in an event of default and the requirement for early repayment;*
- *our liability associated with the indemnification of Old Lorus and its directors, officers and employees*
- *our ability to find and enter into agreements with potential partners;*
- *our drug candidates require time-consuming and costly preclinical and clinical testing and regulatory approvals before commercialization;*
- *clinical studies and regulatory approvals of our drug candidates are subject to delays, and may not be completed or granted on expected timetables, if at all, and such delays may increase our costs and could delay our ability to generate revenue;*
- *the regulatory approval process;*
- *our ability to attract and retain key personnel;*
- *our ability to obtain patent protection and protect our intellectual property rights;*
- *our ability to protect our intellectual property rights and to not infringe on the intellectual property rights of others;*
- *our ability to comply with applicable governmental regulations and standards;*
- *development or commercialization of similar products by our competitors, many of which are more established and have greater financial resources than we do;*
- *commercialization limitations imposed by intellectual property rights owned or controlled by third parties;*
- *our business is subject to potential product liability and other claims;*
- *our ability to maintain adequate insurance at acceptable costs;*
- *further equity financing may substantially dilute the interests of our shareholders;*
- *changing market conditions; and*
- *other risks detailed from time-to-time in our ongoing quarterly filings, annual information forms, annual reports and annual filings with Canadian securities regulators and the United States Securities and Exchange Commission, and those which are discussed under the heading "Risk Factors".*

Should one or more of these risks or uncertainties materialize, or should the assumptions set out in the section entitled "Risk Factors" underlying those forward-looking statements prove incorrect, actual results may vary materially from those described herein. These forward-looking statements are made as of the date of this management, discussion and analysis or, in the case of documents incorporated by reference herein, as of the date of such documents, and we do not intend, and do not assume any obligation, to update these forward-looking statements, except as required by law. We cannot assure you that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements. Investors are cautioned that forward-looking statements are not guarantees of future performance and accordingly investors are cautioned not to put undue reliance on forward-looking statements due to the inherent uncertainty therein.

PLAN OF ARRANGEMENT AND CORPORATION REORGANIZATION

On July 10, 2007 (the “Arrangement Date”), Lorus Therapeutics Inc. (the “Company”, “Lorus” or “New Lorus”) completed a plan of arrangement and corporate reorganization with, among others, 4325231 Canada Inc., formerly Lorus Therapeutics Inc. (“Old Lorus”), 6707157 Canada Inc. and Pinnacle International Lands, Inc (the “Arrangement”). As a result of the plan of arrangement and reorganization, among other things, each common share of Old Lorus was exchanged for one common share of the Company and the assets (excluding certain future tax attributes and related valuation allowance) and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it) were transferred, directly or indirectly, to the Company and/or its subsidiaries. The Company continued the business of Old Lorus after the Arrangement Date with the same officers and employees and continued to be governed by the same directors as Old Lorus prior to the Arrangement Date. Therefore, the Company’s operations have been accounted for on a continuity of interest basis and accordingly, the consolidated financial statement information below reflect that of the Company as if it had always carried on the business formerly carried on by Old Lorus. All comparative figures presented in these consolidated financial statements are those of Old Lorus. References in this Management’s Discussion and Analysis (“MD&A”) to the Company, Lorus, “we”, “our”, “us” and similar expressions, unless otherwise stated, are references to Old Lorus prior to the Arrangement Date and the Company after the Arrangement Date.

The following discussion should be read in conjunction with the audited financial statements for the year ended May 31, 2008 and the accompanying notes (the "Financial Statements") contained in the Company’s annual report. The Financial Statements, and all financial information discussed below, have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). All amounts are expressed in Canadian dollars unless otherwise noted. In this MD&A, "Lorus", the "Company', "we", "us" and "our" each refers to Lorus Therapeutics Inc.

OVERVIEW

Lorus is a life sciences company focused on the discovery, research and development of effective anticancer therapies with a high safety profile. Lorus has worked to establish a diverse anticancer product pipeline, with products in various stages of development ranging from pre-clinical to an advanced Phase II clinical trial. A growing intellectual property portfolio supports our diverse product pipeline. Lorus’ pipeline is a combination of internally developed products and products licensed in from other entities at a pre-clinical stage.

We believe that the future of cancer treatment and management lies in drugs that are effective, safe and have minimal side effects, and therefore improve a patient's quality of life. Many of the cancer drugs currently approved for the treatment and management of cancer are toxic with severe side effects, and we therefore believe that a product development plan based on effective and safe drugs could have broad applications in cancer treatment. Lorus' strategy is to continue the development of our product pipeline using several therapeutic approaches. Each therapeutic approach is dependent on different technologies, which we believe mitigates the development risks associated with a single technology platform. We evaluate the merits of each product throughout the clinical trial process and consider commercial viability as appropriate. The most advanced anticancer drugs in our pipeline, each of which flow from different platform technologies, are antisense, small molecules and immunotherapeutics.

Our business model is to take our product candidates through pre-clinical testing and into Phase I and Phase II clinical trials. It is our intention to then partner or co-develop these product candidates after successful completion of Phase I or II clinical trials. Lorus will give careful consideration in the selection of partners that can best advance the drug candidates into a pivotal Phase III clinical trial and, upon successful results, commercialization. Our objective is to receive cash for milestone payments and royalties from such partnerships which will support continued development of our product pipeline. We assess each product candidate and determine the optimal time to work towards partnering out that product candidate.

Our success is dependent upon several factors, including, maintaining sufficient levels of funding through public and/or private financing, establishing the efficacy and safety of our products in clinical trials and securing strategic partnerships.

Our net loss for 2008 decreased to $6.3 million ($0.03 per share) compared to a net loss of $9.6 million ($0.5 per share) in 2007. Operating net loss, before the gain on sale of shares associated with the completion of the Arrangement, increased to $12.6 million or $0.06 per share in 2008 as compared to $9.6 million or $0.05 per share in 2007. Research and development expenses in 2008 increased to $6.1 million from $3.4 million in 2007. The increase in research and development expenditures is the result of an increase in activity in both our LOR-2040 and LOR-253 (small molecule) development programs. We utilized cash of $10.2 million in our operating activities in 2008 compared with $6.3 million in 2007; the higher utilization is consistent with higher research and development activities. At the end of 2008 we had cash and cash equivalents, short-term investments and marketable securities of $9.4 million compared to $12.4 million at the end of 2007. Subsequent to year-end the rights offering provided the company with gross proceeds of approximately $3.71 million.

RESULTS OF OPERATIONS

Revenues

Revenues for the year decreased to $43 thousand compared with 2007 revenue of $107 thousand and $26 thousand in 2006. The decrease in revenue in 2008 is due to a decrease in services performed by Lorus personnel on behalf of other companies. Lorus recognized $10 thousand in revenue associated with the $100 thousand received as a non-refundable up front milestone payment associated with the license of Virulizin®. This license agreement provides for payments in excess of US$10 million upon the achievement of various milestone events and royalties that vary from 10-20% depending on the level of sales of Virulizin® achieved in those territories covered by the license and subject to certain other adjustments. We do not expect that any of these milestones will be achieved in the next 12 months. The license transaction is considered a multiple deliverable arrangement and as such Lorus is recognizing the milestone payment as agreed upon consulting services are performed. The balance of revenue earned in 2008 is related to laboratory services performed by Lorus personnel on behalf of other companies. The increase in revenue in 2007 compared with 2006 is related to increased laboratory services work performed by Lorus personnel on behalf of other companies. The Company did not receive any revenue under its licensing agreement with Cyclacel Ltd. in connection with the out licensing of our clotrimazole analog library of anticancer drug candidates. The agreement included an initial license fee of $546 thousand received in 2004 with the potential of additional license fees of up to U.S.$11.6 million that may be earned if Cyclacel achieves certain defined research and development milestones. We do not expect that any of these milestones will be achieved in the next 12 months.

Research and Development

Research and development expenses totaled $6.1 million in 2008 compared to $3.4 million in 2007 and $10.2 million in 2006. The increase in research and development expenditures in 2008 is due to a significant increase in activity within our LOR-2040 and small molecule development programs. In particular the initiation of an advanced Phase II clinical trial with LOR-2040 in acute myeloid leukemia and the manufacturing costs of the drug needed to complete the trial, the advancement of our small molecule program into GLP-toxicology studies and GLP-toxicology studies with LOR-2040 for the treatment of bladder cancer. This increase in spending is offset by lower amortization of acquired patents and license of $655 thousand which was fully amortized in 2007. The decrease in spending in 2007 compared with 2006 was the result of the close of the Virulizin® Phase III clinical trial for the treatment of advanced pancreatic cancer in 2006 as well as a reduction in headcount in November 2005 and a reduction in amortization of acquired patents and licenses of $1.6 million which was fully amortized part way through 2007.

General and Administrative

General and administrative expenses totaled $3.9 million in 2008 compared to $3.8 million in 2007 and $4.3 million in 2006. General and administrative expenses remained consistent year over year as we

continue to work to minimize our non-research and development costs. The decrease in general and administrative costs in 2007 over 2006 is the result of staff reductions, and a continued focus on lowering costs in all areas of the business. The cost savings realized during 2007 were partially offset by charges incurred under the mutual separation agreement entered into with Dr. Wright discussed under "Corporate Changes" below.

Stock-Based Compensation

Stock- based compensation expense totaled $719 thousand in 2008 compared with $503 thousand in 2007 and $1.2 million in 2006. The increase in stock based compensation in 2008 compared with 2007 is the result of an of an increase in options granted during 2008 in order to bring option granting practices in line with industry standards as well as an expense of $83 thousand related to a modification as described below. The decrease in stock-based compensation expense in 2007 compared with 2006 was the result of reduced fair values on the stock options issued, due to a decline in our stock price, as well as a significant number of unvested options that were forfeited during 2007 reducing the overall expense.

During 2008, a modification of the expiry date of options previously granted to directors not standing for re-election at the Company's annual general meeting and to Dr. Wright for options granted in his capacity as President and CEO was approved by the Company's Board of Directors. An expense of $83 thousand was recorded during the year due to these expiry date modifications.

During 2006, employees of the Company (excluding directors and officers) were given the opportunity to choose between keeping 100% of the options they held at the existing exercise prices or forfeiting 50% of the options held in exchange for having the remaining 50% of the exercise prices of the options re-priced to $0.30 per share. Employees holding 2,290,000 stock options opted for re-pricing their options, resulting in the amendment of the exercise price of 1,145,000 stock options and the forfeiture of 1,145,000 stock options during the quarter ended February 28, 2006.

Depreciation and Amortization

Depreciation and amortization expenses decreased to $317 thousand in 2008 as compared to $402 thousand in 2007 and $771 thousand in 2006. The decrease in depreciation and amortization expense is the result of reduced capital asset purchases during fiscal 2008 and 2007. In 2006, the Company took a write-down of $250 thousand on certain furniture and equipment whose carrying value was deemed to be unrecoverable and in excess of the fair value of the underlying assets.

Interest Expense

Non-cash interest expense was $1.0 million in 2008 compared with $1.0 million in 2007 and $882 thousand in 2006. These amounts represent interest at a rate of prime plus 1% on the $15 million convertible debentures. The interest expense in 2008 was consistent with 2007 as the average annual interest rate remained comparable between the two years. The increase in interest expense in 2007 compared with 2006 is a function of higher interest rates due to increases in the prime rate in late 2006.

Accretion in Carrying Value of Secured Convertible Debentures

Accretion in the carrying value of the debentures amounted to $1.2 million in 2008 compared with $935 thousand in 2007 and $790 thousand in 2006. Amortization of deferred financing charges totaled nil in 2008 compared with $110 thousand in 2007 and $87 thousand in 2006. The increase in accretion charges in 2008 is due to the reclassification of amortization of deferred financing charges to accretion expense due to the adoption of Section 3855, Financial Instruments as described under Accounting Policy Changes below. These charges arise as under GAAP the Company has allocated the proceeds from each tranche of the debentures to the debt and equity instruments issued on a relative fair value basis resulting in the $15.0 million debentures having an initial cumulative carrying value of $9.8 million as of their dates of issuance. Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be the face value of $15.0 million. The increase in expense in 2007 compared with 2006 is due to a higher effective rate of interest.

Interest and Other Income

Interest income totaled $542 thousand in 2008 compared to $503 thousand in 2007 and $374 thousand in 2006. The slight increase in 2008 over 2007 is the result of a marginally higher average cash balance in 2008 compared with 2007 and the opportunity to earn better rates of return. The increase from 2006 to 2007 is due to higher average cash and marketable securities balances in 2007 and by higher interest rates during 2007. Higher average cash and marketable securities balances in 2007 were primarily a function of the funds received as part to of the August 2006 private placements described under "Financing" below.

Loss for the Year

Operating net loss for the year, before the gain on sale of shares associated with the completion of the Arrangement, increased to $12.6 million or $0.06 per share in 2008 as compared to $9.6 million or $0.05 per share in 2007 and $17.9 million or $0.10 per share in 2006. The increase in operating net loss during 2008 compared with 2007 is primarily the result of increased research and development costs of $2.7 million associated with the ongoing LOR-2040 phase II clinical trial in AML, the advancement of our small molecule program and LOR-2040 for the treatment of bladder cancer into GLP-toxicology studies. The decrease in net loss in 2007 compared with 2006 is due to lower research and development costs resulting from the close of our Virulizin® Phase III clinical trial as well as staff reductions due to corporate changes, lower general and administrative costs due to staff reductions and lower legal, consulting and investor relations charges, depreciation and amortization and higher interest income and offset by higher accretion costs.

Gain on sale of shares

As a result of the Arrangement, we recognized a gain on the sale of the shares of Old Lorus to the Investor of approximately $6.3 million. Under the Arrangement, a number of steps were undertaken. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately $7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement as described below. Those tax attributes remaining with Old Lorus are no longer available to the Company.

Under the Arrangement, New Lorus and its subsidiaries have agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring (i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time; (ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and (iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

With respect to the forgoing indemnity, $600 thousand of the proceeds on the transaction were held in escrow until the first anniversary of the transaction (July 2008). Subsequent to year end the $600 thousand was released from escrow. At May 31, 2008 Lorus has deferred the entire amount of the proceeds held in escrow as its estimate of any liability arising from the indemnity.

License Transaction

Effective April 8, 2008, we entered into a non-exclusive multinational license agreement with ZOR Pharmaceutical LLC ("ZOR") formed as a subsidiary of Zoticon Bioventures Inc. to further develop and commercialize Virulizin® for human therapeutic applications.

Under the terms of the agreement, we will received an upfront licensing fee of $100 thousand, and may receive up to approximately U.S. $10 million in milestone payments based on progress through financing and clinical development, and royalties on net sales that vary from 10-20% depending on the level of

sales of Virulizin® achieved in those territories covered by the license and subject to certain other adjustments. ZOR will assume all future costs for the development of the licensed technology.

We have also entered into a service agreement with ZOR to assist in the transfer of knowledge. Under this agreement, we have agreed to provide ZOR with 300 hours of consulting service during a period of 18 months.

In addition, we acquired a 25% equity interest in ZOR in exchange for a capital contribution of $2,500. This investment has been accounted for as an equity investment. Lorus' equity will not be subject to dilution on the first U.S. $5 million of equity financing in ZOR. Thereafter, Lorus has, at its option, a right to participate in any additional financings to maintain its ownership level.

CORPORATE CHANGES

As discussed above, on July 10, 2007, the Company and Old Lorus completed a plan of arrangement and corporate reorganization with, among others, 6707157 Canada Inc. and Pinnacle International Lands, Inc. As part of the Arrangement, all of the assets and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it), with the exception of certain future tax assets were transferred, directly or indirectly, from Old Lorus to the Company. Securityholders in Old Lorus exchanged their securities in Old Lorus for equivalent securities in New Lorus and the board of directors and management of Old Lorus continued as the board of directors and management of New Lorus. New Lorus obtained substitutional listings of its common shares on both the Toronto Stock Exchange and the American Stock Exchange.

As part of the Arrangement, the Company changed its name to Lorus Therapeutics Inc. and continued as a biopharmaceutical company, specializing in the research and development of pharmaceutical products and technologies for the management of cancer as a continuation of the business of Old Lorus. In October 2007, Old Lorus changed its name from 4325231 Canada Inc. to Global Summit Real Estate Inc.

Dr. Wright resigned as the President and Chief Executive Officer effective September 21, 2006. The Company accrued a liability based on a mutual separation agreement executed during the year. As a result, we recorded severance compensation expense of $500 thousand recorded in general and administrative expense in the year ended May 31, 2007. All amounts payable under the mutual separation agreement were paid during fiscal 2007.

In November 2005, as a means to conserve cash and refocus operations, Lorus scaled back some activities related to the Virulizin® technology and implemented a workforce reduction of approximately 39% or 22 employees. As a result, for the year ended May 31, 2006, the Company recorded severance compensation expense for former employees of $557 thousand. Of this expense, $468 thousand is presented in the income statement as general and administrative expense and $89 thousand as research and development expense. Accounts payable and accrued liabilities at May 31, 2006 includes severance and compensation expense liabilities relating to the Company’s November 2005 corporate changes of $154 thousand that were paid out by December 2006.

REGULATORY MATTER

Lorus received notice from the American Stock Exchange ("AMEX") dated February 13, 2008, indicating that we needed to comply with the $6 million stockholder's equity threshold required for continued listing under AMEX Company Guide Sec. 1003(a)(iii). This notification was triggered by the decline of Lorus' market capitalization to less than $50 million, which previously exempted us from meeting the minimum stockholder's equity requirement. AMEX has renewed and accepted our plan to comply with the stockholder's equity requirements within an eighteen month period ending August 13, 2009. Should we not be able to execute the plan and comply with the AMEX requirements within the prescribed period, Lorus will be subject to de-listing.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Lorus has financed its operations and technology acquisitions primarily from equity and debt financing, the proceeds from the exercise of warrants and stock options, and interest income on funds held for future investment. The remaining costs associated with the completion of the LOR-2040 Phase I/II clinical trial program with the US National Cancer Institute ("NCI") will be borne by the US NCI. Lorus has undertaken an expanded LOR-2040 trial at its own cost and acquired additional quantities of LOR-2040 drug to support this ongoing trial and any further development of LOR-2040. The Company is currently in the assessment phase of results from its LOR-2501 Phase II clinical trial and is not incurring significant costs thereon. We will continue the development of our small molecule programs from internal resources until their anticipated completion.

We have not earned substantial revenues from our drug candidates and are therefore considered to be in the development stage. The continuation of our research and development activities and the commercialization of the targeted therapeutic products are dependent upon our ability to successfully finance and complete our research and development programs through a combination of equity financing and payments from strategic partners. We have no current sources of significant payments from strategic partners. In addition, we will need to repay or refinance the secured convertible debentures on their maturity should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further clinical development of our products or to repay the convertible debentures on maturity. If we are not able to raise additional funds, we may not be able to continue as a going concern and realize our assets and pay our liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for our financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

Management believes that our current level of cash and cash equivalents and short term investments will be sufficient to execute our current planned expenditures for the next twelve months; however, the $15 million convertible debt obligation is due in October 2009 and we currently does not have the cash and cash equivalents to satisfy this obligation. If the Company is not able to raise additional funds, it may not be able to continue as a going concern and realize its assets and pay its liabilities as they fall due. The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenues and expenses and the balance sheet classifications used.

Operating Cash Requirements

Lorus utilized cash in operating activities of $10.2 million in 2008 compared with $6.3 million in 2007 and $13.1 million in 2006. The increase in cash used in operating activities in 2008 of $3.9 million compared with 2007 is due to an increase in research and development expenditures of $2.7 million as well as a reduction in amortized acquired patents and licenses of $655 thousand which were fully amortized in 2007 and an increase in cash used in non-cash working capital of $484 thousand. The decrease in cash used in operating activities in 2007 of is primarily due to lower research and development and general and administrative expenses, as described above and higher interest income.

Cash Position

As at May 31, 2008, Lorus has cash and cash equivalents and short-term investments totaling $9.4 million compared to $12.4 million at the end of 2007. The Company invests in highly rated and liquid debt instruments. Investment decisions are made in accordance with an established investment policy administered by senior management and overseen by the Board of Directors. Working capital (representing primarily cash and cash equivalents and short-term investments having maturities of less that one year) at May 31, 2008 was $8.0 million as compared to $6.2 million at May 31, 2007. As discussed below, subsequent to year-end, Lorus initiated a rights offering that raised gross proceeds of

approximately $3.71 million in additional cash for Lorus. In addition the $600 thousand held in escrow at May 31, 2008 was released to Lorus on July 10, 2008.

We do not expect to generate positive cash flow from operations in the next several years due to additional research and development costs, including costs related to drug discovery, preclinical testing, clinical trials, manufacturing costs and operating expenses associated with supporting these activities. Negative cash flow will continue until such time, if ever, that we receive regulatory approval to commercialize any of our products under development and revenue from any such products exceeds expenses.

We may seek to access the public or private equity markets from time to time, even if we do not have an immediate need for additional capital at that time. We intend to use our resources to fund our existing drug development programs and develop new programs from our portfolio of preclinical research technologies. The amounts actually expended for research and drug development activities and the timing of such expenditures will depend on many factors, including the progress of the Company's research and drug development programs, the results of preclinical and clinical trials, the timing of regulatory submissions and approvals, the impact of any internally developed, licensed or acquired technologies, our ability to find suitable partnership agreements to assist financially with future development, the impact from technological advances, determinations as to the commercial potential of the Company's compounds and the timing and development status of competitive products.

Financing

Subsequent to the year-end the Company announced a rights offering to Lorus shareholders that raised gross proceeds of $3.71 million.

On July 10, 2007, Lorus completed a reorganization that had the effect of providing the Company with non-dilutive financing of $8.5 million in additional cash, before transaction costs, for New Lorus, subject to a $600 thousand holdback. The amount was released to Lorus on July 10, 2008. See Gain on Sale of Shares, above.

On July 13, 2006 the Company entered into an agreement with HighTech Beteiligungen GmbH & Co. KG (“HighTech”) to issue 28.8 million common shares at $0.36 per share for gross proceeds of $10.4 million. The subscription price represented a premium of 7.5% over the closing price of the common shares on the Toronto Stock Exchange on July 13, 2007. The transaction closed on August 31, 2006. In connection with the transaction, HighTech received demand registration rights that will enable HighTech to request the registration or qualification of the common shares for resale in the United States and Canada, subject to certain restrictions. These demand registration rights expire on June 30, 2012. In addition, HighTech received the right to nominate one nominee to the board of directors of Lorus or, if it does not have a nominee, it will have the right to appoint an observer to the board. Upon completion of the transaction, HighTech held approximately 14% of the issued and outstanding common shares of Lorus Therapeutics Inc.

On July 24, 2006 Lorus entered into an agreement with Technifund Inc. to issue on a private placement basis, 5 million common shares at $0.36 per share for gross proceeds of $1.8 million. The transaction closed on September 1, 2006.

In 2008, Lorus issued no common shares on the exercise of stock options for nil proceeds (2007, $22 thousand, 2006, nil).

Use of Proceeds

In our prospectus dated August 11, 2006 related to the subscription of shares by High Tech, the Company indicated that proceeds from the financing would be used as follows: $8.6 million to fund the development of our product candidates, and the balance for working capital and general corporate purposes. Since the date of receipt of funds, the company has incurred $4.5 million in research and development expenses on our immunotherapy and antisense programs and $3.9 million on our small molecule program.

CONTRACTUAL OBLIGATIONS

At May 31, 2008, we had contractual obligations requiring annual payments as follows:

(Amounts in 000's)

	Less than 1 year	1-3 years	4-5 years	5+ years	Total
Operating leases	143	287	—	—	430
Convertible Debenture[1]	—	15,000	—	—	15,000
Total	***143***	***15,287***	***—***	***—***	***15,430***

[1] The convertible debentures as described above may be converted into common shares of Lorus at a conversion price of $1.00. In the event that the holder does not convert the debentures, Lorus has an obligation to repay the $15.0 million in cash. The amounts above exclude interest expense which is payable by issuance of common shares which is calculated at a rate of prime plus 1% on the outstanding balance.

OFF-BALANCE SHEET ARRANGEMENTS

As at May 31, 2008, we have not entered into any off- balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

During the year ended May 31, 2008, we expensed consulting fees of $31,000 to a director of Lorus (2007 – nil, 2006 – nil) of which $30,000 remained payable at May 31, 2008 (2007 – nil, 2006 – nil).

This transaction was in the normal course of business and has been measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

SUBSEQUENT EVENTS

On June 25, 2008, Lorus filed a short-form prospectus for a rights offering to our shareholders.

Under the rights offering, holders of our common shares as of July 9, 2008 (the "Record Date") received one right for each common share held as of the Record Date. Each four (4) rights entitled the holder thereof to purchase a unit of Lorus ("Unit"). Each Unit consists of one common share of Lorus at $0.13 and a one-half warrant to purchase additional common shares of Lorus at $0.18 until August 7, 2010.

Rights expired on August 7, 2008. The Company issued 28,538,889 common shares and 14,269,444 common share purchase warrants in exchange for cash consideration of $3.71 million. We expect to use the net proceeds from the offering to fund research and development activities and for general working capital purposes.

RISK FACTORS

Investing in our securities involves a high degree of risk. Before making an investment decision with respect to our common shares, you should carefully consider the following risk factors, in addition to the other information included or incorporated by reference into this annual information form, as well as our historical consolidated financial statements and related notes. The risks set out below are not the only risks we face. If any of the following risks occur, our business, financial condition, prospects or results of operations would likely suffer. In that case, the trading price of our common shares could decline and you may lose all or part of the money you paid to buy our common shares.

We need to raise additional capital

Our current capital resources are not sufficient to fund our long-term business strategy or to repay our convertible debentures. We need to raise additional capital. To obtain the necessary capital, we must rely on any or all of; grants and tax credits, additional share issues and collaboration agreements or

corporate partnerships to provide full or partial funding for our activities. We cannot assure you that additional funding will be available on terms which are acceptable to us or in amounts that will enable us to carry out our business plan.

If we cannot obtain the necessary capital, we will have to:

- engage in equity financings that would result in significant dilution to existing investors;
- delay or reduce the scope of or eliminate one or more of our development programs;
- obtain funds through arrangements with collaborators or others that may require us to relinquish rights to technologies, product candidates or products that we would otherwise seek to develop or commercialize ourselves; or license rights to technologies, product candidates or products on terms that are less favourable to us than might otherwise be available; or
- considerably reduce, even cease our operations

We have a history of operating losses. We expect to incur net losses and we may never achieve or maintain profitability.

We have not been profitable since our inception in 1986. We reported net losses of $6.3 million; $9.6 million and $17.9 million for the years ended May 31, 2008, 2007 and 2006, respectively. As of May 31, 2008, we had an accumulated deficit of $180.5 million.

To date we have only generated nominal revenues from the sale of Virulizin® in Mexico and we stopped selling Virulizin® in Mexico in July 2005. We have not generated any other revenue from product sales to date and it is possible that we will never have sufficient product sales revenue to achieve profitability. We expect to continue to incur losses for at least the next several years as we or our collaborators and licensees pursue clinical trials and research and development efforts. To become profitable, we, either alone or with our collaborators and licensees, must successfully develop, manufacture and market our current product candidates, LOR-2040, as well as continue to identify, develop, manufacture and market new product candidates. It is possible that we will never have significant product sales revenue or receive significant royalties on our licensed product candidates. If funding is insufficient at any time in the future, we may not be able to develop or commercialize our products, take advantage of business opportunities or respond to competitive pressures.

We are an early stage development company

We are at an early stage of development. Significant additional investment will be necessary to complete the development of any of our products. Pre-clinical and clinical trial work must be completed before our products could be ready for use within the market that we have identified. We may fail to develop any products, to obtain regulatory approvals, to enter clinical trials or to commercialize any products. We do not know whether any of our potential product development efforts will prove to be effective, meet applicable regulatory standards, obtain the requisite regulatory approvals, be capable of being manufactured at a reasonable cost or be accepted in the marketplace.

The product candidates we are currently developing are not expected to be commercially viable for several years and we may encounter unforeseen difficulties or delays in commercializing our product candidates. In addition, our products may cause undesirable side effects.

Our product candidates require significant funding to reach regulatory approval assuming positive clinical results. Such funding will be very difficult, or impossible to raise in the public markets. If such partnerships are not attainable, the development of these product candidates maybe significantly delayed or stopped altogether. The announcement of such delay or discontinuation of development may have a negative impact on our share price.

Our cash flow is not sufficient to repay our debentures at maturity.

Our ability to repay our convertible debentures at maturity or refinance our prime plus 1% convertible debentures due in approximately 14 months (October 2009) will depend on our ability to generate or raise sufficient cash or refinance them. If we cannot repay or refinance the debentures at or prior to maturity, the lender may, at its discretion:

- commence legal action;
- take possession of our assets;
- carry on our business;
- appoint a receiver; and
- take any other action permitted by law to obtain payment.

We may violate one or more of the operational covenants related to our convertible debentures that could result in an event of default and the requirement for early payment of our convertible debentures.

Our convertible debentures are subject to certain operational covenants. In the event that one of those covenants is breached by us, an event of default could be declared requiring the immediate payment of the face value of the debentures. This could result in our inability to pay the principal and interest owing on the debentures and insolvency of the Company, a dilutive equity financing in attempt to raise funds to repay the debentures, or a significant reduction in cash available for us to use towards the development of our product candidates.

The Company has indemnified Old Lorus and its directors, officers and employees in respect of the Arrangement.

Under the Arrangement, we have agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring

(i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time;

(ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and

(iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

This indemnification could result in significant liability to us.

We may be unable to obtain partnerships for one or more of our product candidates which could curtail future development and negatively impact our share price.

Our strategy for the research, development and commercialization of our products requires entering into various arrangements with corporate collaborators, licensers, licensees and others, and our commercial success is dependent upon these outside parties performing their respective contractual responsibilities. The amount and timing of resources that such third parties will devote to these activities may not be within our control. We cannot assure you that such parties will perform their obligations as expected. We also cannot assure you that our collaborators will devote adequate resources to our programs. In addition, we could become involved in disputes with our collaborators, which could result in a delay or termination of the related development programs or result in litigation. We intend to seek additional collaborative arrangements to develop and commercialize some of our products. We may not be able to negotiate collaborative arrangements on favourable terms, or at all, in the future, or that our current or future collaborative arrangements will be successful.

If we cannot negotiate collaboration, licence or partnering agreements, we may never achieve profitability.

Clinical trials are long, expensive and uncertain processes and Health Canada or the FDA may ultimately not approve any of our product candidates. We may never develop any commercial drugs or other products that generate revenues.

None of our product candidates has received regulatory approval for commercial use and sale in North America. We cannot market a pharmaceutical product in any jurisdiction until it has completed thorough preclinical testing and clinical trials in addition to that jurisdiction's extensive regulatory approval process. In general, significant research and development and clinical studies are required to demonstrate the safety and effectiveness of our product candidates before we can submit any regulatory applications.

Clinical trials are long, expensive and uncertain processes. Clinical trials may not be commenced or completed on schedule, and Health Canada or the FDA or any other regulatory body may not ultimately approve our product candidates for commercial sale.

The clinical trials of any of our drug candidates could be unsuccessful, which would prevent us from advancing, commercializing or partnering the drug.

Even if the results of our preclinical studies or clinical trials are initially positive, it is possible that we will obtain different results in the later stages of drug development or that results seen in clinical trials will not continue with longer term treatment. Positive results in early Phase I or Phase II clinical trials may not be repeated in larger Phase II or Phase III clinical trials. For example, results of our Phase III clinical trial of Virulizin® did not meet the primary endpoint of the study despite promising preclinical and early stage clinical data. All of our potential drug candidates are prone to the risks of failure inherent in drug development.

Preparing, submitting and advancing applications for regulatory approval is complex, expensive and time intensive and entails significant uncertainty. A commitment of substantial resources to conduct time-consuming research, preclinical studies and clinical trials will be required if we are to complete development of our products.

Clinical trials of our products require that we identify and enrol a large number of patients with the illness under investigation. We may not be able to enrol a sufficient number of appropriate patients to complete our clinical trials in a timely manner particularly in smaller indications such as acute myeloid leukemia. If we experience difficulty in enrolling a sufficient number of patients to conduct our clinical trials, we may need to delay or terminate ongoing clinical trials and will not accomplish objectives material to our success that could affect the price of our common shares. Delays in planned patient enrolment or lower than anticipated event rates in our current clinical trials or future clinical trials may result in increased costs, program delays, or both.

In addition, unacceptable toxicities or adverse side effects may occur at any time in the course of preclinical studies or human clinical trials or, if any product candidates are successfully developed and approved for marketing, during commercial use of any approved products. The appearance of any such unacceptable toxicities or adverse side effects could interrupt, limit, delay or abort the development of any of our product candidates or, if previously approved, necessitate their withdrawal from the market. Furthermore, disease resistance or other unforeseen factors may limit the effectiveness of our potential products.

Our failure to develop safe, commercially viable drugs would substantially impair our ability to generate revenues and sustain our operations and would materially harm our business and adversely affect our share price. We may never achieve profitability.

As a result of intense competition and technological change in the pharmaceutical industry, the marketplace may not accept our products or product candidates, and we may not be able to compete successfully against other companies in our industry and achieve profitability.

Many of our competitors have:

- drug products that have already been approved or are in development, and operate large, well-funded research and development programs in these fields;

- substantially greater financial and management resources, stronger intellectual property positions and greater manufacturing, marketing and sales capabilities, areas in which we have limited or no experience;

- significantly greater experience than we do in undertaking preclinical testing and clinical trials of new or improved pharmaceutical products and obtaining required regulatory approvals;

- Consequently, our competitors may obtain Health Canada, FDA and other regulatory approvals for product candidates sooner and may be more successful in manufacturing and marketing their products than we or our collaborators are;

- Existing and future products, therapies and technological approaches will compete directly with the products we seek to develop. Current and prospective competing products may provide greater therapeutic benefits for a specific problem or may offer easier delivery or comparable performance at a lower cost.;

- Any product candidate that we develop and that obtains regulatory approval must then compete for market acceptance and market share. Our product candidates may not gain market acceptance among physicians, patients, healthcare payers and the medical community. Further, any products we develop may become obsolete before we recover any expenses we incurred in connection with the development of these products.

As a result, we may never achieve profitability.

If we fail to attract and retain key employees, the development and commercialization of our products may be adversely affected.

We depend heavily on the principal members of our scientific and management staff. If we lose any of these persons, our ability to develop products and become profitable could suffer. The risk of being unable to retain key personnel may be increased by the fact that we have not executed long term employment contracts with our employees, except for our senior executives. Our future success will also depend in large part on our ability to attract and retain other highly qualified scientific and management personnel. We face competition for personnel from other companies, academic institutions, government entities and other organizations.

We may be unable to obtain patents to protect our technologies from other companies with competitive products, and patents of other companies could prevent us from manufacturing, developing or marketing our products.

Patent protection:
The patent positions of pharmaceutical and biotechnology companies are uncertain and involve complex legal and factual questions.

The United States (U.S.) Patent and Trademark Office and many other patent offices in the world have not established a consistent policy regarding the breadth of claims that they will allow in biotechnology patents.

Allowable patentable subject matter and the scope of patent protection obtainable may differ between jurisdictions. If a patent office allows broad claims, the number and cost of patent interference proceedings in the U.S. or analogous proceedings in other jurisdictions and the risk of infringement litigation may increase. If it allows narrow claims, the risk of infringement may decrease, but the value of our rights under our patents, licenses and patent applications may also decrease.

The scope of the claims in a patent application can be significantly modified during prosecution before the patent is issued. Consequently, we cannot know whether our pending applications will result in the issuance of patents or, if any patents are issued, whether they will provide us with significant proprietary protection or will be circumvented, invalidated or found to be unenforceable.

Until recently, patent applications in the U.S. were maintained in secrecy until the patents issued, and publication of discoveries in scientific or patent literature often lags behind actual discoveries. Patent applications filed in the United States after November 2000 generally will be published 18 months after the filing date unless the applicant certifies that the invention will not be the subject of a foreign patent application. In many other jurisdictions, such as Canada, patent applications are published 18 months from the priority date. We cannot assure you that, even if published, we will be aware of all such literature. Accordingly, we cannot be certain that the named inventors of our products and processes were the first to invent that product or process or that we were the first to pursue patent coverage for our inventions.

Enforcement of intellectual property rights:
Protection of the rights revealed in published patent applications can be complex, costly and uncertain. Our commercial success depends in part on our ability to maintain and enforce our proprietary rights. If third parties engage in activities that infringe our proprietary rights, our management's focus will be diverted and we may incur significant costs in asserting our rights. We may not be successful in asserting our proprietary rights, which could result in our patents being held invalid or a court holding that the third party is not infringing, either of which would harm our competitive position.

Others may design around our patented technology. We may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office, European opposition proceedings, or other analogous proceedings in other parts of the world to determine priority of invention and the validity of patent rights granted or applied for, which could result in substantial cost and delay, even if the eventual outcome is favourable to us. We cannot assure you that our pending patent applications, if issued, would be held valid or enforceable.

Trademark protection:
In order to protect goodwill associated with our company and product names, we rely on trademark protection for our marks. For example, we have registered the Virulizin® trademark with the U.S. Patent and Trademark Office. A third party may assert a claim that the Virulizin® mark is confusingly similar to its mark and such claims or the failure to timely register the Virulizin® mark or objections by the FDA could force us to select a new name for Virulizin®, which could cause us to incur additional expense.

Trade secrets:
We also rely on trade secrets, know-how and confidentiality provisions in our agreements with our collaborators, employees and consultants to protect our intellectual property. However, these and other parties may not comply with the terms of their agreements with us, and we might be unable to adequately enforce our rights against these people or obtain adequate compensation for the damages caused by their unauthorized disclosure or use of our trade secrets or know how. Our trade secrets or those of our collaborators may become known or may be independently discovered by others.

Our products and product candidates may infringe the intellectual property rights of others, which could increase our costs.

Our success also depends on avoiding infringement of the proprietary technologies of others. In particular, there may be certain issued patents and patent applications claiming subject matter which we or our collaborators may be required to license in order to research, develop or commercialize at least some of our product candidates, including Virulizin®, LOR-2040 and small molecules. In addition, third-parties may assert infringement or other intellectual property claims against us based on our patents or other intellectual property rights. An adverse outcome in these proceedings could subject us to significant liabilities to third-parties, require disputed rights to be licensed from third-parties or require us to cease or modify our use of the technology. If we are required to license such technology, we cannot assure you that a license under such patents and patent applications will be available on acceptable terms or at all. Further, we may incur substantial costs defending ourselves in lawsuits against charges of patent infringement or other unlawful use of another's proprietary technology.

If product liability claims are brought against us or we are unable to obtain or maintain product liability insurance, we may incur substantial liabilities that could reduce our financial resources.

The clinical testing and commercial use of pharmaceutical products involves significant exposure to product liability claims. We have obtained limited product liability insurance coverage for our clinical trials on humans; however, our insurance coverage may be insufficient to protect us against all product liability damages. Further, liability insurance coverage is becoming increasingly expensive and we might not be able to obtain or maintain product liability insurance in the future on acceptable terms or in sufficient amounts to protect us against product liability damages. Regardless of merit or eventual outcome, liability claims may result in decreased demand for a future product, injury to reputation, withdrawal of clinical trial volunteers, loss of revenue, costs of litigation, distraction of management and substantial monetary awards to plaintiffs. Additionally, if we are required to pay a product liability claim, we may not have sufficient financial resources to complete development or commercialization of any of our product candidates and our business and results of operations will be adversely affected.

We have no manufacturing capabilities. We depend on third-parties, including a number of sole suppliers, for manufacturing and storage of our product candidates used in our clinical trials. Product introductions may be delayed or suspended if the manufacture of our products is interrupted or discontinued.

We do not have manufacturing facilities to produce supplies of LOR-2040, small molecule or any of our other product candidates to support clinical trials or commercial launch of these products, if they are approved. We are dependent on third parties for manufacturing and storage of our product candidates. If we are unable to contract for a sufficient supply of our product candidates on acceptable terms, or if we encounter delays or difficulties in the manufacturing process or our relationships with our manufacturers, we may not have sufficient product to conduct or complete our clinical trials or support preparations for the commercial launch of our product candidates, if approved.

Our operations involve hazardous materials and we must comply with environmental laws and regulations, which can he expensive and restrict how we do business.

Our research and development activities involve the controlled use of hazardous materials, radioactive compounds and other potentially dangerous chemicals and biological agents. Although we believe our safety procedures for these materials comply with governmental standards, we cannot entirely eliminate

the risk of accidental contamination or injury from these materials. We currently have insurance, in amounts and on terms typical for companies in businesses that are similarly situated, that could coverall or a portion of a damage claim arising from our use of hazardous and other materials. However, if an accident or environmental discharge occurs, and we are held liable for any resulting damages, the associated liability could exceed our insurance coverage and our financial resources.

Our interest income is subject to fluctuations of interest rates in our investment portfolio.

Our investments are held to maturity and have staggered maturities to minimize interest rate risk. We cannot assure you that interest income fluctuations will not have an adverse impact on our financial condition. We maintain all our accounts in Canadian dollars, but a portion of our expenditures are in foreign currencies. We do not currently engage in hedging our foreign currency requirements to reduce exchange rate risk.

RISKS RELATED TO OUR COMMON SHARES AND CONVERTIBLE DEBENTURES

Our share price has been and may continue to be volatile and an investment in our common shares could suffer a decline in value.

You should consider an investment in our common shares as risky and invest only if you can withstand a significant loss and wide fluctuations in the market value of your investment. We receive only limited attention by securities analysts and frequently experience an imbalance between supply and demand for our common shares. The market price of our common shares has been highly volatile and is likely to continue to be volatile. Factors affecting our common share price include but are not limited to:

- the progress of our and our collaborators' clinical trials, including our and our collaborators' ability to produce clinical supplies of our product candidates on a timely basis and in sufficient quantities to meet our clinical trial requirements;
- announcements of technological innovations or new product candidates by us, our collaborators or our competitors;
- fluctuations in our operating results;
- published reports by securities analysts;
- developments in patent or other intellectual property rights;
- publicity concerning discovery and development activities by our licensees;
- the cash and short term investments held us and our ability to secure future financing;
- public concern as to the safety and efficacy of drugs that we and our competitors develop;
- governmental regulation and changes in medical and pharmaceutical product reimbursement policies; and
- general market conditions.

Future sales of our common shares by us or by our existing shareholders could cause our share price to fall.

Additional equity financings or other share issuances by us could adversely affect the market price of our common shares. Sales by existing shareholders of a large number of shares of our common shares in the public market and the sale of shares issued in connection with strategic alliances, or the perception that such additional sales could occur, could cause the market price of our common shares to drop.

Conversion of our secured convertible debentures will dilute the ownership interest of existing shareholders.

The conversion of some or all of our convertible debentures will dilute the ownership interests of existing shareholders. Any sales in the public market of the common shares issuable upon such conversion could

adversely affect prevailing market prices of our common shares. In addition, the existence of the secured convertible debentures may encourage short selling by market participants.

We maybe unable to maintain the listing requirements on one or more of the stock exchanges our shares are currently listed on.

We are currently not in compliance with the listing standards of the AMEX. We have been granted 18 months by the AMEX to regain compliance based on a business plan approved by the AMEX in May 2008. We may be unable to reach or sustain the listing requirements which would result in our shares being delisted from the exchange. This would result in our shareholders only being able to trade shares on the Toronto Stock Exchange.

CRITICAL ACCOUNTING POLICIES

The Company periodically reviews its financial reporting and disclosure practices and accounting policies to ensure that they provide accurate and transparent information relative to the current economic and business environment. As part of this process, the Company has reviewed its selection, application and communication of critical accounting policies and financial disclosures. Management has discussed the development and selection of the critical accounting policies with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosure relating to critical accounting policies in this MD&A. Other important accounting polices are described in note 2 of the Financial Statements.

Drug Development Costs

We incur costs related to the research and development of pharmaceutical products and technologies for the management of cancer. These costs include internal and external costs for preclinical research and clinical trials, drug costs, regulatory compliance costs and patent application costs. All research costs are expensed as incurred as required under GAAP.

Development costs, including the cost of drugs for use in clinical trials, are expensed as incurred unless they meet the criteria under GAAP for deferral and amortization. The Company continually assesses its activities to determine when, if ever, development costs may qualify for capitalization. By expensing the research and development costs as required under GAAP, the value of the product portfolio is not reflected on the Company's Financial Statements.

Stock-Based Compensation

We have applied the fair value based method to expense stock options awarded since June 1, 2002 using the Black-Scholes option-pricing model as allowed under Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3870. The model estimates the fair value of fully transferable options, without vesting restrictions, which significantly differs from the stock option awards issued by Lorus. The model also requires four highly subjective assumptions including future stock price volatility and expected time until exercise, which greatly affect the calculated values. The increase or decrease of one of these assumptions could materially increase or decrease the fair value of stock options issued and the associated expense.

Valuation Allowance for Future Tax Assets

We have a net tax benefit resulting from non-capital losses carried forward, and scientific research and experimental development expenditures. In light of the continued net losses and uncertainty regarding our future ability to generate taxable income, management is of the opinion that it is not more likely than not that these tax assets will be realized in the foreseeable future and hence, a full valuation allowance has been recorded against these income tax assets. Consequently, no future income tax assets or liabilities are recorded on the balance sheets.

The generation of future taxable income could result in the recognition of some portion or all of the remaining benefits, which could result in an improvement in our results of operations through the recovery of future income taxes.

Valuation of Long Lived Assets

We periodically review the useful lives and the carrying values of our long-lived assets. We review for impairment in long-lived assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount, it is considered to be impaired. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value; which is estimated as the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset.

ACCOUNTING POLICY CHANGES

Effective on June 1, 2007, the Company adopted the recommendations of CICA Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments - Recognition and Measurement; Section 3861, Financial Instruments - Disclosure and Presentation; and Section 3251, Equity. These sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian GAAP.

Our adoption of the above recommendations had the following impact on the current financial statements:

Short-term investments:

Short-term investments consist of fixed income government investments and corporate instruments. Any government and corporate investments with a stated maturity date that are not cash equivalents are classified as held-to-maturity investments, except where the Company does not intend to hold to maturity and, therefore, the investment is designated as held-for-trading. Held-to-maturity investments are measured at amortized cost using the effective interest rate method, while held-for-trading investments are measured at fair value and the resulting gain or loss is recognized in the consolidated statements of operations. The Company designated certain corporate instruments with maturities greater than one year previously carried at amortized cost as held-for-trading investments. This change in accounting policy resulted in a decrease in the carrying amount of $27 thousand and an increase in the opening deficit accumulated during the development stage of $27 thousand. The Company recognized a net unrealized gain in the consolidated statements of operations for the year ended May 31, 2008 of $7 thousand.

Secured convertible debentures:

The secured convertible debentures are classified as other financial liabilities and accounted for at amortized cost using the effective interest method, which is consistent with the Company's accounting policy prior to the adoption of Section 3855. The deferred financing charges related to the secured convertible debentures, formerly included in long term assets, are now included as part of the carrying value of the secured convertible debentures and continue to be amortized using the effective interest method.

Embedded derivatives:

Section 3855 requires that the Company identify embedded derivatives that require separation from the related host contract and measure those embedded derivatives at fair value. Subsequent change in fair value of embedded derivatives is recognized in the consolidated statement of operations and deficit in the period the change occurs.

The Company did not identify any embedded derivatives that required separation from the related host contract as at June 1, 2007 that resulted in a material adjustment to the consolidated interim financial statements.

Transaction costs:

Transaction costs that are directly attributable to the acquisition or issuance of financial assets or liabilities are accounted for as part of the respective asset or liability's carrying value at inception except for held-for-trading securities where the costs are expensed immediately.

Guarantee:
On July 10, 2007, as part of the Arrangement, the Company, including its subsidiaries, indemnified Old Lorus and its directors. This indemnity is required to be accounted for at fair value in accordance with Section 3855. Management has accrued an amount of $600 thousand being the amount held in escrow and has recorded this amount as a deferred gain on sale of shares within its liabilities. The fair value of the indemnity will be reassessed in the first quarter 2009 as the escrowed amount was released on July 2008.

There were no new accounting policies implemented during the year-end May 31, 2007. The following changes were implemented in 2006:

Variable Interest Entities

Effective June 1, 2005, the Company adopted the recommendations of CICA Handbook Accounting Guideline 15 (AcG-15), *Consolidation of Variable Interest Entities*, effective for fiscal years beginning on or after November 1, 2004. Variable interest entities (VIEs) refer to those entities that are subject to control on a basis other than ownership of voting interests. AcG-15 provides guidance for identifying VIEs and criteria for determining which entity, if any, should consolidate them. The adoption of AcG-15 did not have an effect on the financial position, results of operations or cash flows in the current period or the prior period presented.

Financial Instruments - Disclosure and Presentation

Effective June 1, 2005, the Company adopted the amended recommendations of CICA Handbook Section 3860, *Financial Instruments - Disclosure and Presentation*, effective for fiscal years beginning on or after November 1, 2004. Section 3860 requires that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The Company has determined that there is no impact on the Financial Statements resulting from the adoption of the amendments to Section 3860 either in the current period or the prior period presented.

Accounting for Convertible Debt Instruments

On October 17, 2005, the CICA issued EIC 158, *Accounting for Convertible Debt Instruments* applicable to convertible debt instruments issued subsequent to the date of the EIC. EIC 158 discusses the accounting treatment of convertible debentures in which upon conversion, the issuer is either required or has the option to satisfy all or part of the obligation in cash. The EIC discusses various accounting issues related to this type of convertible debt. The Company has determined that there is no impact on the Financial Statements resulting from the adoption of EIC 158 either in the current period or the prior period presented.

Section 3831, Non-Monetary Transactions

In June 2005, the CICA released a new Handbook Section 3831, *Non-monetary Transactions*, effective for all non-monetary transactions initiated in periods beginning on or after January 1, 2006. This standard requires all non-monetary transactions to be measured at fair value unless they meet one of four very specific criteria. Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. Commercial substance is a function of the cash flows expected by the reporting entity.

RECENT ACCOUNTING PRONOUNCEMENTS

In October 2006, the AcSB approved disclosure and presentation requirements for financial instruments that revise and enhance the disclosure requirements of Section 3861. These requirements included Sections 3862 – Financial Instruments – Disclosure, which replaces Section 3861 and Section 1535,

Capital Disclosures ("Section 1535"), which establishes standards for disclosing information about an entity's capital and how it is managed.

Section 3862 is based on IFRS 7, “Financial Instruments: Disclosures”, and places an increased emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. Section 3862 requires disclosures, by class of financial instrument that enables users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable.

Section 3863 “Financial Instruments – Presentation”, which replaces Section 3861, “Financial Instruments – Disclosure and Presentation”. The existing requirements on presentation of financial instruments have been carried forward unchanged to Section 3863, “Financial Instruments – Presentation”.

These new Sections are effective for interim and annual financial statements with fiscal years beginning on or after October 1, 2007, but may be adopted in place of Section 3861 before that date.

Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for us for interim and annual financial statements relating to fiscal years beginning on December 1, 2007. Early adoption is permitted at the same time an entity adopts other standards relating to accounting for financial instruments.

We do not expect the adoption of these standards to have a material impact on our consolidated financial position and results of operations.

CICA Handbook Section 1400, “General Standards on Financial Statement Presentation”, has been amended to include requirements to assess and disclose an entity’s ability to continue as a going concern. The changes are effective for the Company for interim and annual financial statements beginning on or after January 1, 2008, and specifically June 1, 2008 for the Company. We have not yet assessed the impact, if any, of Section 1400 on the Company’s financial statements.

The CICA plans to converge Canadian GAAP with International Financial Reporting Standards (“IFRS”) over a transition period expected to end in 2011. The impact of the transition to IFRS on the Company’s financial statements has not been determined.

Section 3064, “Goodwill and intangible assets”, will be replacing Section 3062, “Goodwill and other intangible assets” and Section 3450, “Research and development costs”. This new section, issued in February 2008, will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning June 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The impact of adoption of this new section on the Company’s financial statements has not been determined.

SELECTED ANNUAL FINANCIAL DATA

The following selected consolidated financial data have been derived from, and should be read in conjunction with, the accompanying audited consolidated financial statements for the year ended May 31, 2008 which are prepared in accordance with Canadian GAAP.

Consolidated Statements of Loss and Deficit
(amounts in Canadian 000's except for per common share data)

	Years Ended May 31		
	2008	2007	2006
REVENUE	**$ 43**	$ 107	$ 26
EXPENSES			
Cost of sales	**2**	16	3
Research and development	**6,087**	3,384	10,237
General and administrative	**3,888**	3,848	4,334
Stock-based compensation	**719**	503	1,205
Depreciation and amortization	**317**	402	771
Operating expenses	**11,013**	8,153	16,550
Interest expense on convertible debentures	**1,029**	1,050	882
Accretion in carrying value of secured convertible debentures	**1,176**	935	790
Amortization of deferred financing charges	**—**	110	87
Interest income	**(542)**	(503)	(374)
Loss from operation for the period	**12,633**	9,638	17,909
Gain on sale of shares	**(6,299)**	—	—
Net loss and other comprehensive income	**6,334**	9,638	17,909
Basic and diluted loss per common share	**$ 0.03**	$ 0.05	$ 0.10
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share	**215,084**	204,860	173,523
Total Assets	**$ 11,607**	$ 15,104	$ 11,461
Total Long-term liabilities	**$ 12,742**	$ 11,566	$ 10,521

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth certain unaudited consolidated statements of operations data for each of the eight most recent fiscal quarters that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained elsewhere in this annual report and includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information presented.

Research and development expenses have increased during 2008 in comparison with the same quarters in the prior year. This increased spending is the result of the initiation of a Phase II clinical trial with LOR-2040 for the treatment of AML and the related purchase of needed drug supply as well as the escalation of our small molecule program and LOR-2040 for the treatment of bladder cancer into GLP-toxicology studies. Research and development costs decreased throughout 2007 as the remaining costs of the Phase III Virulizin® clinical trial were completed and the escalation of our current programs underway had not yet begun.

General and administrative expenses have remained relatively consistent across quarters in the current fiscal year with the exception of an increase for the quarters ended November 30, 2007 and May 31, 2008. The increase in the second quarter ended November 30, 2007 was due to higher annual meeting costs associated with a special meeting and the amendment of our stock option plan. The increase in Q4 compared with the prior year was predominantly the result of increased legal activity associated with a licensing transaction completed during the quarter and employment litigation which was resolved during Q4. In addition costs were incurred in the preparation for compliance with internal controls requirements. General and administrative expenses increased significantly in the quarter ended November 30, 2006 due to severance charges relating to the mutual separation agreement executed in September as described in the Corporate Changes section, above.

Net loss increased in Q3 and Q4 2008 due to an increase in research and development costs. We had net income in Q1 due to the Gain on Sale of Shares as described above. Net loss decreased in Q3 and Q4 of 2007 as the result of reduced research and development and general and administrative expenditures.

	Fiscal 2008 Quarter Ended				**Fiscal 2007 Quarter Ended**			
(Amounts in 000's except for per common share data)	**May 31, 2008**	**Feb. 29, 2008**	**Nov. 30, 2007**	**Aug. 31, 2007**	**May 31, 2007**	**Feb. 28, 2007**	**Nov. 30, 2006**	**Aug. 31, 2006**
Revenue	$ 13	$ 3	$ 1	$ 26	$ 40	$ 37	$ 23	$ 7
Research and development	1,836	2,222	1,247	782	259	672	1,122	1,331
General and administrative	1,186	863	1,103	736	820	833	1,407	788
Net loss	(3,650)	(3,850)	(2,825)	3,991	(1,689)	(2,062)	(3,117)	(2,770)
Basic and diluted net loss per share	**$ (0.02)**	**$ (0.02)**	**$ (0.01)**	**$ 0.02**	**$ (0.01)**	**$ (0.01)**	**$ (0.01)**	**$ (0.01)**
Cash used in operating activities	$ (2,722)	$ (2,586)	$ (2,537)	$ (2,348)	$ (89)	$ (1,805)	$ (2,585)	$ (1,814)

Disclosure Controls and Procedures

As at May 31, 2008, Lorus management evaluated the effectiveness of the design and operation of its disclosure controls. Based on their evaluation the Chief Executive Officer and the Chief Financial Officer have concluded that there are no material weaknesses in the design and operation of its disclosure controls and that these disclosure controls and procedures are effective.

In July 2008 we released a press release which contained certain clerical errors. We identified the errors quickly and circulated a correct version of the press release within a few hours. We have reviewed the process and put controls in place to ensure that such errors will not happen in the future.

Internal Controls Over Financial Reporting

Management is responsible for certifying the design of our internal control over financial reporting as required by Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings as well as certifying to the design and testing of our internal controls over financial reporting as required under Sarbanes Oxley Section 404. The year ended May 31, 2008 was the first year we have been required to perform detailed testing of our internal controls over financial reporting. As a result of this more detailed level of evaluating and testing our internal controls over financial reporting as at May 31, 2008, management has concluded that the following disclosable weaknesses existed at May 31, 2008.

Segregation of Duties

Given our limited staff, certain duties within the accounting and finance department cannot be properly segregated. We believe that none of the segregation of duty deficiencies has resulted in a misstatement

to the financial statements as we rely on certain compensating controls, including substantive periodic review of the financial statements by the Chief Executive Officer and Audit Committee. This weakness is considered to be a common area of deficiency for many smaller listed companies in Canada. We continue to evaluate whether additional accounting staff should be hired to deal with this weakness.

Complex and Non-Routine Transactions

As required, we record complex and non-routine transactions. These sometimes are extremely technical in nature and require an in-depth understanding of GAAP. Our accounting staff has only a fair and reasonable knowledge of the rules related to GAAP and reporting and the transactions may not be recorded correctly, potentially resulting in material misstatement of our financial statements.

To address this risk, we consult with our third party expert advisors as needed in connection with the recording and reporting of complex and non-routine transactions. In addition, an annual audit is completed by our auditors, and presented to the Audit Committee for its review and approval. During the audit for the fiscal year ended May 31, 2008, no material misstatements were identified. At a future date, we may consider expanding the technical expertise within our accounting function. In the meantime, we will continue to work closely with our third party advisors.

Changes in Controls

There have been no significant changes in our internal controls over financial reporting during the year ended May 31, 2008, that have materially affected, or are reasonably likely to materially affect our' internal control over financial reporting.

OUTSTANDING SHARE DATA

As at August 28, 2008, the Company had 247,354,622 common shares issued and outstanding and 14,269,444 common share purchase warrants convertible into an equal number of common shares. In addition, the Company had issued and outstanding 20,475,000 stock options to purchase an equal number of common shares, and a $15 million convertible debenture convertible into common shares of Lorus at $1.00 per share.

ADDITIONAL INFORMATION

Additional information relating to Lorus, including Lorus' 2008 annual information form and other disclosure documents, is available on SEDAR at www.sedar.com. For any information filed prior to July 10, 2007 please access the information on SEDAR for Global Summit Real Estate Inc. (Old Lorus).

Management's Responsibility for Financial Reporting

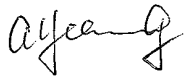
The accompanying consolidated financial statements of Lorus Therapeutics Inc. and other financial information contained in this annual report are the responsibility of Management and have been approved by the Board of Directors of the Company.

The consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles, using Management's best estimates and judgments where appropriate. In the opinion of Management, these consolidated financial statements reflect fairly the financial position and the results of operations and cash flows of the Company within reasonable limits of materiality. The financial information contained elsewhere in this annual report has been reviewed to ensure consistency with that in the consolidated financial statements. The integrity and objectivity of data in the financial statements and elsewhere in this annual report are the responsibility of Management.

In discharging its responsibility for the integrity and fairness of the financial statements, management maintains a system of internal controls designed to provide reasonable assurance, at appropriate cost, that transactions are authorized, assets are safeguarded and proper records are maintained. Management believes that the internal controls provide reasonable assurance that financial records are reliable and form a proper basis for the preparation of the consolidated financial statements, and that assets are properly accounted for and safeguarded. The internal control process includes management's communication to employees of policies that govern ethical business conduct.

The Board of Directors, through an Audit Committee, oversees management's responsibilities for financial reporting. This committee, which consists of three independent directors, reviews the audited consolidated financial statements and recommends the financial statements to the Board for approval. Other key responsibilities of the Audit Committee include reviewing the adequacy of the Company's existing internal controls, audit process and financial reporting with management and the external auditors.

The consolidated financial statements have been audited by KPMG LLP, Chartered Accountants, who are independent auditors appointed by the shareholders of the Company upon the recommendation of the Audit Committee. Their report follows. The independent auditors have free and full access to the Audit Committee.



Aiping Young
President and Chief Executive Officer

Elizabeth Williams
Director of Finance (Acting Chief Financial Officer)

KPMG LLP
Chartered Accountants
Yonge Corporate Centre
4100 Yonge Street Suite 200
Toronto ON M2P 2H3
Canada

Telephone (416) 228-7000
Fax (416) 228-7123
Internet www.kpmg.ca

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Lorus Therapeutics Inc. (formerly 6650309 Canada Inc.) as at May 31, 2008 and 2007 and the consolidated statements of operations and comprehensive income, deficit and cash flows for each of the years in the three-year period ended May 31, 2008 and for the period from inception on September 5, 1986 to May 31, 2008. 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 May 31, 2008 and 2007 and the results of its operations and its cash flows for each of the years in the three-year period ended May 31, 2008 and for the period from inception on September 5, 1986 to May 31, 2008 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

August 28, 2008

KPMG LLP, is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. KPMG Canada provides services to KPMG LLP.

LORUS THERAPEUTICS INC.

(FORMERLY 6650309 CANADA INC.)

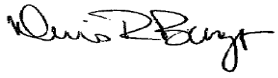
Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

May 31, 2008 and 2007

	2008	2007
Assets		
Current assets:		
Cash and cash equivalents (note 10)	$ 2,652	$ 1,405
Short-term investments (note 4)	6,784	7,265
Prepaid expenses and other assets	721	335
Amount held in escrow (note 1)	600	–
	10,757	9,005
Corporate investments (note 4)	–	3,728
Fixed assets (note 5)	244	503
Deferred arrangement costs (note 2)	–	1,262
Deferred financing costs	–	371
Goodwill	606	606
	$ 11,607	$ 15,475
Liabilities and Shareholders' Equity (Deficiency)		
Current liabilities:		
Accounts payable	$ 923	$ 1,104
Liability to repurchase warrants (notes 1 and 6(g))	–	252
Deferred gain on sale of shares (notes 1 and 12(d))	600	–
Accrued liabilities	1,194	1,421
	2,717	2,777
Secured convertible debentures (note 11)	12,742	11,937
Shareholders' equity (deficiency):		
Share capital (note 6):		
Common shares	158,743	157,714
Equity portion of secured convertible debentures	3,814	3,814
Stock options	4,961	4,898
Contributed surplus	9,181	8,525
Deficit accumulated during development stage	(180,551)	(174,190)
	(3,852)	761
Basis of presentation (note 1)		
Contingencies, commitments and guarantees (note 12)		
Subsequent events (note 17)		
	$ 11,607	$ 15,475

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Director

Director

LORUS THERAPEUTICS INC.

(FORMERLY 6650309 CANADA INC.)

Consolidated Statements of Operations and Comprehensive Income
(Expressed in thousands of Canadian dollars, except for per common share data)

	Years ended May 31,			Period from inception September 5, 1986 to May 31,
	2008	2007	2006	2008
Revenue	$ 43	$ 107	$ 26	$ 856
Expenses:				
Cost of sales	2	16	3	105
Research and development (note 9)	6,087	3,384	10,237	119,946
General and administrative	3,888	3,848	4,334	55,211
Stock-based compensation (note 7)	719	503	1,205	7,972
Depreciation and amortization of fixed assets	317	402	771	9,542
	11,013	8,153	16,550	192,776
	(10,970)	(8,046)	(16,524)	(191,920)
Other expenses (income):				
Interest on convertible debentures	1,029	1,050	882	3,261
Accretion in carrying value of convertible debentures (notes 2(a)(iv) and 11)	1,176	935	790	3,196
Amortization of deferred financing costs (notes 2(a)(iv) and 11)	–	110	87	412
Interest	(542)	(503)	(374)	(11,966)
	1,663	1,592	1,385	(5,097)
Loss from operations	(12,633)	(9,638)	(17,909)	(186,823)
Gain on sale of shares (note 1)	6,299	–	–	6,299
Loss for the period and other comprehensive loss	$ (6,334)	$ (9,638)	$ (17,909)	$ (180,524)
Basic and diluted loss per common share	$ (0.03)	$ (0.05)	$ (0.10)	
Weighted average number of common shares outstanding used in the calculation of basic and diluted loss per share (in thousands)	215,084	204,860	173,523	

See accompanying notes to consolidated financial statements.

LORUS THERAPEUTICS INC.

(FORMERLY 6650309 CANADA INC.)

Consolidated Statements of Deficit
(Expressed in thousands of Canadian dollars)

	Years ended May 31,			Period from inception September 5, 1986 to May 31,
	2008	2007	2006	2008
Deficit, beginning of period:				
As previously reported	$ (174,190)	$ (164,552)	$ (146,643)	$ –
Change in accounting policy (note 2)	(27)	–	–	(27)
As restated	(174,217)	(164,552)	(146,643)	(27)
Loss for the period	(6,334)	(9,638)	(17,909)	(180,524)
Deficit, end of period	$ (180,551)	$ (174,190)	$ (164,552)	$ (180,551)

See accompanying notes to consolidated financial statements.

LORUS THERAPEUTICS INC.

(FORMERLY 6650309 CANADA INC.)

Consolidated Statements of Cash Flows
(Expressed in thousands of Canadian dollars)

	Years ended May 31, 2008	2007	2006	Period from inception September 5, 1986 to May 31, 2008
Cash flows from operating activities:				
Loss for the period	$ (6,334)	$ (9,638)	$ (17,909)	$ (180,524)
Items not involving cash:				
Gain on sale of shares (note 1)	(6,299)	–	–	(6,299)
Stock-based compensation	719	503	1,205	7,972
Interest on convertible debentures	1,029	1,050	882	3,261
Accretion in carrying value of convertible debentures	1,176	935	790	3,196
Amortization of deferred financing costs	–	110	87	412
Depreciation, amortization and write-down of fixed assets and acquired patents and licenses	317	1,057	2,342	22,103
Other	(7)	–	–	455
Change in non-cash operating working capital (note 10)	(794)	(310)	(462)	488
Cash used in operating activities	(10,193)	(6,293)	(13,065)	(148,936)
Cash flows from financing activities:				
Issuance of debentures, net of issuance costs	–	–	–	12,948
Repurchase of warrants (note 6)	(252)	–	–	37,153
Proceeds on sale of shares, net of amount held in escrow and arrangement costs (note 1)	7,561	(1,262)	–	6,299
Issuance of common shares, net of issuance costs (note 6)	–	11,654	–	109,025
Cash provided by financing activities	7,309	10,392	–	165,425
Cash flows from investing activities:				
Maturity (purchase) of investments, net	4,189	(5,366)	13,056	(6,804)
Business acquisition, net of cash received	–	–	–	(539)
Acquired patents and licenses	–	–	–	(715)
Additions to fixed assets	(58)	(20)	(75)	(6,127)
Proceeds on sale of fixed assets	–	–	–	348
Cash provided by (used in) investing activities	4,131	(5,386)	12,981	(13,837)
Increase (decrease) in cash and cash equivalents	1,247	(1,287)	(84)	2,652
Cash and cash equivalents, beginning of period	1,405	2,692	2,776	–
Cash and cash equivalents, end of period	$ 2,652	$ 1,405	$ 2,692	$ 2,652

Supplemental cash flow information (note 10)

See accompanying notes to consolidated financial statements.

1. Basis of presentation:

(a) Reorganization:

On November 1, 2006, Lorus Therapeutics Inc. ("Lorus", the "Company" or "New Lorus") was incorporated as 6650309 Canada Inc. pursuant to the provisions of the Canada Business Corporation Act and did not carry out any active business from the date of incorporation to July 10, 2007. From its incorporation to July 10, 2007, the Company was a wholly owned subsidiary of 4325231 Canada Inc., formerly Lorus Therapeutics Inc. ("Old Lorus").

On July 10, 2007, the Company and Old Lorus completed a plan of arrangement and corporate reorganization with, among others, 6707157 Canada Inc. (the "Investor") and its affiliate, Pinnacle International Lands, Inc. (the "Arrangement"). As part of the Arrangement, all of the assets and liabilities of Old Lorus (including all of the shares of its subsidiaries held by it), with the exception of certain future tax assets were transferred, directly or indirectly, from Old Lorus to the Company. Securityholders in Old Lorus exchanged their securities in Old Lorus for equivalent securities in New Lorus (the "Exchange") and the board of directors and management of Old Lorus continued as the board of directors and management of New Lorus. New Lorus obtained substitutional listings of its common shares on both the Toronto Stock Exchange ("TSX") and the American Stock Exchange ("AMEX").

In connection with the Arrangement and after the Exchange, the share capital of Old Lorus was reorganized into voting common shares and non-voting common shares and the Investor acquired from the Company and the Selling Shareholders (as defined below) approximately 41% of the voting common shares and all of the non-voting common shares of Old Lorus for a cash consideration of approximately $8.5 million less an escrowed amount of $600 thousand related to the indemnification discussed below and in note 12(d), subject to certain post-closing adjustments and before transaction costs. The remaining 59% of the voting common shares of Old Lorus were distributed to the shareholders of New Lorus who were not residents of the United States on a pro-rata basis. Shareholders of New Lorus who were residents of the United States received a nominal cash payment in lieu of their pro-rata share of voting common shares of Old Lorus. After completion of the Arrangement, New Lorus is not related to Old Lorus, which was subsequently renamed 4325231 Canada Inc. and finally Global Summit Real Estate Inc.

1. Basis of presentation (continued):

As a condition of the Arrangement, High Tech Beteiligungen GmbH & Co. KG ("HighTech") and certain other shareholders of Old Lorus (the "Selling Shareholders") agreed to sell to the Investor the voting common shares of Old Lorus to be received under the Arrangement at the same price per share as was paid to shareholders who are residents of the United States. The proceeds received by the Selling Shareholders were nominal.

Also as a condition of the Arrangement, the holder of Old Lorus' secured convertible debenture agreed to vote in favour of the transaction subject to the repurchase by New Lorus of its outstanding three million common share purchase warrants at a purchase price of $252 thousand which was completed concurrent with the closing of the Arrangement.

Under the Arrangement, New Lorus and its subsidiaries agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of various matters discussed in note 12(d). The escrowed amount of $600 thousand was subsequently released to Lorus on July 10, 2008.

As part of the Arrangement, the Company changed its name to Lorus Therapeutics Inc. and continued as a biopharmaceutical company, specializing in the research and development of pharmaceutical products and technologies for the management of cancer as a continuation of the business of Old Lorus.

The Arrangement has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements of New Lorus reflect the financial position, results of operations and cash flows as if New Lorus has always carried on the business formerly carried on by Old Lorus. Consequently, all comparative figures presented in these consolidated financial statements are those of Old Lorus.

1. Basis of presentation (continued):

As a result of the Arrangement, the Company recognized a gain on the sale of the shares of Old Lorus to the Investor of $6.3 million. Under the Arrangement, numerous steps were undertaken as part of a taxable reorganization. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately $7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement as described above. Those tax attributes remaining with Old Lorus are no longer available to the Company. In reference to those indemnifications, $600 thousand of the proceeds on the transaction were held in escrow until the first anniversary of the transaction and released on July 10, 2008. The Company recorded a deferred gain of $600 thousand which it believes is sufficient to address any possible claims related to escrow amounts and its estimate of the obligation for the indemnifications provided.

(b) Going concern:

The Company has not earned substantial revenue from its drug candidates and is therefore considered to be in the development stage. The continuation of the Company's research and development activities is dependent upon the Company's ability to successfully fund its cash requirements through a combination of equity financing and payments from strategic partners. Except as described in note 14, the Company has no current sources of significant payments from strategic partners. In addition, the Company will need to repay or refinance the secured convertible debentures of $15 million on the maturity date, October 6, 2009, should the holder not choose to convert the debentures into common shares. There can be no assurance that additional funding will be available at all or on acceptable terms to permit further development of the Company's product candidates or to repay the convertible debentures on maturity.

1. Basis of presentation (continued):

Management believes that the Company's current level of cash and cash equivalents and short-term investments, including the funds received from the rights offering described in note 17, will be sufficient to execute the Company's current planned expenditures for the next twelve months; however, the debt obligation is due in October 2009 and the Company currently does not have the cash and cash equivalents to satisfy this obligation. If the Company is not able to raise additional funds, it may not be able to continue as a going concern and realize its assets and pay its liabilities as they fall due. The consolidated financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying value of the assets and liabilities, the reported revenue and expenses and the balance sheet classifications used.

2. Changes in accounting policies:

(a) Effective June 1, 2007, the Company adopted the recommendations of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 1530, Comprehensive Income ("Section 1530"); Section 3855, Financial Instruments - Recognition and Measurement ("Section 3855"), retroactively without restatement of prior periods. These sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Section 1530 provides standards for the reporting and presentation of comprehensive income, which represents the change in equity, from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). As a result of adopting the above standards, the Company did not recognize any other comprehensive income in its financial statements.

2. Changes in accounting policies (continued):

Upon adoption of the new standards on June 1, 2007, the Company designated its financial assets and liabilities as follows:

(i) Cash and cash equivalents:

Cash and cash equivalents as at June 1, 2007 and acquired thereafter are classified as held-for-trading investments and measured at fair value. By virtue of the nature of these assets, fair value is generally equal to cost plus accrued interest. Where applicable, any significant change in market value would result in a gain or loss being recognized in the consolidated statements of operations. As a result of adopting the new standards, there was no material change in valuation of these assets.

(ii) Short-term investments, marketable securities and other investments:

Short-term investments consist of fixed income government investments and corporate instruments. Any government and corporate investments with a stated maturity date that are not cash equivalents are classified as held-to-maturity investments, except where the Company does not intend to hold to maturity and, therefore, the investment is designated as held-for-trading. Held-to-maturity investments are measured at amortized cost using the effective interest rate method, while held-for-trading investments are measured at fair value and the resulting gain or loss is recognized in the consolidated statements of operations. The Company designated certain corporate instruments with maturities greater than one year previously carried at amortized cost as held-for-trading investments. This change in accounting policy resulted in a decrease in the carrying amount of $27 thousand and an increase in the opening deficit accumulated during the development stage of $27 thousand. The Company recognized a net unrealized gain in the consolidated statements of operations for the year ended May 31, 2008 of $7 thousand.

(iii) Accounts payable and accrued liabilities:

Accounts payable and accrued liabilities are typically short-term in nature and classified as other financial liabilities. These liabilities are carried at amortized cost. As a result of adopting the new standards, there is no material change in the carrying value of these liabilities.

2. Changes in accounting policies (continued):

(iv) Secured convertible debentures:

The secured convertible debentures are classified as other financial liabilities and accounted for at amortized cost using the effective interest method, which is consistent with the Company's accounting policy prior to the adoption of Section 3855. The deferred financing charges related to the secured convertible debentures, formerly included in long-term assets, are now included as part of the carrying value of the secured convertible debentures and continue to be amortized using the effective interest method.

(v) Embedded derivatives:

Section 3855 requires that the Company identify embedded derivatives that require separation from the related host contract and measure those embedded derivatives at fair value. Subsequent change in fair value of embedded derivatives is recognized in the consolidated statements of operations in the period in which the change occurs.

The Company did not identify any embedded derivatives that required separation from the related host contract and measured at fair value as at June 1, 2007.

(vi) Transaction costs:

Transaction costs that are directly attributable to the acquisition or issuance of financial assets or liabilities are accounted for as part of the respective asset or liability's carrying value at inception except for held-for-trading securities where the costs are expensed immediately.

2. Changes in accounting policies (continued):

(b) Variable interest entities:

Effective June 1, 2005, the Company adopted the recommendations of CICA Handbook Accounting Guideline 15 ("AcG-15"), Consolidation of Variable Interest Entities. Variable interest entities ("VIEs") refer to those entities that are subject to control on a basis other than ownership of voting interests. AcG-15 provides guidance for identifying VIEs and criteria for determining which entity, if any, should consolidate them. The adoption of AcG-15 did not have an impact on the consolidated financial statements.

(c) Financial instruments - disclosure and presentation:

Effective June 1, 2005, the Company adopted the amended recommendations of CICA Handbook Section 3860, Financial Instruments - Disclosure and Presentation ("Section 3860"), effective for fiscal years beginning on or after November 1, 2004. Section 3860 requires that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The adoption of the amendments to Section 3860 did not impact the consolidated financial statements.

(d) Non-monetary transactions:

In June 2005, the CICA released Handbook Section 3831, Non-monetary Transactions, effective for all non-monetary transactions initiated in periods beginning on or after January 1, 2006. This standard requires all non-monetary transactions to be measured at fair value unless they meet one of four very specific criteria. Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. Commercial substance is a function of the cash flows expected by the reporting entity. The Company has not entered into any non-monetary transactions and, as such, this section is not applicable.

3. Significant accounting policies:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of Lorus, its 80% owned subsidiary, NuChem Pharmaceuticals Inc. ("NuChem"), and its wholly owned subsidiaries, GeneSense Technologies Inc. ("GeneSense") and Pharma Immune Inc. ("Pharma Immune"), which are all located in Canada. The results of operations for acquisitions are included in these consolidated financial statements from the date of acquisition. All significant intercompany balances and transactions have been eliminated on consolidation.

The consolidated financial statements have been prepared by management in accordance with Canadian GAAP.

(b) Revenue recognition:

Revenue includes product sales, service, license and royalty revenue.

The Company recognizes revenue from product sales and provision of services when persuasive evidence of an arrangement exists, delivery has occurred, the Company's price to the customer is fixed or determinable and collectibility is reasonably assured. The Company allows customers to return product. Provisions for these returns are estimated based on historical return and exchange levels, and third-party data with respect to inventory levels in the Company's distribution channels.

The Company has entered into two technology licensing agreements. Under the first exclusive worldwide technology licensing agreement entered into in 2004, the Company received an initial fee and is entitled to receive subsequent milestone payments from the licensee. The Company recognized the non-refundable license fee as revenue when the technology license was delivered, when the fee was fixed or determinable and collection of the amount was probable. The Company had no continuing involvement or obligation to perform under the arrangement. Any milestone payments subsequently received from the customer will be recognized when the customer acknowledges achievement of the milestone, when the fee is fixed or determinable and collection of the amount is probable. No subsequent milestone payments have been received under this arrangement.

3. Significant accounting policies (continued):

Under the second non-exclusive territorial technology licensing arrangement entered into in 2008, the Company is required to provide a fixed number of hours of additional technical support over a period of up to 30 months, in addition to the delivery of the technology under license. The Company is entitled to receive an initial fee, payments for technical support services, royalties based on subsequent sales by the licensee and contingent milestone payments from the licensee. The initial fee of $100 thousand is deferred under this arrangement. Revenue is recognized based on the measure of progress toward completion of the technical support services under this contract based on the actual hours provided relative to the total number of hours required to be provided, applied to the total of the initial fee and additional non-contingent contractual payments related to the support services. At any time, the amount of cumulative revenue recognized would not exceed the cumulative amount of non-refundable payments received under the arrangement. Any changes in estimate will be recognized prospectively. Under this arrangement, any contingent royalty or milestone payments subsequently received from the customer will be recognized when the customer acknowledges the sale or achievement of the milestone, when the amount is determinable and collection of the amount is probable. The Company has delivered the technology under this arrangement prior to year end and has recognized $10 thousand as revenue in 2008.

(c) Cash and cash equivalents:

The Company considers unrestricted cash on hand and in banks, term deposits and guaranteed investment certificates with original maturities of three months or less as cash and cash equivalents.

3. Significant accounting policies (continued):

(d) Short-term investments, marketable securities and other investments:

The Company invests in high-quality fixed income government and corporate investments with low credit risk.

Subsequent to the adoption of Section 3855 (note 2(a)), short-term investments, which consist of fixed income securities with a maturity of more than three months but less than one year, are recorded at their accreted value as they are held-to-maturity instruments. Certain corporate instruments have maturities greater than one year, however, the Company has designated these investments as held-for-trading, and have classified these investments as short-term investments on the consolidated balance sheets. These investments are carried at fair value.

(e) Fixed assets:

Fixed assets are recorded at cost less accumulated depreciation. The Company records depreciation at rates which are expected to charge operations with the cost of the assets over their estimated useful lives on a straight-line basis as follows:

Furniture and equipment	Over 3 to 5 years
Leasehold improvements	Over the lease term

(f) Research and development:

Research costs are charged to expense as incurred. Development costs, including the cost of drugs for use in clinical trials, are expensed as incurred unless they meet the criteria under Canadian GAAP for deferral and amortization. No development costs have been deferred to date.

3. Significant accounting policies (continued):

(g) Goodwill and acquired patents and licenses:

Intangible assets with finite lives acquired in a business combination or other transaction are amortized over their estimated useful lives.

Goodwill represents the excess of the purchase price over the fair value of net identifiable assets acquired in the GeneSense business combination. Goodwill acquired in a business combination is tested for impairment on an annual basis and at any other time if an event occurs or circumstances change that would indicate that impairment may exist. When the carrying value of a reporting unit's goodwill exceeds the residual fair value, an impairment loss is recognized in an amount equal to the excess.

The Company has identified no impairment relating to goodwill for 2008 and 2007.

The Company capitalized the cost of acquired patent and license assets on the acquisitions of GeneSense and the NuChem compounds. The nature of this asset is such that it was categorized as an intangible asset with a finite life. These costs have now been fully amortized.

(h) Impairment of long-lived assets:

The Company periodically reviews the useful lives and the carrying values of its long-lived assets. The Company reviews for impairment in long-lived assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the undiscounted expected future cash flows expected to result from the use and eventual disposition of an asset is less than its carrying amount, it is considered to be impaired. An impairment loss is measured at the amount by which the carrying amount of the asset exceeds its fair value, which is estimated as the expected future cash flows discounted at a rate proportionate with the risks associated with the recovery of the asset.

3. Significant accounting policies (continued):

(i) Stock-based compensation:

The Company has a stock-based compensation plan, described in note 7. Prior to June 1, 2004, stock-based awards were accounted for using the intrinsic method with the exception of options with contingent vesting criteria for which the settlement method was used. On June 1, 2004, the Company adopted the fair value method of accounting for stock-based awards to employees, officers and directors granted or modified after June 1, 2004. This method requires the Company to expense, over the vesting period, the fair value of all employee stock-based awards granted or modified since June 1, 2002. Stock options and warrants awarded to non-employees are accounted for using the fair value method and expensed as the service or product is received. Consideration paid on the exercise of stock options and warrants is credited to common shares. The fair value of performance-based options is recognized over the estimated period to achieve the performance conditions. Fair value is determined using the Black-Scholes option pricing model.

The Company has a deferred share unit plan that provides directors the option of receiving payment for their services in the form of share units rather than common shares or cash. Share units entitle the director to elect to receive, on termination of his or her services with the Company, an equivalent number of common shares, or the cash equivalent of the market value of the common shares at that future date. Lorus records an expense and a liability equal to the market value of the shares issued. The accumulated liability is adjusted for market fluctuations on a quarterly basis.

(j) Investment tax credits:

The Company is entitled to Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible research and development expenditures incurred in each taxation year. Investment tax credits are accounted for as a reduction of the related expenditure for items of a current nature and a reduction of the related asset cost for items of a long-term nature, provided that the Company has reasonable assurance that the tax credits will be realized. Investment tax credits receivable at May 31, 2008 of $400 thousand are classified as prepaid expenses and other assets (2007 - $200 thousand).

3. Significant accounting policies (continued):

(k) Income taxes:

Income taxes are accounted for using the asset and liability method. Under this method, future tax assets and liabilities are recorded for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and operating loss and research and development expenditure carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that enactment or substantive enactment occurs. A valuation allowance is recorded if it is not more likely than not that some portion of or all of a future tax asset will be realized.

(l) Loss per share:

Basic loss per common share is calculated by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the loss for the year by the sum of the weighted average number of common shares outstanding and the dilutive common equivalent shares outstanding during the year. Common equivalent shares consist of the shares issuable upon exercise of stock options, warrants and conversion of the convertible debentures calculated using the treasury stock method. Common equivalent shares are not included in the calculation of the weighted average number of shares outstanding for diluted loss per common share when the effect would be anti-dilutive.

(m) Segmented information:

The Company is organized and operates as one operating segment, the research and development of pharmaceuticals. Substantially all of the Company's identifiable assets as at May 31, 2008 and 2007 are located in Canada.

3. Significant accounting policies (continued):

(n) Foreign currency translation:

Foreign currency transactions are translated into Canadian dollars at rates prevailing on the transaction dates. Monetary assets and liabilities are translated into Canadian dollars at the rates in effect on the balance sheet dates. Gains or losses resulting from these transactions are accounted for in the loss for the period and are not significant.

(o) Use of estimates:

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the years. Actual results may differ from those estimates. Significant estimates include the valuation of the convertible debentures, fair value of guarantees, the fair value of stock options granted and warrants issued and the useful lives of fixed and intangible assets.

(p) Recent Canadian accounting pronouncements not yet adopted:

(i) In October 2006, the Accounting Standards Board approved disclosure and presentation requirements for financial instruments that revise and enhance the disclosure requirements of Section 3861, Financial Instruments - Disclosure and Presentation ("Section 3861"). These requirements include Section 3862, Financial Instruments - Disclosures ("Section 3862"), Section 3863, Financial Instruments - Presentation ("Section 3863") (both of which replace Section 3861), and Section 1535, Capital Disclosures ("Section 1535"), which establishes standards for disclosing information about an entity's capital and how it is managed.

3. Significant accounting policies (continued):

Section 3862 is based on International Financial Reporting Standards ("IFRS") 7, Financial Instruments - Disclosures, and places an increased emphasis on disclosures about the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. Section 3862 requires disclosures, by class of financial instrument that enables users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how loss for the period and other comprehensive loss would have been affected by reasonably possible changes in the relevant risk variable.

The existing requirements on presentation of financial instruments have been carried forward unchanged to Section 3863, Financial Instruments - Presentation.

These new sections are effective for interim and annual financial statements with fiscal years beginning on or after October 1, 2007, but may be adopted in place of Section 3861 before that date.

Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for the Company for interim and annual financial statements relating to fiscal years beginning on December 1, 2007. Early adoption is permitted at the same time an entity adopts other standards relating to accounting for financial instruments.

The Company will adopt these new standards for its fiscal year beginning June 1, 2008. The Company does not expect the adoption of these standards to have a material impact on its consolidated financial position and results of operations.

3. Significant accounting policies (continued):

(ii) CICA Handbook Section 1400, General Standards on Financial Statement Presentation, has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The changes are effective for interim and annual financial statements beginning on or after January 1, 2008, and specifically June 1, 2008 for the Company. The Company does not expect this new accounting standard to have any impact to the consolidated financial statements.

(iii) Section 3064, Goodwill and Intangible Assets, will be replacing Section 3062, Goodwill and Other Intangible Assets ("Section 3062") and Section 3450, Research and Development Costs. This new section, issued in February 2008, will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning June 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The impact of adoption of this new section on the Company's consolidated financial statements has not been determined.

(iv) The CICA plans to converge Canadian GAAP with IFRS over a transition period expected to end in 2011. The impact of the transition to IFRS on the Company's consolidated financial statements effective June 1, 2011 has not been determined.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

4. Short-term investments, marketable securities and other investments:

2008	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Corporate investments (including guaranteed investment certificates, medium-term notes and fixed-term notes)	$ 6,304	$ 480	$ 6,784	3.89 - 4.60%
	$ 6,304	$ 480	$ 6,784	

2007	Less than one year maturities	Greater than one year maturities	Total	Yield to maturity
Fixed income government investments	$ 1,549	$ –	$ 1,549	3.91%
Corporate investments (including guaranteed investment certificates, medium-term notes and fixed-term notes)	5,716	3,728	9,444	3.89 - 4.11%
	$ 7,265	$ 3,728	$ 10,993	

At May 31, 2008, investments with maturities of less than one year are classified as held-to-maturity investments and carried at amortized cost. These investments have maturities varying from one to two months. Certain corporate investments, totalling $480 thousand, have maturities greater than one year; however, the Company has designated these investments as held-for-trading, and has classified these investments as short-term investments on the consolidated balance sheets. These investments are carried at fair value. The net increase in fair value for the year ended May 31, 2008 amounted to $7 thousand and has been included in the consolidated statements of operations in interest expense.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

4. Short-term investments, marketable securities and other investments (continued):

At May 31, 2007 and prior to the adoption of Section 3855 (note 2(a)), the carrying values of fixed income government investments and corporate investments were carried at amortized cost and were classified as current or long-term assets consistent with their maturity dates.

At May 31, 2008 and 2007, the carrying values of held-to-maturity investments approximate their quoted market values. Short-term investments held at May 31, 2008, have varying maturities from one to two months (2007 - one to ten months). At May 31, 2007, long-term investments had maturities varying from one to five years and were valued at carrying value that, by virtue of the nature of the investments, primarily interest bearing instruments, approximates their quoted market value.

5. Fixed assets:

2008	Cost	Accumulated depreciation	Net book value
Furniture and equipment	$ 2,728	$ 2,557	$ 171
Leasehold improvements	908	835	73
	$ 3,636	$ 3,392	$ 244

2007	Cost	Accumulated depreciation	Net book value
Furniture and equipment	$ 2,670	$ 2,387	$ 283
Leasehold improvements	908	688	220
	$ 3,578	$ 3,075	$ 503

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

6. Share capital:

(a) Continuity of common shares and warrants:

	Common shares		Warrants	
	Number	Amount	Number	Amount
Balance, May 31, 2006	–	$ –	–	$ –
Original share	1	1	–	–
Balance, May 31, 2007	1	1	–	–
Surrender of Original Share	(1)	(1)	–	–
Share exchange (note 1)	212,628	157,800	–	–
Interest payments (note 11)	5,021	943	–	–
Balance, May 31, 2008	217,649	$ 158,743	–	$ –

On July 10, 2007 as part of the Arrangement described in note 1, the Company surrendered its Original Share, and exchanged all of the shares in Old Lorus for an equivalent number of shares of the Company. Based on a continuity of interests accounting, the following share table reflects transactions in share capital as if the Company had always carried on the business of Old Lorus:

	Common shares		Warrants	
	Number	Amount	Number	Amount
Balance, May 31, 2005	172,541	$ 144,119	3,000	$ 991
Interest payments (note 11)	2,153	882	–	–
Balance at May 31, 2006	174,694	145,001	3,000	991
Share issuance	33,800	11,641	–	–
Interest payments (note 11)	3,726	1,050	–	–
Exercise of stock options	46	22	–	–
Repurchase of warrants (g)	–	–	(3,000)	(991)
Balance, May 31, 2007	212,266	157,714	–	–
Interest payments (note 11)	5,383	1,029	–	–
Balance, May 31, 2008	217,649	$ 158,743	–	$ –

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

6. Share capital (continued):

(b) Contributed surplus:

	2008	2007	2006
Balance, beginning of year	$ 8,525	$ 7,665	$ 6,733
Forfeiture of stock options	656	121	932
Repurchase of warrants (g)	–	739	–
Balance, end of year	$ 9,181	$ 8,525	$ 7,665

(c) Continuity of stock options:

	2008	2007	2006
Balance, beginning of the year	$ 4,898	$ 4,525	$ 4,252
Stock option expense	719	494	1,205
Forfeiture of stock options	(656)	(121)	(932)
Balance, end of year	$ 4,961	$ 4,898	$ 4,525

(d) Alternate compensation plans:

The Company also established a deferred share unit plan that provides directors the option of receiving payment for their services in the form of share units rather than common shares or cash. Share units entitle the directors to elect to receive, on termination of their services to the Company, an equivalent number of common shares, or the cash equivalent of the market value of the common shares at that future date. The share units are granted based on the market value of the common shares on the date of issue. During the year ended May 31, 2008, no deferred share units were issued (2007 - nil; 2006 - 168,581), with a cash value of nil (2007 - nil; 2006 - $64 thousand) being recorded in accrued liabilities.

(e) Share issuance:

On July 10, 2007 as part of the Arrangement described in note 1(a), the Company surrendered its Original Share, and exchanged all of the shares in Old Lorus for an equivalent number of shares of the Company. The transactions below occurred in Old Lorus; however, as a result of the exchange in shares, the shares issued in these transactions became shares in New Lorus.

6. Share capital (continued):

On July 13, 2006, the Company entered into an agreement with HighTech to issue 28,800,000 common shares at $0.36 per share for gross proceeds of $10.4 million. The cost of issuance amounted to $450 thousand. The subscription price represented a premium of 7.5% over the closing price of the common shares on the TSX on July 13, 2006. The transaction closed on August 31, 2006. In connection with the transaction, HighTech received demand registration rights that will enable HighTech to request the registration or qualification of the common shares for resale in the United States and Canada, subject to certain restrictions. These demand registration rights expire on June 30, 2012. In addition, HighTech received the right to nominate one nominee to the board of directors of Lorus or, if it does not have a nominee, it will have the right to appoint an observer to the board. Upon completion of the transaction, HighTech held approximately 14% of the issued and outstanding common shares of Lorus.

On July 24, 2006, Lorus entered into an agreement with Technifund Inc. to issue, on a private placement basis, 5,000,000 common shares at $0.36 per share for gross proceeds of $1.8 million. The cost of issuance amounted to $78 thousand. The transaction closed on September 1, 2006.

(f) Employee share purchase plan:

The Company's employee share purchase plan ("ESPP") was established on January 1, 2005. The purpose of the ESPP is to assist the Company in retaining the services of its employees, to secure and retain the services of new employees and to provide incentives for such persons to exert maximum efforts for the success of the Company. The ESPP provides a means by which employees of the Company and its affiliates may purchase common shares of the Company at a discount through accumulated payroll deductions. Generally, each offering is of three months' duration with purchases occurring every month. Participants may authorize payroll deductions of up to 15% of their base compensation for the purchase of common shares under the ESPP. For the year ended May 31, 2008, 282,000 (2007 - 69,000; 2006 - 293,000) common shares have been purchased under the ESPP, and Lorus has recognized an expense of $10 thousand (2007 - $5 thousand; 2006 - $46 thousand) related to this plan in these consolidated financial statements.

6. Share capital (continued):

(g) Repurchase of warrants:

In May 2007, the Company entered into an agreement, with the holder of Lorus' $15.0 million secured convertible debenture, to repurchase the outstanding 3,000,000 common share purchase warrants at a purchase price of $252 thousand upon close of the Arrangement. The equity-classified carrying value of the warrants was $991 thousand and the difference between the equity value and the purchase price was recorded as contributed surplus of $739 thousand.

7. Stock-based compensation:

Stock option plan:

Under the Company's stock option plan, options may be granted to directors, officers, employees and consultants of the Company to purchase up to a maximum of 15% of the total number of outstanding common shares currently estimated at 32,500,000 options. Options are granted at the fair market value of the common shares on the date immediately preceding the date of the grant. Options vest at various rates (immediate to three years) and have a term of 10 years. Stock option transactions for the three years ended May 31, 2008 are summarized as follows:

	2008		2007		2006	
	Options	Weighted average exercise price	Options	Weighted average exercise price	Options	Weighted average exercise price
	(In thousands)		(In thousands)		(In thousands)	
Outstanding, beginning of year	12,988	$ 0.59	10,300	$ 0.70	8,035	$ 0.96
Granted	6,048	0.21	5,318	0.30	6,721	0.58
Exercised	–	–	(46)	0.30	–	–
Forfeited	(2,598)	0.58	(2,584)	0.44	(4,456)	0.83
Outstanding, end of year	16,438	0.45	12,988	0.59	10,300	0.70
Exercisable, end of year	10,241	$ 0.58	9,796	$ 0.68	6,714	$ 0.79

7. Stock-based compensation (continued):

The following table summarizes information about stock options outstanding at May 31, 2008:

	Options outstanding			Options exercisable	
Range of exercise prices	Options	Weighted average remaining contractual life (years)	Weighted average exercise price	Options	Weighted average exercise price
	(In thousands)			(In thousands)	
$0.18 - $0.24	5,231	9.41	$ 0.21	925	$ 0.20
$0.25 - $0.49	6,853	7.23	0.29	5,007	0.30
$0.50 - $0.99	2,809	5.52	0.74	2,763	0.74
$1.00 - $2.50	1,545	4.43	1.43	1,546	1.43
	16,438	8.42	0.45	10,241	0.58

For the year ended May 31, 2008, stock-based compensation expense of $719 thousand (2007 - $503 thousand; 2006 - $1.2 million) was recognized, representing the amortization applicable to the current period of the estimated fair value of options granted since June 1, 2002.

During the year ended May 31, 2008, the Company extended the option exercise period to those directors not seeking re-election at the annual general meeting and to the Company's former President and Chief Executive Officer. These transactions result in modification of the terms of the original awards, and the incremental compensation expense relating to the modified options amounted to approximately $83 thousand that is included in the stock-based compensation expense for the year ended May 31, 2008.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

7. Stock-based compensation (continued):

During the year ended May 31, 2006, employees of the Company (excluding directors and officers) were given the opportunity to choose between keeping 100% of their existing options at the existing exercise price or forfeiting 50% of the options held in exchange for having the remaining 50% of the exercise price of the options re-priced to $0.30 per share. Employees holding 2,290,000 stock options opted for re-pricing their options, resulting in the amendment of the exercise price of 1,145,000 stock options and the forfeiture of 1,145,000 stock options. This re-pricing resulted in additional compensation expense of $76 thousand, representing the incremental value conveyed to holders of the options as a result of reducing the exercise price, of which $52 thousand has been included in the stock-based compensation expense during the year ended May 31, 2006. The additional compensation expense of $24 thousand will be recognized as the amended options vest. This increased expense is offset by $113 thousand representing amounts previously expensed on unvested stock options due to the forfeiture of 1,145,000 stock options, which was reversed from the stock-based compensation expense for the year ended May 31, 2006.

For the year ended May 31, 2008, stock option expense of $719 thousand (2007 - $503 thousand; 2006 - $1.2 million) comprised $171 thousand (2007 - $216 thousand; 2006 - $300 thousand) related to research and development and $548 thousand (2007 - $287 thousand; 2006 - $900 thousand) related to general and administrative.

The following assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted during the year:

	2008	2007	2006
Risk-free interest rate	3.75% - 4.70%	4.50%	2.25% - 4.00%
Expected volatility	77% - 80%	75% - 80%	70% - 81%
Expected life of options	5 years	5 years	2.5 - 5 years
Weighted average fair value of options granted or modified during the year	$0.14	$0.20	$0.33

The Company has assumed no forfeiture rate as adjustments for actual forfeitures are made in the year they occur.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

8. Income taxes:

Income tax recoveries attributable to losses from operations differ from the amounts computed by applying the combined Canadian federal and provincial income tax rates to pre-tax income from operations primarily as a result of the provision of a valuation allowance on net future income tax benefits.

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

	2008	2007
Non-capital loss carryforwards	$ 1,571	$ 24,459
Capital loss carryforwards	218	–
Research and development expenditures	3,275	20,156
Book over tax depreciation	631	1,904
Intangible asset	3,386	–
Other	–	309
Future tax assets	9,081	46,828
Valuation allowance	(9,081)	(46,828)
	$ –	$ –

Under the Arrangement, numerous steps were undertaken as part of a taxable reorganization. However, these steps did not result in any taxes payable as the tax benefit of income tax attributes was applied to eliminate any taxes otherwise payable. Of the total unrecognized future tax assets available at the time of the Arrangement, approximately $7.0 million was transferred to New Lorus and the balance remained with Old Lorus and is subject to the indemnification agreement (note 1). Those tax attributes remaining with Old Lorus are no longer available to the Company.

In assessing the realizable benefit from future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent on the generation of future taxable income during the years in which those temporary differences become deductible. Management considers projected future taxable income, uncertainties related to the industry in which the Company operates and tax planning strategies in making this assessment. Due to the Company's stage of development and operations, and uncertainties related to the industry in which the Company operates, the tax benefit of the above amounts has been completely offset by a valuation allowance.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

8. Income taxes (continued):

The Company has undeducted research and development expenditures, totalling $14.1 million for federal purposes and $8.2 million for provincial purposes, and these can be carried forward indefinitely. In addition, the Company has non-capital loss and capital loss carryforwards of $5.4 million and $1.5 million, respectively, for federal purposes and $5.5 million and $1.5 million, respectively, for provincial purposes. To the extent that the non-capital loss carryforwards are not used, they expire as follows:

2009	$ 741
2010	141
2015	10
2026	11
2027	4
2028	4,466
	$ 5,373

Income tax rate reconciliation:

	2008	2007	2006
Recovery of income taxes based on statutory rate of 35%	$ (2,217)	$ (3,481)	$ (6,469)
Expiry of losses	127	1,311	1,252
Change in valuation allowance subsequent to the Arrangement	2,048	(3,168)	3,861
Non deductible accretion, stock-based compensation and capital gains	(1,880)	519	721
Change in enacted tax rates	1,585	4,437	–
Other	337	382	635
	$ –	$ –	$ –

9. Research and development programs:

The Company's cancer drug research and development programs focus primarily on the following technology platforms:

(a) Antisense**:**

Antisense drugs are genetic molecules that inhibit the production of disease-causing proteins. LOR-2040 (formerly GTI-2040) is the Company's lead antisense drug, and has shown preclinical anticancer activity across a broad range of cancers and is currently in various Phase I/II trials in several solid tumor types, which are sponsored by the U.S. National Cancer Institute. Lorus has selected Acute Myeloid Leukemia ("AML") as a lead cancer indication for clinical development of LOR-2040. LOR-2040 is currently in a Company-sponsored advanced Phase II clinical trial in combination with high dose Ara-C as salvage therapy in refractory and relapsed AML patients under 60 years of age.

(b) Small molecules**:**

The Company is utilizing its small molecule drug screening technologies and preclinical scientific expertise to identify several groups of novel small molecules that show strong anticancer activity and a high therapeutic index due to low toxicity. The Company's proprietary group of novel small molecule compounds, which include lead compounds LOR-253 and LOR-220, have unique structures and modes of action, and are promising candidates for the development of novel anticancer agents with high safety profiles.

(c) Immunotherapy**:**

This clinical approach stimulates the body's natural defences against cancer. The Company's lead immunotherapeutic drug, Virulizin®, completed a global Phase III clinical trial for the treatment of pancreatic cancer during 2005, but overall survival data did not reach statistical significance. In April 2008, the Company announced the signing of an exclusive multinational license agreement with Zor Pharmaceuticals, LLC ("ZOR") formed as a subsidiary of Zoticon Bioventures Inc, a research-driven biopharmaceutical group, to further develop and commercialize Virulizin® for human therapeutic applications.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

9. Research and development programs (continued):

	Years ended May 31,			Period from inception September 5, 1986 to May 31,
	2008	2007	2006	2008
Antisense:				
Expensed	$ 3,200	$ 1,676	$ 2,550	$ 34,685
Acquired	–	–	–	11,000
Small molecules:				
Expensed	2,743	1,621	1,485	10,071
Acquired	–	–	–	1,228
Immunotherapy:				
Expensed	144	87	6,202	75,190
Acquired	–	–	–	–
Total expensed	$ 6,087	$ 3,384	$ 10,237	$ 119,946
Total acquired	$ –	$ –	$ –	$ 12,228

Amortization of the acquired patents and licenses is included in the 'Expensed' line of the table.

(Tabular amounts in thousands of Canadian dollars, except per share amounts)

10. Supplemental cash flow and other information:

Cash and cash equivalents consist of:

	2008	2007
Cash	$ 143	$ 495
Term deposits and guaranteed investment certificates	2,509	910
	$ 2,652	$ 1,405

Change in non-cash operating working capital is summarized as follows:

	Years ended May 31,			Period from inception September 5, 1986 to May 31,
	2008	2007	2006	2008
Prepaid expenses and other assets	$ (386)	$ 180	$ 611	$ (145)
Accounts payable	(181)	549	(514)	(321)
Accrued liabilities	(227)	(1,039)	(559)	954
	$ (794)	$ (310)	$ (462)	$ 488

During the year ended May 31, 2008, the Company received interest of $519 thousand (2007 - $412 thousand; 2006 - $627 thousand).

Supplementary disclosure relating to non-cash financing activities consists of $252 thousand related to the liability to repurchase warrants.

11. Convertible debentures:

On October 6, 2004, the Company entered into a Subscription Agreement (the "Agreement") to issue an aggregate of $15.0 million of secured convertible debentures (the "debentures"). The debentures are secured by a first charge over all of the assets of the Company.

The Company received $4.4 million on October 6, 2004 (representing a $5.0 million debenture less an investor fee representing 4% of the $15.0 million to be received under the Agreement), and $5.0 million on each of January 14 and April 15, 2005. All debentures issued under this Agreement are due on October 6, 2009 and are subject to interest payable monthly at a rate of prime plus 1% until such time as the Company's share price reaches $1.75 for 60 consecutive trading days, at which time interest will no longer be charged. Interest is payable in common shares of Lorus until Lorus' shares trade at a price of $1.00 or more after which interest would be payable in cash or common shares at the option of the debenture holder. Common shares issued in payment of interest are issued at a price equal to the weighted average trading price of such shares for the 10 trading days immediately preceding their issue in respect of each interest payment. For the year ended May 31, 2008, the Company issued 5,383,000 (2007 - 3,726,000; 2006 - 2,153,000) shares in settlement of approximately $1.0 million (2007 - $1.0 million; 2006 - $882 thousand) in interest.

The $15.0 million principal amount of debentures issued on October 6, 2004, January 14, 2005 and April 15, 2005 is convertible at the holder's option at any time into common shares of the Company with a conversion price per share of $1.00.

With the issuance of each $5.0 million debenture, the Company issued to the debenture holder from escrow 1,000,000 purchase warrants expiring October 6, 2009 to buy common shares of the Company at a price per share equal to $1.00. In May 2007, the 3,000,000 common share purchase warrants were repurchased in connection with the Arrangement (note 6(g)).

11. Convertible debentures (continued):

Prior to the adoption of Section 3855, deferred financing costs were amortized over the five-year life of the Agreement. For the year ended May 31, 2007, the Company has recognized $110 thousand (2006 - $87 thousand) in amortization expense. As a consequence of the adoption of Section 3855, deferred financing costs at June 1, 2007 were reclassified and reduced the carrying value of the debentures. Deferred financing costs are recognized in the consolidated statements of operations as accretion expense.

Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that at maturity on October 6, 2009, the carrying value of the debentures will be their face value of $15.0 million. For the year ended May 31, 2008, the Company has recognized $1.2 million (2007 - $935 thousand; 2006 - $790 thousand) in accretion expense.

The lender has the option to demand repayment in the event of default, including the failure to maintain certain subjective covenants, representations and warranties. Management assesses on a quarterly basis whether or not events during the quarter could be considered an event of default. This assessment was performed and management believes that there has not been an event of default and that, at May 31, 2008, the term of the debt remains unchanged.

12. Contingencies, commitments and guarantees:

(a) Operating lease commitments:

The Company has entered into operating leases for premises and equipment under which it is obligated to make minimum annual payments of approximately $143 thousand in 2009, $148 thousand in 2010 and $129 thousand in 2011.

During the year ended May 31, 2008, operating lease expenses were $140 thousand (2007 - $139 thousand; 2006 - $130 thousand).

12. Contingencies, commitments and guarantees (continued):

(b) Other contractual commitments:

In December 1997, the Company acquired certain patent rights and a sub-license to develop and commercialize the anticancer application of certain compounds in exchange for:

(i) A 20% share interest in NuChem;

(ii) A payment of U.S. $350 thousand in shares of Lorus; and

(iii) Up to U.S. $3.5 million in cash.

To date, the Company has made cash payments of U.S. $500 thousand. The remaining balance of up to U.S. $3.0 million remains payable upon the achievement of certain milestones based on the commencement and completion of clinical trials. Additional amounts paid will be classified as acquired patents and licenses and will be amortized over the estimated useful life of the licensed asset.

The Company does not currently expect to achieve any of the above milestones in fiscal years ended May 31, 2008 or 2009 and cannot reasonably predict when such milestones will be achieved, if at all.

The Company holds an exclusive world-wide license from the University of Manitoba (the "University") and Cancer Care Manitoba ("CCM") to certain patent rights to develop and sub-license certain oligonucleotide technologies. In consideration for the exclusive license of the patent rights, the University and CCM are entitled to an aggregate of 1.67% of the net sales received by the Company from the sale of products or processes derived from the patent rights and 1.67% of all monies received by the Company from sub-licenses of the patent rights. Any and all improvements to any of the patent rights derived in whole or in part by the Company after the date of the license agreement, being June 20, 1997, are not included within the scope of the agreement and do not trigger any payment of royalties.

12. Contingencies, commitments and guarantees (continued):

The Company has not yet earned any revenue from the products covered under this agreement and, therefore, has not paid any royalties thereunder and cannot reasonably predict the timing and amount of any future payment. The Company does not expect to make any royalty payments under this agreement in fiscal years ended May 31, 2008 or 2009, and cannot reasonably predict when such royalties will become payable, if at all.

(c) Guarantees:

The Company entered into various contracts, whereby contractors perform certain services for the Company. The Company indemnifies the contractors against costs, charges and expenses in respect of legal actions or proceedings against the contractors in their capacity of servicing the Company. The maximum amounts payable from these guarantees cannot be reasonably estimated. Historically, the Company has not made significant payments related to these guarantees.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers. The fair value of this indemnification is not determinable.

(d) Indemnification on Arrangement:

Under the Arrangement (note 1), the Company has agreed to indemnify Old Lorus and its directors, officers and employees from and against all damages, losses, expenses (including fines and penalties), other third party costs and legal expenses, to which any of them may be subject arising out of any matter occurring

(i) prior to, at or after the effective time of the Arrangement ("Effective Time") and directly or indirectly relating to any of the assets of Old Lorus transferred to New Lorus pursuant to the Arrangement (including losses for income, sales, excise and other taxes arising in connection with the transfer of any such asset) or conduct of the business prior to the Effective Time;

12. Contingencies, commitments and guarantees (continued):

(ii) prior to, at or after the Effective Time as a result of any and all interests, rights, liabilities and other matters relating to the assets transferred by Old Lorus to New Lorus pursuant to the Arrangement; and

(iii) prior to or at the Effective Time and directly or indirectly relating to, with certain exceptions, any of the activities of Old Lorus or the Arrangement.

The Company has recorded a deferred gain of $600 thousand, which it believes is sufficient to address any possible claims related to escrow amounts and its estimate of the fair value of the obligation of $150 thousand for the indemnifications provided. There have been no claims under this indemnification to date.

(e) Regulatory matter:

The Company received notice from the American Stock Exchange ("AMEX") dated February 13, 2008, indicating that the Company needed to comply with the $6 million stockholder's equity threshold required for continued listing under AMEX Company Guide Sec. 1003(a)(iii). This notification was triggered by the decline of Lorus' market capitalization to less than $50 million, which previously exempted Lorus from meeting the minimum stockholder's equity requirement. AMEX has renewed and accepted the Company's plan to comply with the stockholder's equity requirements within an eighteen-month period ending August 13, 2009. Should the Company not be able to execute the plan and comply with the AMEX requirements within the prescribed period, the Company will be subject to de-listing.

13. Financial instruments:

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(a) Cash and cash equivalents, short-term marketable securities, other assets, amount held in escrow, accounts payable and accrued liabilities:

Due to the short period to maturity of the financial instruments, the carrying values as presented in the consolidated balance sheets are reasonable estimates of fair value.

(b) Long-term marketable securities and other investments:

The carrying values by virtue of the nature of the investments, primarily interest-bearing instruments, approximate their quoted market values.

(c) Convertible debentures:

The fair value of the convertible debentures at May 31, 2008 is $13.9 million (2007 - $13.6 million).

Financial instruments potentially exposing the Company to a concentration of credit risk consist principally of cash equivalents and short-term investments. The Company mitigates this risk by investing in high grade fixed income securities.

The Company is exposed to interest rate risk due to the convertible debentures that require interest payments at a variable rate of interest.

14. License agreement:

Effective April 8, 2008, the Company entered into a non-exclusive multinational license agreement with ZOR Pharmaceutical LLC ("ZOR") formed as a subsidiary of Zoticon Bioventures Inc. to further develop and commercialize Virulizin® for human therapeutic applications.

Under the terms of the agreement, the Company will receive an upfront licensing fee of $100 thousand, and may receive certain milestone payments totalling approximately U.S. $10 million based on progress through financing and clinical development, and royalties on net sales that vary from 10-20% depending on the level of sales of Virulizin® achieved in those territories covered by the license and subject to certain other adjustments. ZOR will assume all future costs for the development of the licensed technology.

The Company has also entered into a service agreement with ZOR to assist in the transfer of knowledge. Under this agreement, the Company has agreed to provide ZOR with 300 hours of consulting service during a period of 18 months.

In addition, Lorus acquired a 25% equity interest in ZOR in exchange for a capital contribution of $2,500. This investment has been accounted for as an equity investment. Lorus' equity will not be subject to dilution on the first U.S. $5 million of equity financing in ZOR. Thereafter, Lorus has, at its option, a right to participate in any additional financings to maintain its ownership level.

15. Related party transaction:

During the year ended May 31, 2008, the Company expensed consulting fees of $31 thousand to a director of the Company (2007 - nil; 2006 - nil) of which $30 thousand remained payable at May 31, 2008 (2007 - nil; 2006 - nil).

This transaction was in the normal course of business and has been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

16. Comparative figures:

Certain 2007 and 2006 figures have been reclassified to conform with the financial statement presentation adopted in 2008.

17. Subsequent events:

On June 25, 2008, the Company filed a short-form prospectus for a rights offering to its shareholders.

Under the rights offering, holders of the Company's common shares as of July 9, 2008 (the "Record Date") received one right for each common share held as of the Record Date. Each four (4) rights entitled the holder thereof to purchase a unit of Lorus ("Unit"). Each Unit consists of one common share of Lorus at $0.13 and a one-half warrant to purchase additional common shares of Lorus at $0.18 until August 7, 2010. Rights expired on August 7, 2008.

The Company issued 28,538,889 common shares and 14,269,444 common share purchase warrants in exchange for cash consideration of $3.71 million. The Company expects to use the net proceeds from the offering to fund research and development activities and for general working capital purposes.

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