Financial Statements
(Expressed in Canadian Dollars)

# KANE BIOTECH INC.

Years ended December 31, 2013 and 2012

KANE BIOTECH

## MANAGEMENT REPORT

The accompanying financial statements have been prepared by management and approved by the board of directors of Kane Biotech Inc. (the "Company"). Management is responsible for the information and representations contained in these financial statements.

These financial statements have been prepared in accordance with International Financial Reporting Standards. The significant accounting policies, which management believes are appropriate for the Company, are described in note 3 to these financial statements. The Company maintains a system of internal control and appropriate processes to provide reasonable assurance that assets are safeguarded and to ensure that relevant and reliable financial information is produced.

The board of directors is responsible for reviewing and approving these financial statements and overseeing management's performance of its financial reporting responsibilities. An audit committee of three directors is appointed by the board. The audit committee reviews the financial statements, audit process and financial reporting with management and with the external auditors and reports to the board of directors prior to the approval of the audited financial statements for publication.

MNP LLP, the Company's external auditors, who are appointed by the shareholders, audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on these financial statements. Their report follows.

*/s/ Gord Froehlich*

**Mr. Gord Froehlich**
President & Chief Executive Officer

*/s/ Mark Matthewson*

**Mr. Mark Matthewson, CA**
Chief Financial Officer

April 3, 2014

## Independent Auditors' Report

To The Shareholders of Kane Biotech Inc.:

We have audited the accompanying financial statements of Kane Biotech Inc., which comprise the statements of financial position as at December 31, 2013 and 2012 and the statements of comprehensive loss, statements of changes in equity and statements of cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Financial Statements*
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditors' Responsibility*
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*
In our opinion, the financial statements present fairly, in all material respects, the financial position of Kane Biotech Inc. as at December 31, 2013 and 2012 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

*Emphasis of Matter*
Without qualifying our opinion, we draw attention to Note 2(c) in the financial statements which indicates that Kane Biotech Inc. has experienced operating losses and cash outflows since incorporation, has a deficit of $11,393,194 and has not reached successful commercialization of its products. These conditions, along with other matters as set forth in Note 2(c), indicate the existence of a material uncertainty that may cast significant doubt about Kane Biotech Inc.'s ability to continue as a going concern.

Winnipeg, Manitoba

April 3, 2014

MNP LLP
Chartered Accountants

# KANE BIOTECH INC.

**Statement of Financial Position**

| | Note | December 31, 2013 | December 31, 2012 |
|---|---|---|---|
| **Assets** | | | |
| Current assets: | | | |
| Cash | | $ 634,442 | $ 1,415,015 |
| Other receivables | | 216,772 | 134,114 |
| Other current assets | | 35,796 | 17,214 |
| Total current assets | | 887,010 | 1,566,343 |
| Non-current assets: | | | |
| Property and equipment | **5** | 42,238 | 43,087 |
| Intangible assets | **6** | 954,261 | 915,370 |
| Total non-current assets | | 996,499 | 958,457 |
| **Total assets** | | **$ 1,883,509** | **$ 2,524,800** |
| **Liabilities and Shareholders' Equity** | | | |
| Current liabilities: | | | |
| Accounts payable and accrued liabilities | **7** | 187,063 | 176,726 |
| Total current liabilities | | 187,063 | 176,726 |
| Non-current liabilities: | | | |
| Convertible note | **9** | 413,248 | - |
| Total non-current liabilities | | 413,248 | 176,726 |
| **Shareholders' Equity** | | | |
| Share capital | **10(b)** | 9,431,781 | 9,373,205 |
| Contributed surplus | | 2,737,335 | 1,796,405 |
| Warrants | **10(d)** | 480,783 | 1,124,293 |
| Convertible note option | **9** | 26,493 | - |
| Deficit | | (11,393,194) | (9,945,829) |
| Total | | 1,283,198 | 2,348,074 |
| **Total liabilities and equity** | | **$ 1,883,509** | **$ 2,524,800** |

# KANE BIOTECH INC.
**Statements of Comprehensive Loss**

| | Note | | Year ended December 31, 2013 | | Year ended December 31, 2012 |
|---|---|---|---|---|---|
| **Revenue** | **4** | | 159,945 | | - |
| **Expenses** | | | | | |
| General and administration | **14** | $ | 1,084,665 | $ | 777,616 |
| Research | **14** | | 525,898 | | 686,286 |
| Loss from operations | | | (1,450,618) | | (1,463,902) |
| **Finance income (costs):** | | | | | |
| Finance income | | | 10,935 | | 12,801 |
| Finance expense | | | (4,093) | | (4,985) |
| Foreign exchange loss, net | | | (2,366) | | (3,544) |
| Net finance income | | | 4,476 | | 4,272 |
| **Gain (loss) on disposal of property and equipment** | | | (1,223) | | 135 |
| **Loss and comprehensive loss for the period** | | **$** | **(1,447,365)** | **$** | **(1,459,495)** |
| **Basic and diluted loss per share for the period** | **10(e)** | **$** | **(0.02)** | **$** | **(0.02)** |

# KANE BIOTECH INC.

**Statement of Changes in Equity**
**Year ended December 31, 2013 and 2012**

| | Note | Share Capital | Contributed Surplus | Warrants | Convertible Note Option | Deficit | Total |
|---|---|---|---|---|---|---|---|
| Balance December 31, 2011 | | $ 8,505,641 | $1,530,429 | $ 828,347 | $ - | $ (8,486,334) | $ 2,378,083 |
| Loss and comprehensive loss for the period | | | | | | (1,459,495) | (1,459,495) |
| Transactions with owners, recorded directly in equity | | | | | | | |
| Issue of common shares | 10(b) | 867,564 | - | - | - | - | 867,564 |
| Share based payments | 10(c) | - | 85,317 | - | - | - | 85,317 |
| Warrrants granted | 10(d) | - | - | 476,605 | - | - | 476,605 |
| Warrants expired | 10(d) | - | 180,659 | (180,659) | - | - | - |
| Total transactions with owners | | 867,564 | 265,976 | 295,946 | - | - | 1,429,486 |
| Balance December 31, 2012 | | $ 9,373,205 | $1,796,405 | $1,124,293 | | $ (9,945,829) | $ 2,348,074 |
| Loss and comprehensive loss for the period | | | | | | (1,447,365) | (1,447,365) |
| Transactions with owners, recorded directly in equity | | | | | | | |
| Share based payments | 10(c) | - | 273,244 | - | - | - | 273,244 |
| Share options issued | 9 | | | | 26,493 | - | 26,493 |
| Warrants exercised | 10(d) | 58,576 | - | (21,048) | - | - | 37,528 |
| Warrrants granted | 10(d) | - | - | 45,224 | - | - | 45,224 |
| Warrants expired | 10(d) | - | 667,686 | (667,686) | - | - | - |
| Total transactions with owners | | 58,576 | 940,930 | (643,510) | 26,493 | - | 382,489 |
| Balance December 31, 2013 | | $ 9,431,781 | $2,737,335 | $ 480,783 | $ 26,493 | $ (11,393,194) | $ 1,283,198 |

The notes on pages 5 to 24 are an integral part of these financial statements.

# KANE BIOTECH INC.

**Statement of Cash Flows**

| | Note | | Year ended December 31, 2013 | | Year ended December 31, 2012 |
|---|---|---|---|---|---|
| **Cash provided by (used in):** | | | | | |
| **Operating activities:** | | | | | |
| Loss and comprehensive loss for the period | | $ | (1,447,365) | $ | (1,459,495) |
| Adjustments for: | | | | | |
| Depreciation of property and equipment | | | 9,880 | | 8,984 |
| Amortization of patents | | | 25,563 | | 26,493 |
| Write down of patents | **6** | | 58,702 | | 141,177 |
| Accretion on convertible note | | | 3,215 | | |
| Share based compensation | | | 273,244 | | 85,317 |
| Gain (loss) on disposal of assets | | | 1,223 | | (135) |
| Change in the following: | | | | | |
| Other receivables | | | (82,658) | | (40,642) |
| Other current assets | | | (18,582) | | (993) |
| Accounts payable and accrued liabilities | | | 10,336 | | 84,001 |
| | | | (1,166,443) | | (1,155,293) |
| **Financing activities:** | | | | | |
| Issuance of convertible note | **9** | | | | |
| net of issuance costs | | | 481,750 | | - |
| Issuance of common shares, | **10(b) 10(d)** | | | | |
| net of share issuance costs | | | - | | 1,344,169 |
| Warrants exercised | **10(d)** | | 37,528 | | - |
| | | | 519,278 | | 1,344,169 |
| **Investing activities:** | | | | | |
| Purchase of property and equipment, | | | | | |
| net of proceeds on disposal | **5** | | (10,253) | | (15,495) |
| Patent and trademark costs | **6** | | (123,156) | | (77,752) |
| | | | (133,409) | | (93,247) |
| **Increase (decrease) in cash** | | | (780,574) | | 95,629 |
| **Cash, beginning of period** | | | 1,415,015 | | 1,319,386 |
| **Cash, end of period** | | **$** | **634,442** | **$** | **1,415,015** |
| Supplemental cash flow information: | | | | | |
| Non-cash financing activities: | | | | | |
| Warrants issued as share issue costs | **10(d)** | **$** | **-** | **$** | **41,045** |

The notes on pages 5 to 24 are an integral part of these financial statements.

## 1. Reporting entity:

Kane Biotech Inc. (the "Company") is a company domiciled and incorporated in Canada. The address of the Company's registered office is 162-196 Innovation Drive, Winnipeg, Manitoba, Canada. The Company is primarily involved in research and development. To date, the Company has no products in commercial production or use.

## 2. Basis of preparation of financial statements:

### (a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

The financial statements were authorized for issue by the Board of Directors on April 3, 2014.

### (b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following items:

- financial instruments at fair value at the issue date
- equity settled share-based payment awards are measured at fair value at the grant date

### (c) Going concern

These financial statements have been prepared using IFRSs that are applicable to a going concern, which contemplates that Kane Biotech Inc. will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. There is substantial doubt about the appropriateness of the use of the going concern assumption because the Company has experienced operating losses and cash outflows from operations since inception and has not reached successful commercialization of its products.

The Company's future operations are completely dependent upon its ability to generate product sales, negotiate collaboration or licence agreements with upfront payments, obtain research grant funding, or other strategic alternatives, and/or secure additional funds. While the Company is striving to achieve the above plans, there is no assurance that such sources of funds will be available or obtained on favourable terms. If the Company cannot generate product sales, negotiate collaboration or licence agreements with upfront payments, obtain research grant funding, or if it cannot secure additional financing on terms that would be acceptable to it, the Company will have to consider additional strategic alternatives which may include, among other strategies, exploring the monetization of certain tangible and intangible assets as well as seeking to license assets, potential asset divestitures, winding up, dissolution or liquidation of the Company.

The ability of the Company to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities and commitments when due is dependent on the successful completion of the actions taken or planned, some of which are described above, which management believes will mitigate the adverse conditions and events which raise doubt about the validity of the going concern assumption used in preparing these financial statements. There is no certainty that these and other strategies will be sufficient to permit the Company to continue as a going concern.

These financial statements do not reflect adjustments in the carrying values of the Company's assets and liabilities, revenue and expenses, and the statement of financial position classifications used, that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

### (d) Functional and presentation currency

The financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented has been rounded to the nearest dollar except where indicated otherwise.

**2. Basis of preparation of financial statements (continued):**

**(e) Use of estimates and judgments**

The preparation of these financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements and information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial years are included in the following notes:

- Note 3(c)(iii) Convertible note
- Note 3(d)(i) Research and development costs
- Note 3(d)(ii) Patents and trademarks
- Note 3(d)(iii)Technology licenses
- Note 3(f)(ii) and Note 13(b) Share-based compensation
- Note 3 (e) (ii) impairment of non-financial assets.

**3. Significant accounting policies:**

The accounting policies set out below have been applied consistently to all periods presented in these financial statements and to the 2013 annual audited financial statements unless otherwise indicated.

**(a) Revenue recognition**

Licensing option revenue is recognized when contractually earned.

**(b) Foreign currency transactions**

Transactions in foreign currencies are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are re-translated at the exchange rate at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

**(c) Financial instruments**

**(i) Non-derivative financial assets**

The Company initially recognizes receivables and deposits on the date that they are originated.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire.

The Company classifies non-derivative financial assets into the following categories: loans and receivables. The Company has not classified any assets or liabilities as held-to-maturity or as available-for-sale. The Company had no "other comprehensive income or loss" transactions during the year ended December 31, 2013 or 2012 and no opening or closing balances for accumulated other comprehensive income or loss.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash balances.

**3. Significant accounting policies (continued):**

**(ii) Non-derivative financial liabilities**

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Company has the following non-derivative financial liabilities which are classified as other financial liabilities: accounts payable and accrued liabilities.

**(iii) Convertible note**

The proceeds received on the issuance of the Company's convertible redeemable note and detachable warrants are allocated into their liability and equity components. The amount initially attributed to the debt component is equal to the discounted cash flows using a market rate of interest that would be payable on a similar debt instrument that does not include an option to convert or detachable warrants. It is accounted for as a financial liability measured at amortized cost until extinguished on conversion or maturity of the note. The remainder of the proceeds is allocated to an equity component. The value of the equity component is allocated between the conversion option and the detachable warrants using the fair value determined at the date of measurement using the Black Scholes option pricing model on a pro-rata basis. The conversion option is recognized in the "Convertible note option" within shareholders' equity, net of income tax effects and the detachable warrants are classified in “Warrants” within shareholders’ equity, net of income tax effects. Incremental costs directly attributable to the issue of convertible debt are recognized as a deduction from the liability and equity components, net of any tax effects.

**(iv) Share capital**

Common voting shares are classified as equity. Incremental costs directly attributable to the issue of common voting shares are recognized as a deduction from equity, net of any tax effects.

**(iv) Warrants**

Warrants are classified as equity. Incremental costs directly attributable to the exercise of warrants and related issue of common voting shares are recognized as a deduction from equity, net of any tax effects.

**(c) Property and equipment**

**(i) Recognition and measurement**

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. The costs of the day-to-day servicing of property and equipment are recognized in the statement of comprehensive loss in the period in which they are incurred.

**(ii) Depreciation**

Depreciation is recognized in profit or loss over the estimated useful lives of each part of an item of property and equipment in a manner which most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives and depreciation method for the current and comparative periods are as follows:

**3. Significant accounting policies (continued):**

| Asset | Basis | Rate |
|---|---|---|
| Computer equipment | Diminishing balance | 30% |
| Scientific equipment | Diminishing balance | 20% |
| Office equipment | Diminishing balance | 20% |

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

**(d) Intangible assets**

**(i) Research and development**

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. No development costs have been capitalized to date.

**(ii) Patents and trademarks**

Costs incurred in obtaining a patent are capitalized and amortized on a straight-line basis over the legal life of the respective patent, being approximately twenty years, or its economic life, if shorter. Trademarks have an indefinite life. Costs incurred in successfully obtaining a patent or trademark are measured at cost less accumulated amortization and accumulated impairment losses. The cost of servicing the Company's patents and trademarks is expensed as incurred.

**(iii) Technology licenses**

Technology licenses are recorded at cost. The cost of technology licences will be amortized over their estimated useful life commencing in the period in which the product is commercially launched and sales of the licensed products are first earned.

**(iv) Subsequent expenditure**

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures are recognized in profit or loss as incurred.

**(e) Impairment**

**(i) Financial assets**

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

If such evidence exists, the Company recognizes an impairment loss for financial assets. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

**3. Significant accounting policies (continued):**

**(ii) Non-financial assets**

The carrying amount of long-lived non-financial assets, including intangible assets and property and equipment, is reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Intangible assets with indefinite lives and intangible assets not yet put into use are evaluated for impairment at least annually.

An impairment exists when the carrying value of an asset exceeds its recoverable amount, which is the higher of its fair value less costs to sell or its value in use. The fair value less costs to sell calculation is based on available data from observable market prices, less incremental costs. The value in use calculation is based on a discounted cash flow model. These calculations require the use of estimates and forecasts of future cash flows. Qualitative factors, including market size and market growth trends, strength of customer demand and degree of variability in cash flows, as well as other factors, are considered when making assumptions with regard to future cash flows and the appropriate discount rate. A change in any of the significant assumptions of estimates used to evaluate the underlying assets could result in a material change to the results of operations.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed, to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of amortization, if no impairment had been recognized. Write-downs as a result of impairment are recognized in research expense in the statement of comprehensive loss.

**(f) Employee benefits**

**(i) Short-term employee benefits**

Short-term employee benefit obligations are expensed as the related service is provided.

**(ii) Share-based payment transactions**

The grant date fair value of share-based payment awards granted to employees is recognized as a personnel expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

Share-based payment arrangements in which the Company receives goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions. In situations where equity instruments are issued and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment.

**(g) Government grants**

An unconditional government grant related to research and development activities is recognized in profit or loss as a deduction from the related expenditure when the grant becomes receivable. Grants that compensate the company for the cost of an asset are recognized in profit or loss on a systematic basis over the useful life of the asset.

**(h) Finance income and finance costs**

Finance income comprises interest income on funds invested which is recognized as it accrues in profit or loss, using the effective interest method. Finance costs comprise accretion expense on borrowings which are recognized in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

**3. Significant accounting policies (continued):**

**(i) Income tax**

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Scientific research and development tax credits, which are earned as a result of incurring qualifying research and development expenditures, are recorded as a reduction of the related expense or cost of the asset acquired when there is reasonable assurance that they will be realized.

**(j) Earnings (loss) per share**

The Company presents basic earnings per share (EPS) data for its common voting shares. Basic EPS is calculated by dividing the profit or loss attributable to common voting shareholders of the Company by the weighted average number of common voting shares outstanding during the period, adjusted for own shares held. Common voting share equivalents have been excluded from the calculation of diluted loss per share as their effect is anti-dilutive.

**(k) New standards, interpretations and amendments effective from 1 January 2013**

**IFRS 13 - Fair Value Measurement**

In May 2011, the IASB published IFRS 13 - Fair Value Measurement, which is effective prospectively for annual periods beginning on or after January 1, 2013. IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRS. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. IFRS 13 did not materially affect any fair value measurements of the Company's assets or liabilities and therefore has no effect on the Company's financial position or performance. See note 2 Basis of preparation of financial statements for more details and further references related to fair value measurement.

### 3. Significant accounting policies (continued):

#### (l) New standards and interpretations not yet adopted

Certain new standards, interpretations and amendments to existing standards issued by the IASB or the International Financial Reporting Interpretations Committee (IFRIC) that are not yet effective up to the date of issuance of the Company's financial statements are listed below. The Company is assessing the impact of these pronouncements on its results and financial position. The Company intends to adopt those standards when they become effective.

**IFRS 9 Financial Instruments: Classification and Measurement**

IFRS reflects the first phase of the IASB's work on the replacement of IAS 39- Financial Instruments, Recognition and Measurement, and deals with the classification and measurement of financial assets and financial liabilities. This standard establishes two primary measurement categories for financial assets, amortized cost and fair value, and eliminates the existing categories of held-to-maturity, available-for-sale, and loans and receivables. The new classification will depend on the entity's business model and contractual cash flow characteristics of the financial asset.

### 4. Revenue

Revenue consists of licensing option income. The Company entered into an option and license agreement with a global health care company. Under the terms of the agreement, the health care company will complete their due diligence of the Company's antibiofilm and antimicrobial technologies with the option to an exclusive, worldwide license to develop, commercialize and market these technologies in the global animal health market.

### 5. Property and equipment:

The following is a summary of property and equipment as at December 31, 2013:

| Cost | Computer and Office Equipment | Scientific Equipment | Total |
|---|---|---|---|
| Balance December 31, 2011 | $ 10,367 | $ 134,366 | $ 144,733 |
| Additions | 1,737 | 14,811 | 16,548 |
| Disposals | - | (4,668) | (4,668) |
| Balance December 31, 2012 | 12,104 | 144,509 | 156,613 |
| Additions | 4,241 | 6,012 | 10,253 |
| Disposals | (6,280) | (4,350) | (10,630) |
| Balance December 31, 2013 | $ 10,065 | $ 146,171 | $ 156,236 |

**5. Property and equipment (continued):**

| Depreciation and impairment losses | Computer and Office Equipment | Scientific Equipment | Total |
|---|---|---|---|
| Balance December 31, 2011 | $ 8,837 | $ 99,455 | $ 108,292 |
| Additions | 636 | 8,348 | 8,984 |
| Disposals | - | (3,750) | (3,750) |
| Balance December 31, 2012 | 9,473 | 104,053 | 113,526 |
| Additions | 1,261 | 8,618 | 9,879 |
| Disposals | (5,796) | (3,611) | (9,407) |
| Balance December 31, 2013 | $ 4,938 | $ 109,060 | $ 113,998 |

| Carrying amounts | Computer and Office Equipment | Scientific Equipment | Total |
|---|---|---|---|
| Balance December 31, 2011 | $ 1,530 | $ 34,911 | $ 36,441 |
| Balance December 31, 2012 | $ 2,631 | $ 40,456 | $ 43,087 |
| Balance December 31, 2013 | $ 5,127 | $ 37,111 | $ 42,238 |

**6. Intangible assets:**

The following is a summary of intangible assets as at December 31, 2013:

| Cost | Patents | Trademarks | Technology Licenses | Total |
|---|---|---|---|---|
| Balance December 31, 2011 | $ 743,254 | $ 26,810 | $ 298,150 | $ 1,068,214 |
| Additions | 77,264 | 488 | - | 77,752 |
| Change due to derecognition | (160,402) | - | - | (160,402) |
| Balance December 31, 2012 | 660,116 | 27,298 | 298,150 | 985,564 |
| Additions | 123,031 | 125 | - | 123,156 |
| Change due to derecognition | (58,702) | - | - | (58,702) |
| Balance December 31, 2013 | $ 724,445 | $ 27,423 | $ 298,150 | $ 1,050,018 |

**6. Intangible assets (continued):**

| Accumulated amortization and derecognition | Patents | Trademarks | Technology Licenses | Total |
|---|---|---|---|---|
| Balance December 31, 2011 | $ 62,926 | $ - | $ - | $ 62,926 |
| Amortization | 26,493 | - | - | 26,493 |
| Change due to derecognition | (19,225) | - | - | (19,225) |
| Balance December 31, 2012 | 70,194 | - | - | 70,194 |
| Amortization | 25,563 | - | - | 25,563 |
| Change due to derecognition | - | - | - | - |
| Balance December 31, 2013 | $ 95,757 | $ - | $ - | $ 95,757 |

| Carrying amounts | Patents | Trademarks | Technology Licenses | Total |
|---|---|---|---|---|
| Balance December 31, 2011 | $ 680,328 | $ 26,810 | $ 298,150 | $ 1,005,288 |
| Balance December 31, 2012 | $ 589,922 | $ 27,298 | $ 298,150 | $ 915,370 |
| Balance December 31, 2013 | $ 628,688 | $ 27,423 | $ 298,150 | $ 954,261 |

The Company has considered indicators of impairment as of December 31, 2013. To December 31, 2013, the Company has recorded aggregate impairment losses of $499,370, primarily resulting from patent applications not pursued.

Amortization and write down expenses are recognized in research expense.

**7. Accounts payable and accrued liabilities:**

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Other trade payables | $ 87,878 | $ 132,439 |
| Non-trade payables and accrued expenses | 99,185 | 44,287 |
| | $ 187,063 | $ 176,726 |

## 8. Income taxes:

### (a) Income tax provision

The reconciliation of the income tax provision using statutory income tax rates prevailing in Canada with the income tax expense reported in the financial statements is as follows:

| | | 2013 | | 2012 |
|---|---|---|---|---|
| Canadian federal and provincial income tax rates - 27% (2012 - 27%) | **$** | **(390,789)** | $ | (394,064) |
| Change in unrecognized deductible temporary differences and unused tax losses | | **289,210** | | 428,042 |
| Permanent differences and other | | **101,579** | | (33,978) |
| | **$** | **-** | $ | - |

The Company recognized no income taxes in the statement of comprehensive loss as it has been incurring losses since inception.

### (b) Unrecognized deferred tax assets:

As at December 31, 2013 and 2012, temporary differences for which no deferred tax asset was recognized were as follows:

| | | 2013 | | 2012 |
|---|---|---|---|---|
| Tax losses | **$** | **2,313,467** | $ | 2,026,500 |
| Scientific research and experimental development costs | | **573,582** | | 511,449 |
| Financing costs | | **59,616** | | 91,754 |
| Other | | **182** | | 196 |
| | **$** | **2,946,847** | $ | 2,629,899 |

Given the Company's past losses, management does not believe that it is more probable than not that the Company can utilize its deferred tax assets and therefore it has not recognized any amount in the statement of financial position.

**8. Income taxes (continued):**

**(c) Deferred tax liabilities:**

As at December 31, 2013 and 2012, deferred tax liabilities were as follows:

| | 2013 | 2012 |
|---|---|---|
| Patents and technology licenses | **$ 146,111** | $ 137,230 |
| Property and equipment | **10,171** | 11,024 |
| Convertible note | **19,229** | - |
| Other | **481** | |
| | **$ 175,992** | $ 148,254 |

The deferred tax liability for temporary differences of $651,822 (2012 - $549,090) have been offset by sufficient deductible temporary differences (SR&ED costs) from (b) above which are available to reverse in the same period as the taxable temporary differences.

**(d) At December 31, 2013, the Company has the following available for application in future years:**

| | 2013 | 2012 |
|---|---|---|
| Unutilized scientific research and development expenditures without time limitation | $ 2,124,376 | $ 1,894,254 |
| Unutilized non-capital loss carried forward balances | | |
| Expires in: | | |
| 2014 | $ 462,832 | $ 462,832 |
| 2015 | 726,171 | 726,171 |
| 2026 | 767,228 | 767,228 |
| 2027 | 846,139 | 846,139 |
| 2028 | 851,022 | 851,022 |
| 2029 | 843,989 | 843,989 |
| 2030 | 810,574 | 810,574 |
| 2031 | 975,188 | 975,188 |
| 2032 | 1,222,411 | 1,222,411 |
| 2033 | 1,062,842 | - |
| | $ 8,568,396 | $ 7,505,554 |

**8. Income taxes (continued):**

| | 2013 | 2012 |
|---|---|---|
| Unutilized scientific research and development tax credits | | |
| Expires in: | | |
| 2014 | $ 41,562 | $ 41,562 |
| 2015 | 84,169 | 84,169 |
| 2016 | 86,060 | 86,060 |
| 2017 | 39,486 | 39,486 |
| 2018 | 100,277 | 100,277 |
| 2019 | 64,534 | 64,534 |
| 2020 | 80,154 | 80,154 |
| 2021 | 51,214 | 51,214 |
| 2022 | 46,542 | 46,542 |
| 2023 | 48,474 | 4,105 |
| 2024 | 47,104 | 47,104 |
| 2025 | 71,115 | 71,115 |
| 2026 | 68,848 | 68,848 |
| 2027 | 51,926 | 51,926 |
| 2028 | 80,221 | 80,221 |
| 2029 | 51,627 | 51,627 |
| 2030 | 59,669 | 59,669 |
| 2031 | 54,268 | 54,268 |
| 2032 | 72,935 | 72,935 |
| 2033 | 70,990 | - |
| | **$ 1,271,175** | $ 1,155,816 |

**9. Convertible Note:**

On December 18, 2013, the Company closed a private placement offering of a $500,000 principal, 2 year, 10% convertible redeemable unsecured note (the "Note") and 4,000,000 share purchase warrants ("Warrants") for gross proceeds of $500,000. The Note can be converted at any time into common shares at the holder's option at the rate of $0.15 per share. The Note is also redeemable at any time at the option of the Company at an amount equal to the face value of the Note, plus all accrued and unpaid interest, subject to the right of the holder to convert the Note into common shares of the Company prior to redemption. The Company may elect to pay the interest on the Note or the redemption price of the Note in common shares, in lieu of cash, at the market price of the common shares on such interest payment or redemption due date.

Each Warrant entitles the holder to purchase one common voting share at a price of $0.095 for a period of 2 years.

At the time of issuance the present value of the liability component of the convertible promissory note based on an estimated market interest rate of 18% was $425,566.

The total cost of the offering of $18,250 has been allocated to the convertible note ($15,533), conversion option ($1,004) and warrants ($1,713) on a pro rata basis.

## 9. Convertible Note (continued):

The following is a summary of the convertible note as at December 31, 2013:

| | Proceeds | Convertible Note | Conversion Option | Warrants |
|---|---|---|---|---|
| Balance December 31, 2012 | $ - | $ - | $ - | |
| Note issued December 18, 2013 | 500,000 | 425,566 | 27,497 | 46,937 |
| Accretion | | 3,215 | | |
| Issuance costs | (18,250) | (15,533) | (1,004) | (1,713) |
| Balance December 31, 2013 | 481,750 | 413,248 | 26,493 | 45,224 |

## 10. Share capital

### (a) Authorized

The Company has authorized share capital of an unlimited number of common voting shares, an unlimited number of class A common shares and an unlimited number of preferred shares. The preferred shares may be issued in one or more series, and the directors may fix prior to each series issued, the designation, rights, privileges, restrictions and conditions attached to each series of preferred shares.

### (b) Shares issued and outstanding

Shares issued and outstanding are as follows:

| | Number of Common Voting Shares | Amount |
|---|---|---|
| Balance December 31, 2011 | **60,596,229** | **$ 8,505,641** |
| Issued for cash, net of issue costs of $111,087 | **18,035,000** | **867,564** |
| Exercise of options | **-** | **-** |
| Exercise of warrants | **-** | **-** |
| Balance, December 31, 2012 | **78,631,229** | **9,373,205** |
| Exercise of options | **-** | **-** |
| Exercise of warrants | **469,100** | **58,576** |
| Balance, December 31, 2013 | **79,100,329** | **$ 9,431,781** |

During the year ended December 31, 2013 469,100 compensation warrants from the 2012 private placement offering (the “2012 Offering”) were exercised for common shares for gross proceeds of $37,528.

On December 14, 2012, the Company closed a private placement offering (the "2012 Offering") of 18,035,000 units (a "Unit") at a price of $0.08 per Unit, for aggregate gross proceeds to the Company of $1,442,800 from the sale. Each Unit was comprised of one common share of the Company (a "Share") and one Share purchase warrant (a "Warrant"). Each whole Warrant entitles the holder to purchase one Share at a price of $0.15 for a period of 12 months from the date the warrant was issued. On December 6, 2013 the Company amended the warrants expiry date from December 14, 2013 to January 31, 2014. The gross proceeds have been prorated to share capital and warrants based on the relative fair value of each component as follows: share capital - $978,651 and warrants - $464,149.

**10. Share capital (continued):**

Certain individuals and companies assisted the Company by introducing potential subscribers for the 2012 offering and received a finder's fee in the amount of $73,184 calculated as eight percent of the total subscription proceeds received from subscribers introduced to the Company by each particular individual and company. In addition, these individuals and companies were issued 914,800 compensation warrants, equivalent to eight percent of the Units subscribed for by subscribers introduced to the Company by each particular individual and company. Each compensation warrant entitles the holder thereof to purchase one Share at a price of $0.08 for a period of 12 months from the date of issue. The fair value of $41,045 assigned to the compensation warrants upon issuance is included in share and warrant issue costs of $139,677. The total costs of the 2012 Offering of $139,677 have been allocated to share capital ($111,087) and warrants ($28,590) on a pro rata basis.

**(c) Stock option plan**

The Company has an equity-settled Stock Option Plan ("Plan") in place for employees, directors, officers and consultants of the Company which is administered by the Board of Directors. The number of common shares reserved for issuance of stock options is limited to a maximum of 10% of the issued and outstanding shares of the Company at any one time. At December 31, 2013, an aggregate maximum of 7,910,033 (December 31, 2012 – 7,863,123) common voting shares are available to be purchased under the Plan and 1,622,533 (December 31, 2012 – 3,640,623) common share options remain available to be issued under the Plan.

Share options issued to employees, directors and officers of the Company under the Plan expire five years from the grant date. Share options issued to non-employee consultants expire five years from grant and generally vest over twenty-four months. The attributed exercise price of the grant per the Plan cannot be less than the closing price per common share on the date of the grant:

Changes in the number of options outstanding during the period ended December 31, 2013 and 2012 are as follows:

| | December 31, 2013 | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | Options | | Weighted average exercise price | Options | | Weighted average exercise price |
| Balance , beginning of period | 4,222,500 | $ | 0.16 | 3,815,000 | $ | 0.17 |
| Granted | 2,740,000 | | 0.14 | 1,032,500 | | 0.15 |
| Exercised | - | | - | - | | - |
| Forfeited, cancelled or expired | (675,000) | | 0.12 | (625,000) | | 0.37 |
| Balance, end of period | 6,287,500 | $ | 0.16 | 4,222,500 | $ | 0.16 |
| Options exercisable, end of period | 6,287,500 | $ | 0.16 | 3,605,832 | $ | 0.15 |
| Weighted average fair value per unit of option granted during the year | | $ | 0.10 | | $ | 0.09 |

**10. Share capital (continued):**

Options outstanding at December 31, 2013 consist of the following:

| Range of exercise prices | Outstanding number | Weighted average remaining contractual life | Weighted average exercise price | Exercisable number |
|---|---|---|---|---|
| $0.10-$0.25 | 6,287,500 | 2.75 | $ 0.16 | 6,287,500 |

For the year ended December 31, 2013, the Company recorded share option compensation expense of $273,244 (December 31, 2012 - $85,317) with a corresponding credit to contributed surplus. The share option compensation expense for options issued to employees was determined based on the fair value of the options at the date of measurement using the Black-Scholes option pricing model (Note 15) with the following weighted average assumptions:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Expected option life | 4.6 years | 5.0 years |
| Risk free interest rate | 1.44% | 1.21% |
| Expected volatility | 137.72% | 139.12% |

For awards that vest at the end of a vesting period, compensation cost is recognized on a straight-line basis over the period of service. For awards subject to graded vesting, each instalment is treated as a separate award with separate fair value and a separate vesting period.

The share option expense of stock-based payments to non-employees was determined based on the fair value of the services received and recognized over the period in which the related service is received.

The expected life of the share options is based on historical data and current expectations and is not necessarily indicative of exercise patterns that may occur. Volatility is determined based on the five-year share price history. The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options is indicative of future trends, which may also not necessarily be the actual outcome.

**10. Share capital (continued):**

**(d) Warrants**

Changes in the number of warrants outstanding during the period ended December 31, 2013 and 2012 are as follows:

| | December 31, 2013 | | | December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | Warrants | Amount | Weighted average exercise price | Warrants | Amount | Weighted average exercise price |
| Balance , beginning of period | 38,876,128 | $ 1,124,293 | $ 0.16 | 24,624,435 | $ 828,347 | $ 0.16 |
| Issued, pursuant to private placements | 4,000,000 | 45,224 | 0.10 | 18,035,000 | 435,559 | 0.15 |
| Issued, pursuant to finder's fee | - | - | - | 914,800 | 41,046 | 0.08 |
| Exercised | (469,100) | (21,048) | 0.08 | - | - | - |
| Expired | (20,372,028) | (667,686) | 0.17 | (4,698,107) | (180,659) | 0.13 |
| Balance, end of period | 22,035,000 | $ 480,783 | $ 0.14 | 38,876,128 | $ 1,124,293 | $ 0.16 |
| Weighted average remaining contractual life (years) | | | 0.43 years | | | 0.61 years |

The relative fair value of warrants was determined at the date of measurement using the Black Scholes option pricing model with the following weighted average assumptions:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Expected life | 2 years | 1 year |
| Risk free interest rate | 1.11% | 1.12% |
| Expected volatility | 85.36% | 97.62% |

**(e) Per share amounts**

The weighted average number of common voting shares outstanding for the year ended December 31, 2013 and 2012 was 78,802,505 and 61,433,920, respectively. The dilution created by options and warrants has not been reflected in the per share amounts as the effect would be anti-dilutive.

## 11. Commitments and contingencies:

### (a) Commitments

As at December 31, 2013 and in the normal course of business, the Company has obligations to make future payments, representing contracts and other commitments that are known and committed.

Contractual obligation payments due by fiscal period ending December 31:

| | | |
|---|---|---|
| 2014 | | 85,758 |
| 2015 | | 33,583 |
| 2016 | | 10,000 |
| 2017 | | 10,000 |
| 2018 | | 10,000 |
| | $ | 149,341 |

The Company has no planned capital commitments for the coming year.

The Company holds a worldwide exclusive right to Competence Stimulating Peptide (CSP) technology from the University of Toronto Innovations Foundation (UTIF). In consideration for the right, the Company will pay UTIF a royalty of a stipulated percentage of the net sales, if any, of the licensed products. If the Company sublicenses any rights to a third party, the Company will pay UTIF a percentage of a sublicense fee or sublicense royalty fee. The Company does not expect to make royalty payments under this agreement in fiscal 2014 and cannot predict when such royalties will become payable, at all.

The Company also holds a worldwide exclusive license to DispersinB® enzyme from the University of Medicine and Dentistry of New Jersey (UMDNJ). In consideration for the right, the Company will pay a royalty to UMDNJ of a stipulated percentage of the net sales, if any, of the licensed products. If the Company sublicenses any rights to a third party, the Company will pay a percentage of a sublicense fee or sublicense royalty fee. A minimum royalty fee of $10,000 USD per annum is payable for the life of the patent, and, additional milestone payments throughout the term of the agreement.

### (b) Guarantees

The Company periodically enters into research and licence agreements with third parties that include indemnification provisions customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of claims arising from research and development activities undertaken on behalf of the Company. In some cases, the maximum potential amount of future payments that could be required under these indemnification provisions could be unlimited. These indemnification provisions generally survive termination of the underlying agreement. The nature of the indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay. Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued in the accompanying financial statements with respect to these indemnification obligations.

## 12. Government and other assistance:

During the year ended December 31, 2013, the Company received $44,369 (December 31, 2012 - $113,941) in government and other assistance for the purpose of research. Government and other assistance has been recorded as a reduction to research expenses, property and equipment and intangible assets.

## 13. Related parties:

### (a) Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The Board of Directors, President & CEO, and Chief Scientific Officer are key management personnel.

In addition to their salaries, the Company also provides non-cash benefits and participation in the Stock Option Plan (Note 10(c)). The following table details the compensation paid to key management personnel:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Salaries, fees and short-term employee benefits | $ 355,034 | $ 354,972 |
| Post-employment benefits | 4,717 | 4,439 |
| Share-based payments | 189,455 | 48,656 |
| | $ 549,206 | $ 408,067 |

### (b) Key management personnel and director transactions

Directors and key management personnel control four percent of the voting shares of the Company.

During the year ended December 31, 2013, a Director purchased a convertible note for gross proceeds of $500,000 (Note 9). The Director received $15,000 for the related issue costs on the transaction. The Company also paid $19,123 (December 31, 2012 - $3,486) for services to a legal firm in which a Director is a partner.

## 14. Expenses by nature:

Expenses incurred for the year ended December 31, 2013 and 2012 are as follows:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Personnel expenses | | |
| Wages and salaries | $ 650,890 | $ 590,429 |
| Short-term benefits and insurance premiums | 32,336 | 27,840 |
| Share-based payments | 273,244 | 85,099 |
| | 956,470 | 703,368 |
| Depreciation and writedowns | 94,145 | 176,655 |
| Science consumables and contract research | 48,952 | 176,803 |
| Occupancy | 89,971 | 84,346 |
| License fees | 10,156 | 9,917 |
| Investor relations | 169,488 | 183,733 |
| Other | 285,749 | 220,403 |
| Less: Government assistance | (44,369) | (91,323) |
| | $ 1,610,562 | $ 1,463,902 |

## 15. Determination of fair values:

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following models. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

**Share-based payment transactions**

The fair value of the employee share options is measured using the Black-Scholes formula. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value.

## 16. Financial risk management:

### (a) Financial assets and liabilities:

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. The carrying values of current monetary assets and liabilities approximate their fair values due to their relatively short periods to maturity.

### (b) Risks arising from financial instruments and risk management:

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange and interest rate risks), credit risk and liquidity risk. Risk management is the responsibility of the Company, which identifies, evaluates and, where appropriate, mitigates financial risks.

#### (i) Market risk:

##### (a) Foreign exchange risk:

The Company operates in Canada and has relationships with entities in other countries. Foreign exchange risk arises because the cost of transactions denominated in foreign currencies may vary due to changes in exchange rates.

Balances in foreign currencies at December 31, 2013 were approximately:

| | U.S. Dollars |
|---|---|
| Cash | $ 586 |
| Other receivables | 152,190 |
| Accounts payables and accrued liabilities | (9,099) |
| | $ 143,677 |

Fluctuations in the U.S. dollar exchange rates may potentially have a significant impact on the Company's results of operations.

**16. Financial risk management (continued):**

**(b) Interest rate risk:**

The Company is exposed to interest rate risk to the extent that short-term deposits are at a floating short-term rate of interest and their market value will vary with the change in short-term market interest rates. The Company's maximum exposure to interest rate risk is based on the effective interest rate and the current carrying value of these assets.

There is a risk that future cash flows from invested cash, cash equivalents and short-term deposits will vary as the market interest rates fluctuate because these investments earn interest at market rates. Based on the December 31, 2013 balance of approximately $634,422, a variation of 100 basis points in the market interest rate would not affect the financial statements of comprehensive income by a material amount. For the year ended December 31, 2013, the Company recorded interest income of $10,935 (2012 - $12,801) in relation to these assets.

**(ii) Credit risk:**

The Company limits its exposure to credit risk by investing only in banks that have a strong credit rating. Accounts receivable are subject to normal credit risk. The maximum exposure to credit risk is equal to the carrying value of the accounts receivable. The Company regularly assesses the accounts receivable and takes action to collect the amounts or provide adequate reserves against doubtful accounts. The Company currently has no reserve for doubtful accounts as there have been no bad debts to date.

**(iii) Liquidity risk:**

Liquidity risk is the risk that the current financial obligations exceed the cash available to satisfy those obligations at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available cash in order to meet its liquidity requirements. The Company achieves this by primarily relying on private placement offerings of common shares and warrants.

**(c) Capital management:**

The Company's primary objective when managing capital, defined as shares, warrants and options, is to ensure that it has sufficient cash resources to fund its development and commercialization activities and to maintain its ongoing operations.

To fund its activities, the Company relied on private placements of its common shares. To secure the additional capital the Company may attempt to raise additional funds through the issuance of equity or by securing strategic partners.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital management strategy during the year ended December 31, 2013.

**17. Subsequent Event**

Subsequent to the end of the year, 2,650,000 warrants from the 2012 private placement offering were exercised for common shares for gross proceeds of $397,500.