Consolidated financial statements of

Biorem Inc.

December 31, 2011 and 2010

Biorem Inc.

December 31, 2011 and 2010

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Biorem Inc.

We have audited the accompanying consolidated financial statements of Biorem Inc., which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of operations, comprehensive loss, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Biorem Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw attention to Note 2 in the financial statements which indicates that Biorem Inc. has experienced significant losses in the current and prior periods, and its working capital has deteriorated in the year ended December 31, 2011 compared to the prior period. Also, Biorem Inc. had violated certain of its financial covenants under its debenture agreement as disclosed in Note 16. These conditions indicate the existence of a material uncertainty that may cast significant doubt about Biorem Inc.'s ability to continue as a going concern.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

April 30, 2012
Waterloo, Canada

Biorem Inc.

Consolidated statements of financial position
December 31, 2011, 2010 and January 1, 2010

In Canadian dollars	Note	December 31, 2011	December 31, 2010	January 1, 2010
		$	$	$
Assets				
Current assets				
Cash and cash equivalents	**10**	924,032	831,343	4,030,814
Restricted cash	**10**	1,152,381	500,000	-
Accounts receivable	**11**	4,627,245	5,010,779	2,897,842
Unbilled revenue		1,114,690	4,601,515	3,448,529
Inventories	**12**	780,224	768,706	649,374
Prepaid expenses and deposits		84,870	87,927	65,984
Investment tax credits recoverable		150,000	150,000	100,000
		8,833,442	11,950,270	11,192,543
Non-current assets				
Long-term receivables		-	394,000	-
Plant and equipment	**13**	866,252	921,004	897,534
Investment tax credits recoverable	**8**	-	-	250,000
Intangible assets	**14**	668,066	859,341	1,089,568
Total Assets		10,367,760	14,124,615	13,429,645
Liabilities				
Current liabilities				
Accounts payable		2,984,040	3,818,041	1,588,199
Accrued liabilities		1,907,231	3,415,635	1,978,169
Provisions	**15**	585,322	366,292	250,000
Unearned revenue		1,863,466	782,742	287,030
Short-term debt	**16**	648,591	-	-
Debenture	**16**	1,750,000	1,833,128	-
		9,738,650	10,215,838	4,103,398
Non-current liabilities				
Debenture	**16**	-	-	2,498,227
Shareholders’ equity				
Common shares	**17**	13,277,462	13,201,212	13,201,212
Contributed surplus		1,784,728	1,712,456	1,565,380
Accumulated other comprehensive loss		(62,241)	(3,468)	-
Deficit		(14,370,839)	(11,001,423)	(7,938,572)
Total shareholders' equity		629,110	3,908,777	6,828,020
Total liabilities and shareholders' equity		10,367,760	14,124,615	13,429,645

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of operations
Years ended December 31, 2011 and 2010

In Canadian dollars	Note	2011	2010
		$	$
Revenue	**4**	12,045,195	17,359,556
Cost of goods sold		9,175,906	12,315,704
		2,869,289	5,043,852
Expenses (income)			
Sales and marketing		2,616,715	3,560,860
Research and development	**6**	1,071,652	1,892,251
General and administration		2,847,635	2,758,254
Other income	**6**	(799,905)	(1,079,618)
Total operating expenses		5,736,097	7,131,747
Results from operating activities		(2,866,808)	(2,087,895)
Finance and other costs			
Interest expense	**7**	261,985	390,055
Accretion of finance and warrant costs	**7**	83,564	334,901
Loss on remeasurement of debenture	**7,16**	157,059	-
Write down of long-term tax asset		-	250,000
Total finance and other costs		502,608	724,956
Net loss		(3,369,416)	(2,812,851)
Loss per share basic and diluted	**9**	$ (0.28)	$ (0.26)

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of comprehensive loss
Years ended December 31, 2011 and 2010

In Canadian dollars	Note	2011	2010
		$	$
Net loss		(3,369,416)	(3,062,851)
Other comprehensive loss			
Foreign currency translation difference on foreign operations		(58,773)	(3,468)
Total comprehensive loss		(3,428,189)	(3,066,319)

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of shareholders' equity
Years ended December 31, 2011 and 2010

In Canadian dollars	Note	Share capital	Contributed surplus	Accumulated other comprehensive ncome	Deficit	Total
		$	$	$	$	$
Balance, as at January 1, 2010		13,201,212	1,565,380	-	(7,938,572)	6,828,020
Total comprehensive loss						
Loss		-	-	-	(3,062,851)	(3,062,851)
Foreign curerncy translation differences on foreign operations		-	-	(3,468)	-	(3,468)
Total comprehensive loss						(3,066,319)
Stock option compensation	**18**	-	147,076	-	-	147,076
Balance, as at December 31, 2010		13,201,212	1,712,456	(3,468)	(11,001,423)	3,908,777
Balance, as at January 1, 2011						
Total comprehensive loss						
Loss		-	-	-	(3,369,416)	(3,369,416)
Foreign currency translation differences on foreign operations		-	-	(58,773)	-	(58,773)
Total comprehensive loss						(3,428,189)
Stock option compensation	**18**	-	72,272	-	-	72,272
Shares issued for services	**17**	76,250	-	-	-	76,250
Balance, as at December 31, 2011		13,277,462	1,784,728	(62,241)	(14,370,839)	629,110

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of cash flows
Years ended December 31, 2011 and 2010

In Canadian dollars	Notes	2011	2010
		$	$
Operating activities			
Net loss		(3,369,416)	(3,062,851)
Items not involving cash:			
Depreciation	13	341,079	319,400
Amortization of intangible assets	14	215,085	226,198
Write down of long-term tax asset		-	250,000
Loss on remeasurement of debenture - non cash portion	16	157,059	-
Finance costs	7	345,549	724,956
Stock option compensation	18	72,272	147,076
Loss on disposal of equipment	13	12,403	-
Foreign exchange		(57,116)	18,616
		(2,283,085)	(1,376,605)
Change in non-cash operating working capital			
Accounts receivable		383,533	(2,112,937)
Restricted cash		(652,381)	(500,000)
Unbilled revenue		3,486,825	(1,152,986)
Inventories		(11,519)	(119,332)
Prepaid expenses and deposits		3,057	(21,943)
Investment tax credits recoverable		-	(50,000)
Long-term receivable		394,000	(394,000)
Accounts payable		(185,410)	2,229,842
Accrued liabilites		(1,529,516)	1,437,466
Provisions		219,031	116,292
Unearned revenue		1,080,724	495,711
Cash generated from (used in) operations		905,259	(1,448,492)
Investing activities			
Additions to intangible assets		(17,617)	-
Proceeds from disposal of equipment		500	-
Purchase of equipment		(294,620)	(342,308)
		(311,737)	(342,308)
Financing activities			
Repayment of debenture	7	(250,000)	(1,000,000)
Interest paid		(261,985)	(390,055)
		(511,985)	(1,390,055)
Foreign exchange on foreign denominated cash and cash equivalents		11,152	(18,616)
Increase (decrease) in cash and cash equivalents		92,688	(3,199,471)
Cash and cash equivalents, beginning of year		831,343	4,030,814
Cash and cash equivalents, end of year	10	924,032	831,343

See accompanying notes to consolidated financial statements.

1. General information

BIOREM Inc. ("BIOREM" or the "Company") is a company domiciled in Canada.

The address of the Company's registered office is R.R. # 3, 7496 Wellington Road 34, Guelph, Ontario. The Company's Class A subordinate voting shares are listed on the Toronto Stock Exchange and trade under the symbol BRM.V. The consolidated financial statements of BIOREM as at and for the year ended December 31, 2011 comprise BIOREM and its subsidiaries (together referred to as "the Company"). The Company primarily is involved in the manufacturing of a comprehensive line of high efficiency air pollution control systems that are used to eliminate odorous and harmful contaminants.

2. Basis of presentation

a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These are the Company's first annual consolidated financial statements prepared in accordance with IFRS and accordingly IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 24. This Note includes reconciliations of equity and total comprehensive loss for comparative periods and of equity at the date of transition reported under previous Canadian GAAP to those reported for those periods and at the date of transition under IFRS.

The financial statements were approved by the Board of Directors and authorized for issue on April 30, 2012.

b) Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis of accounting, with the exception of financial instruments classified as fair value through profit and loss, which are recorded at fair value.

c) Functional and presentation currency

The functional currency of BIOREM and its subsidiaries is the currency of their primary economic environment. These consolidated financial statements are presented in Canadian dollars, which is BIOREM's functional currency. The functional currency of BIOREM's subsidiary located in the United States is the US dollar.

d) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income 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 consolidated financial statements is included in notes 3b, 3i and 3k. Significant estimates and assumptions are also used in the determination of the estimated total sales contract costs, and the estimation of useful lives of intangible assets and plant and equipment.

2. Basis of presentation (continued)

e) Going concern basis of presentation

These financial statements have been prepared on a going concern basis. The going concern basis of presentation assumes that the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of operations. However, there are material uncertainties related to certain conditions and events that raise significant doubts about the appropriateness of the use of the going concern assumptions because the Company has experienced significant losses in the current and prior year, and its working capital has deteriorated in 2011 compared to the prior period. Also, the Company has violated certain of its financial covenants under its debenture agreement as at December 31, 2011, September 30, 2011 and June 30, 2011 (note 16).

The Company is addressing these conditions through the following actions taken or planned:

- Reduce expenses to be in line with expected revenues;
- Continue to improve the order fulfillment process to improve future working capital;
- Actively seek additional customers, partners and collaborators to generate new revenue streams;
- Renegotiation of debenture covenants (See note 23); and
- Secure alternative sources of financing including the Company's undertaking to raise gross proceeds of up to $1.4 million through a private placement of 8% convertible debentures (See note 23).

The ability of the Company to continue as a going concern 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. There is no certainty that any of the aforementioned strategies will enable the Company to alleviate the going concern risk in future periods.

If the going concern basis was not appropriate for these financial statements, then adjustments would be necessary in the carrying values of assets and liabilities and the reported revenues and expenses and the balance sheet classifications used; such adjustments could be material.

3. Significant accounting policies

a) Basis of consolidation

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing the opening IFRS statement of financial position at January 1, 2010 for the purposes of the transition to IFRS, unless otherwise indicated.

Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries (which are wholly owned by the Company) are included in the consolidated financial statements from the date that control commences until the date that control ceases. Accordingly, the consolidated financial statements include the accounts of Biorem Technologies Inc., and Biorem Environmental Inc., in addition to those of BIOREM. All significant inter-company transactions and balances have been eliminated.

b) Recognizing revenue

The Company generates revenues from the sale of goods in the form of standard products, through construction projects for specialized products and services revenue for repairs and maintenance. Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates.

3. Significant accounting policies (continued)

b) Recognizing revenue (continued)

i) Standard products

Revenue for standard products is recognized when persuasive evidence exists, usually in the form of an executed sales agreement, the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. The timing of the transfers of risks and rewards of ownership varies depending on the individual terms of the contract of sale but are primarily on the delivery to the end user.

ii) Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. Contract costs are expensed as incurred. Contract costs include all amounts that relate directly to the specific contract, are attributable to contract activity, and are specifically chargeable to the customer under the terms of the contract.

The stage of completion is assessed by reference to detailed cost estimates of work performed and estimates of work to be completed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognized immediately in profit or loss.

On an ongoing basis, the estimated total costs for construction projects are revised based on the information available at the end of the reporting period. Changes in estimated total costs are reflected in the percentage of completion calculation of applicable projects in the same period as the change in estimate occurs.

iii) Service revenue

Revenue relating to services rendered is recognized in profit or loss when the service is provided.

iv) Unbilled revenue

Unbilled revenues represent revenues earned in excess of amounts billed on uncompleted contracts

v) Unearned revenue

Unearned revenue represents the excess of amounts billed to customers over revenue earned on uncompleted contracts.

c) Foreign currency

i) Foreign currency transactions

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into Canadian dollars at rates of exchange in effect at that date. Non-monetary assets and liabilities arising from transactions denominated in foreign currencies are translated at the historical exchange rate. Revenues denominated in a foreign currency are translated at the monthly average exchange rate which approximates the historical exchange rate on the date of the transaction. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in other income at each reporting period.

3. Significant accounting policies (continued)

c) Foreign currency (continued)

ii) Foreign operations

On consolidation, assets and liabilities of Company entities reported in their functional currencies are translated into the Canadian dollar, being the presentation currency, at the exchange rate on the reporting date. The income and expenses of foreign operations are translated to Canadian dollars using average exchange rates for the month during which the transactions occurred. Since January 1, 2010, the Company's date of transition, foreign currency differences arising on the translation of foreign operations are recognized and presented in other comprehensive loss.

d) Financial instruments

The Company aggregates its financial instruments into classes based on their nature and characteristics. The Company has classified its financial instruments as follows:

- Cash and cash equivalents are classified as loans and receivables;
- Restricted cash and cash equivalents are classified as loans and receivables. This restricted cash includes cash which has been deposited as collateral for letters of credit issued by the Company. This cash is not available for general use by the Company;
- Accounts receivables and long-term receivables are classified as loans and receivables;
- Accounts payable and accrued liabilities are classified as other liabilities;
- Debentures and short-term debt is classified as other liabilities; and
- Derivative financial instruments are classified as fair value through profit or loss.

e) Financial assets and financial liabilities

Financial assets and financial liabilities are initially recognized at fair value plus directly attributable transaction costs, unless the transaction costs relate to financial instruments classified as fair value through profit and loss, in which case they are expensed immediately. Subsequent measurement is determined based on initial classification.

The Company uses trade date accounting for regular-way purchases and sales of financial assets.

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method less appropriate allowances for doubtful receivables. Allowances for doubtful receivables represent the Company's estimates of losses that could arise from the failure or inability of customers to make payments when due. Loans and receivables are further classified as current or non-current depending on whether these will be realized within twelve months after the balance sheet date or beyond.

ii) Other liabilities

Subsequent to initial measurement, other liabilities are carried at amortized cost using the effective interest rate method.

iii) Fair value through profit or loss

A financial instrument is classified as fair value through profit or loss if it is held for trading or is designated as such on initial recognition.

3. Significant accounting policies (continued)

e) Financial assets and financial liabilities (continued)

iv) Derivative financial instruments

From time to time the Company enters into forward foreign exchange contracts to hedge its exposure to changes in foreign exchange rates. The Company records all of its forward contracts at fair value, with changes in fair value recorded in other income.

v) Fair value

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques that refer to observable market data.

f) Inventories

Inventories are valued at the lower of cost and net realizable value. The cost of inventories is based on the weighted average basis and includes expenditures incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing condition. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. An impairment loss is recognized when events or circumstances arise that indicate the carrying value of the inventory is less than the related net realizable value. When circumstances which previously caused inventories to be written down to its net realizable value no longer exist, the previous impairment is reversed.

g) Plant and equipment

Plant and equipment are measured at cost less accumulated depreciation, applicable government assistance or investment tax credits, and any recognized impairment loss.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and borrowing costs on qualifying assets for which the commencement date for capitalization is on or after January 1, 2010. Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Depreciation is recognized so as to write off the cost or valuation of assets less their residual values over their useful lives on the following bases:

Asset	Basis	Rate
Research and production equipment	Declining balance	20%
Office equipment		
Office furniture	Declining balance	20%
Computer hardware	Straight-line	3 years
Computer software	Straight-line	3 years
Leasehold improvements	Straight-line	lesser of term of leave and useful life

3. Significant accounting policies (continued)

g) Plant and equipment (continued)

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

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in income.

h) Intangible assets

i) Research and development

Expenditures on research activities are recognized as expenses in the period in which they are incurred.

An internally-generated intangible asset arising from the Company's development is recognized only if all of the following conditions are met:

- an asset is created that can be identified;
- the product or process is technically and commercially feasible;
- it is probable that the asset created will generate future economic benefits;
- the Company intends to and has sufficient resources to complete development and to use or sell the asset; and
- the development cost of the asset can be measured reliably.

To date no development expenditures have been capitalized.

ii) Intangible assets

Patents and trademarks are measured initially at cost and are amortized on a straight-line basis to their estimated residual values. Technology and customer lists represent assets that were acquired by the Company and measured initially at fair value and are amortized on a straight line basis to their estimated residual values. These intangible assets are amortized over their estimated useful lives as follows:

Asset	Basis	Rate
Technology	Straight-line	10 years
Patents	Straight-line	10 years
Trademarks	Straight-line	10 years
Customer lists	Straight-line	10 years

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

i) Impairment of non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories, are reviewed at each reporting date to determine if there is any indication of impairment. If such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset or its related cash generating unit ("CGU") exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

3. Significant accounting policies (continued)

i) Impairment of non-financial assets (continued)

The Company's corporate assets do not generate separate cash inflows and are utilized by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Assets that suffer an impairment are tested for possible reversal of the impairment at each reporting date.

j) Leases

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

k) Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities.

l) Stock-based compensation

The grant-date fair value of share-based payment awards granted to employees is recognized as an employee 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 meet the related service and non-market performance conditions at the vesting date.

m) Government grants

Government grants are not recognized until there is reasonable assurance that the Company will comply with the conditions attaching to them and that the grants will be received.

The benefit of a government loan at a below-market rate of interest is treated as a government grant, measured as the difference between proceeds received and the fair value of the loan based on prevailing market interest rates.

Government grants whose primary condition is that the Company should purchase, construct or otherwise acquire non-current assets are treated as a reduction of the plant and equipment costs.

Other government grants are recognized as other income over the periods necessary to correspond with the costs for which they are intended to compensate, on a systematic basis. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Company with no future related costs are recognized in profit or loss in the period in which they become receivable.

3. Significant accounting policies (continued)

n) Finance costs

Finance costs comprise interest expense on borrowings and accretion of warrant and transaction costs netted against the Company's debenture, that are not directly attributable to the acquisition, construction or production of a qualifying asset, are recognized in profit or loss using the effective interest method.

o) Earnings/loss per share

The Company presents basic and diluted earnings/loss per share data for its ordinary shares. Basic earnings/loss per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding adjusted for the effects of all dilutive potential ordinary shares, which comprise of warrants and share options granted to employees. The number of additional shares is calculated by assuming that outstanding stock were exercised and that proceeds from such exercises along with the unamortized stock based compensation were used to acquire shares of common stock at the average market price during the reporting period.

p) Income tax

Income tax expense comprises current and deferred tax. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantially 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 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. 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 utilized. No deferred tax assets have been recorded on the Company's statement of financial position as of December 31, 2011 or 2010.

q) Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief decision maker is responsible for allocating resources and assessing the performance of the operating segments and has been identified as the Senior Leadership Team that makes strategic decisions. The Company operates in a single operating segment.

r) New accounting pronouncements

The International Accounting Standards Board has issued the following Standards, Interpretations and amendments to Standards that are not yet effective and while considered relevant to the Company have not yet been adopted by the Company.

3. Significant accounting policies (continued)

r) New accounting pronouncements (continued)

Financial instruments

In October 2010, the International Accounting Standards Board ("IASB") issued IFRS 9*, Financial Instruments* ("IFRS 9"). This standard is effective for annual periods beginning on or after January 1, 2015 and is part of a wider project to replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset or liability. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2015. The classification and measurement of the Company's financial assets and financial liabilities is not expected to change under IFRS 9 because of the nature of the Company's operations and the types of financial assets and liabilities that it holds.

Consolidated financial statements

In May 2011, the IASB issued IFRS 10, *Consolidated Financial Statements* ("IFRS 10"). This standard is effective for annual periods beginning on or after January 1, 2013 and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The Company intends to adopt IFRS 10 in its financial statements for the annual period beginning on January 1, 2013. The Company does not expect IFRS 10 to have a material impact on the financial statements.

Joint arrangements

In May 2011, the IASB issued IFRS 11, *Joint Arrangements* ("IFRS 11"). This standard is effective for annual periods beginning on or after January 1, 2013 and establishes principles for financial reporting by parties to a joint arrangement. IFRS 11 requires a party to assess the rights and obligations arising from an arrangement in determining whether an arrangement is either a joint venture or a joint operation. Joint ventures are to be accounted for using the equity method while joint operations will continue to be accounted for using proportionate consolidation.

The Company intends to adopt IFRS 11 in its financial statements for the annual period beginning on January 1, 2013. The Company does not expect IFRS 11 to have a material impact on the financial statements.

Disclosure of interests in other entities

In May 2011, the IASB issued IFRS 12, *Disclosure of Interests in Other Entities* ("IFRS 12"). This standard is effective for annual periods beginning on or after January 1, 2013 and applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 integrates and makes consistent the disclosure requirements for a reporting entity's interest in other entities and presents those requirements in a single standard. The Company intends to adopt IFRS 12 in its financial statements for the annual period beginning on January 1, 2013. When applied, it is expected that IFRS 12 will increase the current level of disclosure of interests in other entities.

3. Significant accounting policies (continued)

r) New accounting pronouncements (continued)

Fair value measurement

In May 2011, the IASB issued IFRS 13, *Fair Value Measurement* ("IFRS 13"). This standard is effective for annual periods beginning on or after January 1, 2013 and provides additional guidance where IFRS requires fair value to be used. IFRS 13 defines fair value, sets out in a single standard a framework for measuring fair value and establishes the required disclosures about fair value measurements. The Company intends to adopt IFRS 13 prospectively in its financial statements for the annual period beginning on January 1, 2013. The Company does not expect IFRS 13 to have a material impact on the financial statements.

Employee benefits

In June 2011, the IASB issued an amended version of IAS 19, *Employee Benefits* ("IAS 19"). This amendment is effective for annual periods beginning on or after January 1, 2013 and requires the recognition of actuarial gains and losses immediately in other comprehensive income and full recognition of past service costs immediately in profit or loss. Revised IAS 19 also streamlines the presentation of changes in assets and liabilities arising from defined benefit plans, and enhances the disclosure requirements for defined benefit plans. The Company intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2013. The Company does not expect IFRS 13 to have a material impact on the financial statements.

Presentation of other comprehensive income ("OCI")

In June 2011, the IASB issued an amended version of IAS 1*, Presentation of Financial Statements* ("IAS 1"). This amendment is effective for annual periods beginning on or after July 1, 2012 and requires companies preparing financial statements in accordance with IFRS to group together items within OCI that may be reclassified to the profit or loss section of the statement of earnings. Revised IAS 1 also reaffirms existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The Company intends to adopt the amendments in its financial statements for the annual period beginning on January 1, 2013. As the amendments only require changes in the presentation of items in other comprehensive income, the Company does not expect the amendments to IAS 1 to have a material impact on the financial statements.

4. Revenue

The following is an analysis of the Company's revenue for the year from continuing operations.

	2011	2010
	$	$
Revenue from the sale of goods	1,595,452	1,074,954
Construction contract revenue	10,449,743	16,284,602
	12,045,195	17,359,556

At December 31, 2011, aggregate costs incurred under open construction-type contracts and recognized profits, net of recognized losses amounted to $7,051,097 (2010 - $7,102,839). Progress billings and advances received from customers under open construction contracts amounted to $6,730,013 (2010 - $5,438,695).

5. Segmented information

The Company attributes revenues to geographical regions based on the domicile of the customers.

Management has determined that the Company operates in one dominant industry segment, which involves the manufacture and sale of industrial machinery.

The Company's revenue and capital assets breaks down geographically as follows:

	Revenue		Capital assets (1)	
	2011	2010	2011	2010
	$	$	$	$
Canada	3,535,730	6,997,007	1,141,960	1,351,374
United States	6,902,833	7,893,377	325,698	428,971
Other	1,606,632	2,469,172	66,660	-
Total	12,045,195	17,359,556	1,534,318	1,780,345

(1) Includes plant and equipment, goodwill, technology, patents and other assets

In 2011, one customer accounted for 12% of total revenue (2010 - 16% of total revenue). One customer accounted for 13% of accounts receivable as at December 31, 2011 (2010 - one customer accounted for 26%).

6. Other Income

	2011	2010
	$	$
Foreign exchange loss (gain)	(31,742)	53,991
Government funding	(640,552)	(924,516)
Investment tax credits	(127,611)	(209,093)
	(799,905)	(1,079,618)

The Company is eligible for Federal investment tax credits at a rate of 20% of qualifying scientific research and experimental development expenditures conducted in Canada, in addition to investment tax credits or deductions available from provincial jurisdictions. Federal investment tax credits are only available to the Company to be applied against future income taxes payable.

The Company has been approved for financial assistance with the Ministry of Research and Innovation - Innovation Demonstration Fund Program in the form of a forgivable loan. The loan bears interest at 3.98% per annum, payable at maturity, and is due December 31, 2014. The loan is secured by a general security agreement over all assets of the Company that is subordinate to long-term debt. The principal and interest is to be forgiven pro rata based on certain milestones having been reached. The loan is to support the Company's development and demonstration of a potential long-term solution for sewage treatment plant odour control. The Company receives contributions of 50% of the specified costs of the project to a maximum of $1,189,018. The Company has recorded $125,564 (2010 - $348,035) as other income and has received $1,017,000 (2010 - $973,000) to December 31, 2011.

6. Other income (continued)

The Company has been approved for funding through the Industrial Research Assistance Program (IRAP). The funding is to support the Company's research and development efforts for the treatment of volatile organic compounds. The Company receives contributions of 50% of the specified costs to a maximum of $404,120. The Company has recorded $99,651 (2010 - $104,295) as other income and has received $403,709 (2010 - $374,673) to December 31, 2011 of which $29,036 (2010 - $90,507) was received in 2011.

During 2010, the Company was approved for financial assistance with the Ministry of Research and Innovation – Innovation Demonstration Fund Program in the form of a forgivable loan. The loan bears interest at 3.97% per annum, payable at maturity, and is due June 30, 2015. The loan is secured by a general security agreement over all assets of the Company that was subordinate to long-term debt. The principal and interest is to be forgiven pro rata based on certain milestones having been reached. The loan is to support the Company's development and demonstration of a potential long-term solution for sewage treatment plant odour control. The Company receives contributions of 50% of the specified costs of the project to a maximum of $1,226,000. The Company has recorded $382,701 (2010-$412,653) as other income and has received $720,840 to December 31, 2011

During 2010, the Company was approved for funding through the Industrial Research Assistance Program (IRAP). The funding is to support the Company's sales and research into the Biogas conditioning market throughout North America. The Company receives contributions of 50% of the specified costs to a maximum of $50,000. The Company has recorded $35,489 as other income in December 31, 2010.

7. Finance costs

	2011	2010
	$	$
Accretion of financing and warrant costs	83,564	334,901
Loss on remeasurement of debenture	157,059	-
Short term interest	261,985	390,055
	502,608	724,956

8. Income taxes

a) *Income tax recognized in profit or loss*

The expense for the year can be reconciled to the accounting profit as follows:

	2011	2010
	$	$
Loss	(3,369,416)	(3,062,851)
Income tax expense calculated at 28.25% (2010 - 31%)	(951,860)	(949,484)
Effect of tax rate differential in foreign operations	(56,027)	(78,178)
Effect of expenses that are not deductible in determining taxable profit	90,582	57,000
Effect of change in tax rates	-	10,001
Other	138,316	53,161
Write off of investment tax credit	-	77,500
Valuation allowance	778,989	830,000
Income tax expense recognized in profit or loss	-	-

b) *Unrecognized tax assets and liabilities*

	December 31, 2011	December 31, 2010
	$	$
Tax assets		
Benefit of tax losses to be carried forward	1,842,000	1,201,000
Scientific Research and experimental development development expendtitures available in future years	1,069,000	915,000
Provisions not yet deducted for tax	308,000	317,000
Financing costs	37,000	79,000
	3,256,000	2,512,000
Tax liabilities		
Capital assets - Difference in accounting book value and undepreciated tax capital cost	(343,000)	(378,000)
	(343,000)	(378,000)
	2,913,000	2,134,000

8. Income taxes (continued)

c) Unrecognized deferred tax assets

As at December 31, 2011, the Company has income tax losses available to reduce future years' taxable income, which expire as follows:

	Canada	U.S.	Other	Total
	$	$	$	$
2025	-	205,000	-	205,000
2026	-	360,000	-	360,000
2027	980,000	520,000	-	1,500,000
2028	-	150,000	-	150,000
2029	-	95,000	-	95,000
2030	600,000	65,000	-	665,000
2031	1,400,000	1,305,000	-	2,705,000
Indefinite	3,500,000	-	385,000	3,885,000
	6,480,000	2,700,000	385,000	9,565,000

In addition, the Company has Canadian investment tax credits available to be applied against future income taxes payable in the amount of approximately $1,544,500, which expire as follows:

	$
2024	78,000
2025	260,500
2026	148,000
2027	205,000
2028	260,000
2029	243,000
2030	350,000
	1,544,500

9. Loss per share

Basic and diluted earnings per share

		2011		2010
Numerator:				
Loss	$	3,369,416	$	3,062,851
Denominator:				
Basic and diluted average shares outstanding		12,098,913		12,057,246
Loss per share:				
Basic and diluted	$	(0.28)	$	(0.26)

At December 31, 2011, 1,102,000 options (2010 - 1,464,335) were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive.

10. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and short-term investments include cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and short-term investments at the end of the reporting period as shown in the statement of cash flows can be reconciled to the related items in the statement of financial position as follows:

	2011	2010
	$	$
Cash and cash equivalents		
Cash and bank balances	924,032	831,343
Short-term investments	-	-
Restricted cash		
Cash and bank balances	648,631	-
Short-term investments	503,750	500,000
	1,152,381	500,000
	2,076,413	1,331,343

Restricted cash includes $503,750 in cash which has been deposited as collateral for a letter of credit issued to an insurance company under the terms of a performance bond and US$637,500 for a letter of credit issued to a supplier. This cash is not available for general use by the Company.

11. Accounts receivable

Accounts receivables are classified as loans and receivables and are measured at amortized cost.

The aging of the trade receivables (including long-term receivables, net of allowance for doubtful accounts) as at December 31 was as follows:

	2011		2010	
	$		$	
0-30 days	2,891,435	62%	2,960,321	55%
31-60 days	488,072	11%	463,367	9%
61-90 days	117,185	3%	192,137	3%
91-120 days	21,242	0%	1,143,100	21%
over 120 days	1,109,311	24%	645,874	12%
	4,627,245	100%	5,404,799	100%

Accounts receivable in the amount of $1,519,267 (2010 - $997,844) (net of allowance for doubtful debts) relate to holdbacks associated with project completion and commissioning.

The gross amount due from customers for contracts accounted for as construction contracts at December 31, 2011 is $4,325,958 (2010 - $4,755,000).

11. Accounts receivable (continued)

Movement in the allowance for doubtful debts

	2011	2010
	$	$
Balance at beginning of the year	171,916	16,000
Impairment losses recognized on receivables	332,225	155,916
Amounts written off during the year as uncollectable	-	-
Amounts recovered during the year	(158,452)	-
Balance at end of the year	345,689	171,916

In determining the recoverability of a trade receivable, the Company considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the end of the reporting period. The concentration of credit risk is limited due to the customer base being large and unrelated.

12. Inventory

	December 31, 2011	December 31, 2010	January 1, 2010
	$	$	$
Raw materials	563,122	691,337	621,169
Finished goods	217,102	77,369	28,205
	780,224	768,706	649,374

Inventory consists of raw materials and manufactured media carried at the lower of cost and net realizable value. The total amount of purchased materials and components included in cost of goods sold for the year was $6,455,193 (2010 - $10,294,266).

The cost of inventories recognized as an expense includes $50,000 (2010 - $10,399) in respect of write-downs of inventory to net realizable value.

13. Plant and equipment

	Research & production equipment	Office equipment	Leasehold Improvements	Total
	$	$	$	$
Cost				
At January 1, 2010	1,070,421	484,009	350,664	1,905,094
Additions	285,955	56,353	-	342,308
Exchange differences	(19,605)	(3,582)	(813)	(24,000)
At December 31, 2010	1,336,771	536,780	349,851	2,223,402
Additions	198,345	96,275	-	294,620
Disposals	(97,372)	-	-	(97,372)
Exchange differences	9,307	1,974	350	11,631
At December 31, 2011	1,447,051	635,029	350,201	2,432,281
Accumulated depreciation and impairment				
At January 1, 2010	580,937	240,217	186,406	1,007,560
Charge for the year	185,629	101,749	32,022	319,400
Exchange differences	(19,577)	(4,236)	(749)	(24,562)
At December 31, 2010	746,989	337,730	217,679	1,302,398
Charge for the year	197,201	113,127	30,751	341,079
Disposals	(84,469)	-	-	(84,469)
Exchange differences	6,357	636	28	7,021
At December 31, 2011	866,078	451,493	248,458	1,566,029
Carrying amount				
At January 1, 2010	489,484	243,792	164,258	897,534
At December 31, 2010	589,782	199,050	132,172	921,004
At December 31, 2011	580,973	183,536	101,743	866,252

Amortization of $33,206 (2010 - $40,112) has been recognized in cost of goods sold, $163,913 (2010 - $133,479) has been recognized in research and development expense and $143,960 (2010 $145,809) has been recognized in general and administrative expenses.

14. Intangible assets

	Technology	Customer Lists	Patents and trademarks	Total
	$	$	$	$
Cost				
At January 1, 2010	1,426,416	450,581	337,534	2,214,531
Exchange differences	-	(22,387)	(14,185)	(36,572)
At December 31, 2010	1,426,416	428,194	323,349	2,177,959
Additions	-	-	17,617	17,617
Exchange differences	-	11,200	6,720	17,920
At December 31, 2011	1,426,416	439,394	347,686	2,213,496
Amortization				
At January 1, 2010	709,416	219,733	195,814	1,124,963
Charge for the year	143,400	48,188	34,610	226,198
Exchange differences	-	(19,871)	(12,672)	(32,543)
At December 31, 2010	852,816	248,050	217,752	1,318,618
Charge for the year	143,400	43,350	28,335	215,085
Exchange differences	-	8,741	2,986	11,727
At December 31, 2011	996,216	300,141	249,073	1,545,430
Carrying amount				
At January 1, 2010	717,000	230,848	141,720	1,089,568
At December 31, 2010	573,600	180,144	105,597	859,341
At December 31, 2011	430,200	139,253	98,613	668,066

Amortization of $215,085 (2010 - $226,198) has been recognized in general and administrative expenses.

None of the intangibles assets other than patents have been internally developed.

15. Provisions

	Warranty provisions
At January 1, 2011	$ 366,292
Provisions used during the year	(156,090)
Provisions made during the year	375,120
At December 31, 2011	$ 585,322

The Company has also recorded termination benefits for certain former employees within accrued liabilities. The Company has recorded its best estimate of the liability based on individual facts and circumstances and on advice from external legal counsel. The final amount eventually paid may differ from the amount that has been accrued by the Company.

16. Debt Instruments

	2011	2010	2009
	$	$	$
Debenture			
12.75% debenture	1,750,000	2,000,000	3,000,000
Less			
Deferred financing costs	-	(71,898)	(215,367)
Deferred warrant costs	-	(94,974)	(286,406)
	1,750,000	1,833,128	2,498,227
Short-term debt			
17.75% promissory note (US$637,500)	648,591	-	-

a) Debenture

2010 activities

On October 31, 2008, the Company secured long-term financing in the form of a $3,000,000 debenture bearing interest at 12.75% per annum payable monthly. On December 31, 2009, the Company entered into an extension agreement whereby the maturity date of the debenture was extended from the original date of October 31, 2010 to October 31, 2011. Certain other terms contained within the debenture were also amended.

The amended terms included an option to repay the debenture anytime after November 1, 2010 without penalty to the Company. In December 2010, the Company made a payment of $1,000,000 against the outstanding principal balance. The debenture is secured by a general security agreement covering all assets of the Company and is subject to meeting certain financial covenants each quarter as amended in the extension agreement.

In relation to the debenture, the Company issued 1,153,846 special warrants which are exercisable into 1,153,846 share purchase warrants, each of which is exercisable to acquire one common share of the Company upon payment of the exercise price of $0.65 per share. The share purchase warrants expire October 31, 2013.

Using the Black-Scholes model, the fair value of the warrants was calculated to be $423,461. The fair value of the warrants, together with the financing costs of $320,951 related to the loan were deferred and are accreted into income using the effective interest method over 36 months. The offset to the fair value of the warrants was recorded to contributed surplus.

The following were the assumptions used to derive the Black-Scholes model value of $0.367:

Risk-free interest rate	2.8 %
Expected life	5 years
Expected volatility	65 %
Expected dividends	-

The Company is subject to certain financial and operating covenants. The Company was not in compliance with certain covenants at December 31, 2010. Subsequent to December 31, 2010, the lender agreed in writing to waive its right to take action under the debenture agreement as a result of such non-compliance at December 31, 2010. In the event of a future covenant violation, the Company's lender may increase the interest rate on the debenture to 18.00%.

2011 activities

The Company was not in compliance with its sales order bookings covenant for the trailing six months ending June 30, 2011 as required under the terms of the original debenture agreement. The lender agreed in writing to waive its right to take action under the debenture agreement as a result of such non-compliance at June 30, 2011. The lender accepted a $30,000 fee consideration in exchange for the waiver. The Company accounted for the modification as a debt modification without a settlement.

16. Debt instruments (continued)

2011 activities (continued)

As at September 30, 2011, the Company was not in compliance with certain financial covenants in respect of its debenture. Subsequent to September 30, 2011, the lender agreed in writing to waive its right to take action under the debenture agreement as a result of such non-compliance at September 30, 2011. At September 30, 2011, the Company concluded that the terms of the debenture have been substantially modified and, therefore, recorded the debenture at fair value at the September 30, 2011 balance sheet date. As the debenture is due on demand, the fair value was determined to be the face value of the debenture. The difference between the fair value and the previous carrying value of$157,059 has been expensed as a loss on remeasurement of debenture in the consolidated statements of operations.

In November 2011, the Company made a payment of $250,000 against the outstanding principal balance of the debenture. As at December 31, 2011, the Company was in violation of the debenture covenants. The Company has negotiated an amendment to this agreement subsequent to December 31, 2011. (See note 23)

b) Short-term debt

During the year, the Company obtained project financing in the form of a promissory note in the amount of US$637,500, having an interest rate of 17.75%, maturing on May 8, 2012. In addition, the Company paid a fee to the lender of US$35,000. The proceeds from the promissory are being used to secure a letter of credit in favour of a supplier. The borrowing costs related to this arrangement have been included as a cost of the related revenue project. The amount of the letter of credit has been classified as restricted cash. The letter of credit was released on March 6, 2012 at the time that the promissory note was repaid.

17. Issued capital

	2011	2010	2009
	$	$	$
Issued:			
12,307,246 common shares (2010 and 2009 - 12,057,246)	13,277,462	13,201,212	13,201,212

Common shares do not have a par value and carry one vote per share. There are an unlimited number of common shares authorized for issuance. During 2011, the Company issued 250,000 common shares to settle a liability in the amount of $76,500 arising on the renegotiation of the debenture covenants.

Share options granted under the employee share option plan

As at December 31, 2011, executives and employees held options over 1,102,000 commons shares (of which 284,681 were unvested), in aggregate, which expire over the period from May 12, 2012 to June 23, 2021. As at December 31, 2010, executives and employees held options over 1,464,335 common shares, in aggregate, which expire over the period from June 7, 2011 to May 12, 2020. Share options granted under the employee share option plan carry no rights to dividends and no voting rights. Further details of the employee share option plan are contained in note 18 to the financial statements.

Special Warrants

In connection with the 12.75% debenture, the Company issued 1,153,846 special warrants which are exercisable into 1,153,846 share purchase warrants, each of which is exercisable to acquire one common share of the Company upon payment of the exercise price of $0.65 per share. The share purchase warrants expire October 31, 2013.

18. Stock-based compensation

The Company uses an equity settled stock option plan to attract and retain key employees, senior executives and directors. Under the terms of the plan, which received shareholder approval, the aggregate number of shares reserved for issuance is fixed at 1,796,745. The maximum number of shares reserved for issuance pursuant to options granted to any one person is limited to 5% of the common shares outstanding at the time of the grant. The stock option exercise price is the closing market price of the Company's common shares on the day prior to the date of the grant. Options granted under the plan may be exercised during a period not exceeding ten years from the date of the grant, subject to termination upon the option holder ceasing to be a director, senior executive or employee of the Company and have vesting periods of at least three years. Options issued under the plan are non-transferable.

i) The following table illustrates the significant assumptions underlying the Company's accounting policy for stock-based compensation:

	2011	2010
	$	$
Weighted average fair value of each option	0.18	0.30
Assumptions		
Weighted average share price	0.39	0.68
Weighted average exercise price	0.39	0.68
Expected volatility	40%	40%
Risk free interest rate	2.4%	2.4%
Expected life in years	10 years	10 years
Expected dividend yield	0%	0%

Expected volatility was determined based on historical volatility

ii) The following table summarizes the continuity of options issued under the plan:

	2011		2010	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
		$		$
Outstanding, beginning of year	1,464,335	1.19	1,438,333	1.45
Options forfeited	(314,667)	0.41	(103,167)	0.64
Options expired	(399,668)	1.19	(104,831)	3.04
Granted during the year	352,000	0.39	234,000	0.68
Outstanding, end of year	1,102,000	1.19	1,464,335	1.19
Exercisable, end of year	817,319	1.23	901,495	1.25

18. Stock-based compensation (continued)

iii) The following table summarizes the continuity of options issued under the plan (continued):

Options outstanding and exercisable at December 31, 2011:

Options outstanding				Options exercisable	
Number outstanding	Exercise price	Exercise price as % of year end share price of $0.12	Remaining life in years	Number exercisable	Weighted average exercise price
	$				$
22,000	1.75	1458%	5.18	22,000	1.75
500,000	1.62	1350%	5.26	400,000	1.62
42,000	1.70	1417%	5.40	42,000	1.70
75,000	1.11	925%	6.00	75,000	1.11
42,000	0.90	750%	6.40	42,000	0.90
187,000	0.68	567%	8.40	68,321	0.68
140,000	0.48	400%	7.00	140,000	0.48
42,000	0.33	275%	7.30	27,998	0.33
52,000	0.34	283%	9.50	-	0.34
1,102,000	1.15	958%	5.67	817,319	1.23

19. Employee benefits

	2011	2010
	$	$
Wages and salaries	3,474,463	4,262,258
Termination benefits	131,598	101,344
Compulsory social security contributions	265,517	303,369
Contributions to defined contribution plans	189,059	206,700
Share-base payments	72,272	147,076
	$ 4,132,909	$ 5,020,747

20. Related party transactions

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	2011	2010
	$	$
Short-term benefits	1,163,693	1,347,422
Share-based payments	56,651	92,026
Termination benefits	64,650	77,000
	1,284,994	1,516,448

20. Related party transactions (continued)

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends. Short-term benefits include salaries, bonuses, and non-monetary benefits such as company vehicles.

21. Operating lease arrangements

Operating leases relate to leases of a building, land and computer equipment with lease terms of between 5 and 60 years. The Company does not have an option to purchase the leased land at the expiry of the lease periods.

a) *Payments recognized as an expense*

	2011	2010
	$	$
Minimum lease payments	162,724	181,473

b) *Non-cancellable operating lease commitments*

	2011	2010
	$	$
Not later than 1 year	196,809	148,747
Later than 1 year and not later than 5 years	214,682	257,080
Less than 5 years	-	-
	411,491	405,827

22. Financial instruments

a) *Financial and capital risk management*

The Company is exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives for growth. The main objectives of the Company's risk management process are to ensure that risks are properly identified and that the capital base is adequate in relation to those risks. The principal financial risks to which the Company is exposed are described below.

i) *Credit risk*

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. Credit risk arises primarily from the Company's cash and cash equivalents and trade receivables. The Company has adopted a policy of only dealing with creditworthy counterparties as a means of mitigating the risk of financial loss from defaults. The Company's exposure is continuously monitored.

The Company's objective of managing credit risk is to mitigate the credit losses incurred. Credit risk is mitigated by entering into contracts with stable, creditworthy parties. The Company measures credit risk by reviewing the aging of its receivables. Credit reviews are conducted as deemed necessary and take into account the third party's financial position and past payment experience. The Company minimizes the credit risk of cash and cash equivalents and restricted cash by making deposits with only reputable entities that have high credit ratings assigned by national credit rating agencies.

22. Financial instruments (continued)

i) Credit risk (continued)

The carrying amount of financial assets and other receivables recorded in the financial statements represents the Company's maximum exposure to credit risk. No collateral or credit enhancements are in place.

ii) Market risks

Foreign currency risk

The Company's functional and reporting currency is the Canadian dollar. Foreign currency risk is primarily related to the Company's operations in the US. US operations are conducted primarily in US dollars. The operations of this wholly owned subsidiary are consolidated in Canadian dollars. For the Company's foreign currency transactions, fluctuations in the respective exchange rates relative to the Canadian dollar will create volatility in the Company's cash flows and the reported amounts of sales, cost of goods sold and general and administrative expenses on a period-to-period basis. The Company's sales are transacted primarily in Canadian and US dollars. The Company's objective of managing foreign currency risk is to mitigate or eliminate the losses incurred.

At December 31, 2010, the Company held two contracts to sell Canadian (Cdn._ dollars in exchange for US dollars; one contract to sell Cdn. $150,000 at an exchange rate of 1.011 and one contract to sell Cdn. $100,000 at an exchange rate of 1.0125. As at December 31, 2010, the exchange rate was 0.9946. Changes in the fair market value of the contracts are recognized in the statement of earnings. The fair value of these forward exchange contracts at December 31, 2010 was nominal. At December 31, 2011, the Company held no forward exchange contracts. The Company plans to evaluate the use of forward exchange contracts in the future.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at December 31 are as follows:

	Assets		Liabilities	
	2011	2010	2011	2010
	$	$	$	$
United States dollars	6,404,159	5,345,533	2,345,699	2,381,125

The following table details the Company's sensitivity to a 10% increase and decrease in the Canadian dollar against the United States dollar. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. A negative number below indicates an increase in loss and other comprehensive loss where the Canadian dollar strengthens 10% against the United States dollar. For a 10% weakening of the Canadian dollar against the United States dollar, there would be an equal and opposite impact on the loss and other comprehensive loss, and the balances below would be possitive.

	United States dollar impact	
	2011	2010
	$	$
Loss	(204,810)	(217,123)
Other comprehensive loss	(200,936)	(191,922)

22. Financial instruments (continued)

ii) Market risks (continued)

Interest rate risk

The Company's interest rate risk is primarily related to the Company's debt instruments (note 16). The interest rate on the short-term debt liability is fixed at 17.75%. The Company is currently paying a fixed rate of 12.75% on the debenture. Due to the debenture covenant violation, the interest rate on the debenture liability may change and any such change is currently unpredictable. The Company's objective of managing interest rate risk is to mitigate interest rate fluctuations while securing financing with the most favourable terms possible. Interest rate risk is managed by negotiating the most favourable terms possible with the Company's lenders.

The sensitivity analysis has been determined based on the exposure to interest rates at the balance sheet date. For the debenture, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Company's loss for the year ended December 31, 2011 would decrease by $35,000 (2010 - decrease by $40,000).

The Company's sensitivity to interest rates has remained largely unchanged from the prior year.

iii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Board of Directors reviews and approves the Company's operating and capital budgets, as well as any material transactions out of the ordinary course of business including proposals on major investments. The Company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecasts and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The Company's objectives of managing liquidity risk are to forecast the liquidity position as accurately as possible and to maintain sufficient resources to pursue its growth strategy. The Company's financial liabilities include accounts payable and accrued liabilities, unearned revenue and contract advances as well as debenture and short-term debt. The Company will likely continue to require equity investments in addition to credit facilities to support the liquidity requirements of the business. (See note 2e – *Going concern basis of presentation and note 23 – Subsequent Events*)

A maturity analysis of the Company's financial liabilities based on gross, undiscounted cash flows is presented below. The maturity analysis is based on the earliest date that liabilities may be due although the Company expects some of its liabilities to be paid later than the earliest date on which the Company can be required to pay.

22. Financial instruments (continued)

iii) Liquidity risk

	Carrying Amount	Contractual Cash Flow	Less than 1 month	1-3 months	3 months to 1 year	1+ years	Total
	$	$	$	$	$	$	$
2011							
Accounts payable	2,984,040	2,984,040	2,984,040	-	-	-	2,984,040
Accrued liabilities	1,907,231	1,907,231	1,907,231	-	-	-	1,907,231
Short-term debt	648,591	698,991	9,600	28,800	660,591	-	698,991
Debenture	1,750,000	1,750,000	1,750,000	-	-	-	1,750,000
	7,289,862	7,340,262	6,650,871	28,800	660,591	-	7,340,262
2010							
Accounts payable	3,818,041	3,818,041	3,818,041	-	-	-	3,818,041
Accrued liabilities	3,415,635	3,415,635	3,415,635	-	-	-	3,415,635
Debenture	1,833,128	2,000,000	21,250	63,750	2,148,750	-	2,233,750
	9,066,804	9,233,676	7,254,926	63,750	2,148,750	-	9,467,426

iv) Capital management risk

The policy of the Board of Directors is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The capital structure of the Company consists of net debt (borrowings offset by cash and bank balances) and equity of the Company (comprising issued capital, reserves, retained earnings and contributed surplus). The Company is not subject to any externally imposed capital requirements.

The gearing ratio at end of the reporting period was as follows:

	2011	2010
	$	$
Debt (i)	1,750,000	2,000,000
Cash and bank balances (ii)	924,032	831,343
Net debt	825,968	1,168,657
Equity (iii)	629,110	3,908,777
Net debt to equity ratio	131%	30%

(i) Debt is defined as debenture liability. The short-term debt is excluded as it is offset by restricted cash.

(ii) Cash and bank balances excludes restricted cash

(iii) Equity includes all capital and reserves of the Group that are managed as capital.

22. Financial instruments (continued)

The Company is currently in negotiations with its debenture holder to modify certain debt covenants and establish a repayment schedule. This negotiation is being undertaken in concert with the Company's planned Private Placement (note 23). If these planned activities are not successful, the Company will seek alternative sources of financing. There can be no assurance that alternative sources of financing will be available to the Company or available at terms acceptable to the Company.

b) Financial Instruments

Categories and fair value of financial instruments

		2011		2010
	Carrying amount	Fair value	Carrying amount	Fair value
	$	$	$	$
Financial assets				
Loans and receivables				
Cash and cash equivalents	924,032	924,032	831,343	831,343
Restricted cash	1,152,381	1,152,381	500,000	500,000
Accounts receivable including-long term portion	4,627,245	4,627,245	5,404,776	5,404,776
Unbilled revenue	1,114,690	1,114,690	4,601,515	4,601,515
	7,818,348	7,818,348	11,337,634	11,337,634
Financial liabilities				
Other financial liabilities				
Accounts payable and accrued liabilities	4,891,271	4,891,271	3,818,041	3,818,041
Unearned revenue	1,863,466	1,863,466	3,415,635	3,415,635
Short-term debt	2,398,591	2,398,591	1,833,128	2,000,000
	9,153,328	9,153,328	9,066,804	9,233,676

The Company has determined that the fair value of its short-term financial assets and liabilities approximates their respective carrying amounts as at the balance sheet dates because of the short-term maturity of those instruments. The fair value of short-term debt has been determined based on current market conditions.

The Company does not currently carry any financial instruments at fair value.

23. Subsequent events

a) Planned Private Placement

On April 20, 2012, the Company announced a proposed private placement of up to 1,400 units at a price per unit of $1,000 for gross proceeds of up to $1.4 million (the “Private Placement”). Each Unit will consist of $1,000 principal amount of 8.00% convertible extendible secured subordinated debentures (the “Debentures”) with a maturity date two years from the date of issuance and 2,808 common share purchase warrants (the “Warrants”). The Debentures will be convertible into fully paid and non-assessable common shares of the Company at the option of the holder at any time over their term at a price of $0.178 per common share. Each Warrant entitles the holder to purchase one common share at a price of $0.178 per share for a period of two years from issuance. The private placement is subject to raising a minimum of $500,000 of gross proceeds. The private placement is subject to regulatory approval. There is no certainty that the Private Placement will be successful.

b) 12.75% Debenture

On April 30, 2012, the Company obtained an amendment to the 12.75% debenture agreement amending the repayment terms and the financial covenants. The Company also obtained a waiver of the covenant breaches at both December 31, 2011 and March 31, 2012 effectively waiving the debenture holder’s rights under the debenture in respect of any non-compliance with such covenants. The amendments to the terms and conditions of the 12.75% debenture and the waiver of the covenant breaches are conditional on the Company’s requirement to raise a minimum of $500,000 under the Private Placement, described above, by May 7, 2012. The 12.75% debenture is repayable in monthly installments of $60,000 plus interest commencing September 30, 2012 with the balance of $550,000 due on May 5, 2014. The Company must maintain an unrestricted cash balance of $400,000 at the end of each quarter. The Company must maintain a minimum tangible net worth or negative $450,000 at June 30, 2012, negative $350,000 at September 30, 2012 and negative $250,000 thereafter. The Company must maintain as at the end of each quarter a sum of unrestricted cash and accounts receivable that is equal to at least twice the outstanding debenture balance.

24. First-time adoption of international financial reporting standards

For all periods up to and including the year ended December 31, 2010, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). As stated in note 2(a), these consolidated annual financial statements are the first the Company has prepared in accordance with International Financial Reporting Standards.

Accordingly, the Company has prepared financial statements which comply with IFRS applicable for periods beginning on or after January 1, 2010. In preparing these financial statements, the opening balance sheet was prepared as of January 1, 2010, the Company's date of transition to IFRS. This note explains the principal adjustments made by the Company in restating its Canadian GAAP balance sheet as at January 1, 2010 and its previously published Canadian GAAP financial statements for the year ended December 31, 2010.

Exemptions applied and mandatory exceptions

IFRS 1, *First-Time Adoption of International Financial Reporting Standards* allows first-time adopters certain exemptions from the general requirement to apply IFRS as effective for fiscal years ended December 31, 2010 retrospectively. IFRS 1 also includes mandatory exceptions to the retrospective application of IFRSs.

The Company has applied the following optional exemptions:

<u>IFRS 2 - Share-based payment transactions</u>

IFRS 1 encourages, but does not require, first-time adopters to apply IFRS 2 "*Share based Payment"* to equity instruments that were granted on or before November 7, 2002, or equity instruments that were granted subsequent to November 7, 2002 and vested before the later of the date of transition to IFRS and January 1, 2005. The Company has elected not to apply IFRS 2 to awards that vested prior to January 1, 2010, which had been accounted for in accordance with Canadian GAAP.

<u>IFRS 3 - Business Combinations</u>

IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3 "*Business Combinations"* retrospectively to business combinations that occurred before the date of transition to IFRS. The Company has taken advantage of this election.

<u>IAS 21 - Cumulative translation differences</u>

IFRS 1 allows a first-time adopter to not comply with the requirements of IAS 21 "*The Effects of Changes in Foreign Exchange Rates"* for cumulative translation differences that existed at the date of transition to IFRS. The Company has chosen to apply this election and has eliminated the cumulative translation difference and adjusted retained earnings by the same amount at the date of transition to IFRS. If, subsequent to adoption, a foreign operation is disposed of, the translation differences that arose before the date of transition to IFRS will not affect the gain or loss on disposal.

The two remaining optional exceptions to the retrospective application of IFRSs relate to consolidated and separate financial statements, and leases. The Company has determined that these mandatory exceptions have not had a material impact on the consolidated financial statements.

The Company has applied the following mandatory exceptions:

In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of January 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

The three remaining mandatory exceptions to the retrospective application of IFRSs relate to the de-recognition of financial assets and liabilities, hedge accounting and assets classified as held for sale and discontinued operations. The Company has determined that these mandatory exceptions have not had a material impact on the consolidated financial statements.

24. First-time adoption of international financial reporting standards (continued)

Financial statement reconciliations

Company reconciliation as at January 1, 2010 (date of transition to IFRS):

	Notes	Canadian GAAP	Adjustments	IFRS
		$	$	$
Assets				
Current assets				
Cash and cash equivalents		4,030,814	-	4,030,814
Accounts receivable		2,897,842	-	2,897,842
Unbilled revenue		3,448,529	-	3,448,529
Inventories		649,374	-	649,374
Prepaid expenses and deposits		65,984	-	65,984
Investment tax credits recoverable		100,000	-	100,000
		11,192,543	-	11,192,543
Non-current assets				
Plant and equipment	b, c	1,011,228	(113,694)	897,534
Investment tax credits recoverable		250,000	-	250,000
Intangible assets	b, c	1,267,671	(178,103)	1,089,568
Goodwill	b	1,428,000	(1,428,000)	-
Total assets		15,149,442	(1,719,797)	13,429,645
Liabilities				
Current liabilities				
Accounts payable		1,588,199	-	1,588,199
Accrued liabilities	f	2,228,169	(250,000)	1,978,169
Provisions	f	-	250,000	250,000
Unearned revenue		287,030	-	287,030
		4,103,398	-	4,103,398
Non-current liabilities				
Debenture		2,498,227	-	2,498,227
Shareholders' equity				
Common shares		13,201,212	-	13,201,212
Contributed surplus	d	1,440,605	124,775	1,565,380
Deficit	e	(6,094,000)	(1,844,572)	(7,938,572)
Total shareholders' equity		8,547,817	(1,719,797)	6,828,020
Total liabilities and shareholders' equity		15,149,442	(1,719,797)	13,429,645

24. First-time adoption of international financial reporting standards (continued)

Financial statement reconciliations (continued)

Company reconciliation as at December 31, 2010:

	Notes	Canadian GAAP	Adjustments	IFRS
		$	$	$
Assets				
Current assets				
Cash and cash equivalents		831,343	-	831,343
Restricted cash and cash equivalents		500,000		500,000
Accounts receivable		5,010,779	-	5,010,779
Unbilled revenue		4,601,515	-	4,601,515
Inventories		768,706	-	768,706
Prepaid expenses and deposits		87,927	-	87,927
Investment tax credits recoverable		150,000	-	150,000
		11,950,270	-	11,950,270
Non-current assets				
Long-term receivables		394,000	-	394,000
Plant and equipment	b, c	1,020,264	(99,260)	921,004
Intangible assets	b, c	1,015,261	(155,920)	859,341
Goodwill	b	1,428,000	(1,428,000)	-
Total assets		15,807,795	(1,683,180)	14,124,615
Liabilities				
Current liabilities				
Accounts payable		3,818,041	-	3,818,041
Accrued liabilities	f	3,781,927	(366,292)	3,415,635
Provisions	f	-	366,292	366,292
Unearned revenue		782,742	-	782,742
Debenture		1,833,128		1,833,128
Total liabilities		10,215,838	-	10,215,838
Shareholders' equity				
Common shares		13,201,212	-	13,201,212
Contributed surplus	d	1,622,527	89,929	1,712,456
Accumulated other comprehensive income	c	-	(3,468)	(3,468)
Deficit	e	(9,231,782)	(1,769,641)	(11,001,423)
Total shareholders' equity		5,591,957	(1,683,180)	3,908,777
Total liabilities and shareholders' equity		15,807,795	(1,683,180)	14,124,615

24. First-time adoption of international financial reporting standards (continued)

Financial statement reconciliations (continued)

Company reconciliation of statement of total comprehensive loss for the year ended December 31, 2010:

	Notes	Canadian GAAP	Adjustments	IFRS
		$	$	$
Revenue		17,359,556	-	17,359,556
Cost of goods sold	g	12,275,592	40,112	12,315,704
		5,083,964	(40,112)	5,043,852
Expenses (income)				
Sales and marketing		3,560,860	-	3,560,860
Research and development	g	1,758,772	133,479	1,892,251
Government assistance	g	(1,133,609)	1,133,609	-
General and administration	g	2,260,102	498,152	2,758,254
Amortization	c, g	585,682	(585,682)	-
Stock option compensation	d	181,922	(181,922)	-
Loss on foreign exchange	c, g	33,060	(33,060)	-
Other income	g	-	(1,079,618)	(1,079,618)
Total operating expenses		7,246,789	(115,042)	7,131,747
Results from operating activities		(2,162,825)	74,930	(2,087,895)
Finance and othe costs				
Interest expense		390,055	-	390,055
Write down of long-term tax asset		250,000		250,000
Accretion of finance and warrant costs		334,901	-	334,901
Total finance costs		974,956	-	974,956
Net loss for the period		(3,137,781)	74,930	(3,062,851)
Other comprehensive income (loss)				
Exchange differences on translation of foreign operations	c	-	3,468	3,468
Total comprehensive loss for the period		**(3,137,781)**	**78,398**	**(3,059,383)**

24. First-time adoption of international financial reporting standards (continued)

Notes to the financial statement reconciliations

a) Cumulative translation differences

IFRS 1 permits the cumulative translation gains and losses account to be reset to zero at the transition date. This provides relief from determining cumulative transition differences in accordance with IAS 21, "*The Effects of Changes in Foreign Exchange Rates*", from the date a subsidiary was acquired. The Company has elected to reset the cumulative translation gains and losses account to zero at the transition date.

b) Impairment of long-lived assets including goodwill

IFRS 1 requires entities to test long-lived assets including goodwill for impairment upon transition to IFRS. IAS 36, "*Impairment of Assets",* requires this assessment to be made at the cash-generating unit level, which differs from the requirement under Canadian GAAP to assess impairment at the reporting unit level. The Company has identified its modular unit business as a cash generating unit. Accordingly, effective January 1, 2010, the assets, including goodwill, of the modular unit business were tested for impairment.

Due to the requirement to assess impairment at a more granular level under IFRS as compared to Canadian GAAP the effect upon transition was that the entire goodwill balance of $1,428,000 was impaired with an offsetting entry to increase deficit on transition. In addition the carrying values of the long-lived assets of Biorem Environmental Inc. exceeded their value in use by an amount of $169,000. Accordingly an adjustment to opening deficit was recorded to reduce the carrying value of the long lived assets by $169,000.

The Company assessed the recoverability of the modular unit business's long lived assets using the value-in-use methodology. The value-in-use was determined using the discounted cash flow method by considering the future expected cash flows over the next five years along with a terminal value. Future expected cash flows where based on operating plans which take into account past performance, known trends and anticipated capital expenditures. The terminal value was determined using estimated long-term growth rate of 4% which is based on Biorem's expected future operating results for this cash generating unit. The Company used a discount rate of 15% which was set considering the weighted average cost of capital to Biorem and certain risk premiums, based on past experience.

c) Functional currency

Under previous Canadian GAAP, the functional currency of BIOREM and its subsidiaries was determined to be the Canadian dollar, as the BIOREM's subsidiaries operate as integrated foreign operations due to the fact that they are financially and operationally interdependent with BIOREM. As a result, the temporal method was used to translate assets, liabilities, revenues and expenses. The result of the application of this method was that monetary items were translated at the exchange rate in effect at the balance sheet date, non-monetary items were translated at historical rates, revenue and expense items were translated at the exchange rates in effect on the dates they occurred, and depreciation was translated at the historical exchange rates of the related assets.

In accordance with IFRS, BIOREM examined the functional currencies for each of its subsidiaries upon transition. Under IFRS, when the indicators are mixed and the functional currency is not obvious, priority should be given to indicators that have a greater weighting. Canadian GAAP has similar indicators as IFRS in determining functional currency; however, Canadian GAAP does not have a hierarchy of indicators under which certain indicators are given priority. In particular, under IFRS, the Company evaluated the primary economic environment within which each entity operates. In performing this evaluation, the Company looked to the currency that mainly influences sales prices, the currency of the country whose competitive forces and regulations mainly determine the sales prices, and the currency that mainly influences labour, material and other costs of providing goods. The result of this assessment was the determination that the domestic currency of each subsidiary is the functional currency. Accordingly, the functional currency of Biorem Environmental Inc. became the US dollar, and the functional currency of Biorem Inc. and Biorem Technologies Inc. remained the Canadian dollar.

24. First-time adoption of international financial reporting standards (continued)

Under IAS 21, "*Foreign Operations*", assets and liabilities are translated from their functional currency into the Company's presentation currency at the exchange rate at the reporting date, and revenue and expenses are translated at the transaction date. Since January 1, 2010, the Company's date of transition, foreign currency translation differences arising on the translation of foreign operations are recognized and presented in other comprehensive income. The effect of the change in functional currency in Biorem Environmental Inc. at the date of transition was to recognize accumulated translation losses or $123,213 with a corresponding reduction in plant and equipment of $46,213 and intangible assets of $77,000. This also resulted in a decreased amortization expense for the year ending December 31, 2010 by $24,127.

d) Share-based payments

Under previous Canadian GAAP, the Company's accounting policy for equity-settled share-based payments with distinct estimated lives was to treat these instruments as a pool and determine the fair value using the average life of the instruments, subsequently recognizing compensation on a straight-line basis, subject to the vested portion of the award being recognized at each reporting date. Under IFRS, where share-based payments vest in installments over the contractual life of the award, each installment is accounted for as a separate arrangement.

Additionally, under Canadian GAAP, the Company did not elect to estimate the number of equity-settled instruments that were expected to be forfeited and include these in the determination of compensation. IFRS 2, "*Share-based Payments*", is explicit in the requirement for the consideration of estimated forfeitures in the determination of compensation. The impact was to decrease stock-based compensation by $34,846 for the year ended December 31, 2010. The impact also gave rise to an adjustment on transition, increasing contributed surplus and decreasing deficit by $124,775.

As a result of these differences, the Company has determined its stock-based compensation utilizing graded vesting and an estimate of forfeitures.

(e) The above changes decreased (increased) deficit as follows:

	Note	Dec 31 2010	Jan 1 2010
		$	$
Plant and equipment	4 b, c	(99,260)	(113,694)
Intangible assets	4 b, c	(155,920)	(178,103)
Goodwill impairment	4b	(1,428,000)	(1,428,000)
Stock option	4d	34,846	-
Stock option transition	4d	(124,775)	(124,775)
Change in functional currency	4c	3,468	123,213
Election to reset cumulative translation	4a	-	(123,213)
Increase in deficit		(1,769,641)	(1,844,572)

f) Provisions

Upon adoption of IFRS, the Company presented provisions previously classified as accrued liabilities separately on the statement of financial position. The provision balance is comprised of the Company's product warranty provision.

24. First-time adoption of international financial reporting standards (continued)

g) Presentation of statements of comprehensive income

IFRSs require the presentation of expenses in the statement of comprehensive income to be made based on their nature or the function to which the expenditure relates. Previous Canadian GAAP permitted a combination of these approaches. The Company has elected to present items in its consolidated statements of comprehensive income based on the function to which they relate, and accordingly, has reclassified items previously presented are listed below:

i) Amortization has been reclassified to cost of goods sold, research and development and general and administration,
ii) Loss on foreign exchange has been reclassified between other income and exchange differences on translation of foreign operations,
iii) Share-based payments expense has been reclassified to general and administration,
iv) Government assistance has been reclassified to other income.

h) Presentation of statements of cash flows

Upon transition to IFRS the Company has incorporated the amount of cash paid for interest within the body of the statements of cash flows as a financing activity, whereas this was previously disclosed as supplementary information. There are no other material differences between the statement of cash flows presented under IFRSs and the statement of cash flows presented under previous Canadian GAAP.