

Consolidated Financial Statements of

Biorem Inc.

December 31, 2016 and 2015

Biorem Inc.

December 31, 2016 and 2015

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Independent Auditors' Report

To the Shareholders of BIOREM Inc.:

We have audited the accompanying consolidated financial statements of BIOREM Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2016 and 2015, and the consolidated statements of operations, comprehensive earnings, changes in shareholders' equity, and cash flows for the years then ended, and 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 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 the auditors' 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, the auditor considers 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 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 financial position of BIOREM Inc. and its subsidiaries as at December 31, 2016 and 2015 and their financial performance, the results of their operations, and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

MNP LLP

Chartered Professional Accountants

Licensed Public Accountants

Mississauga, Ontario

April 4, 2017

MNP
LLP

Biorem Inc.

Consolidated statements of financial position December 31, 2016 and 2015

In Canadian dollars	Note	2016	2015
		\$	\$
Assets			
Current assets			
Cash and cash equivalents	10	1,118,297	2,725,043
Restricted cash and cash equivalents	10	528,023	715,167
Accounts receivable	11	7,124,365	2,698,940
Unbilled revenue	4	1,762,979	2,155,649
Inventories	12	464,315	701,180
Prepaid expenses and deposits		213,825	150,977
Investment tax credits recoverable		27,023	-
		11,238,827	9,146,956
Non-current assets			
Equipment and leasehold improvements	13	104,548	147,709
Total assets		11,343,375	9,294,665
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable		2,963,576	1,794,540
Accrued liabilities		711,949	1,040,870
Provisions	14	504,052	379,411
Unearned revenue	4	2,571,279	1,272,023
Current portion of long-term debt	16	2,165,571	2,874,416
		8,916,427	7,361,260
Non-current liabilities			
Long-term debt	16	-	-
Shareholders' equity			
Common shares	17	13,789,081	13,723,800
Share purchase warrants	17	51,351	54,146
Contributed surplus		2,368,659	2,364,591
Accumulated other comprehensive income		187,147	307,433
Deficit		(13,969,290)	(14,516,565)
Total shareholders' equity		2,426,948	1,933,405
Commitments	21		
Contingency	15		
Subsequent events	23		
Total liabilities and shareholders' equity		11,343,375	9,294,665

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Directors of Biorem Inc:

Signed "signed"
Director Anthony Ennis

Signed "signed"
Director Brian Herner

Biorem Inc.

Consolidated statements of operations

Years ended December 31, 2016 and 2015

In Canadian dollars	Notes	2016	2015
		\$	\$
Revenue	4	15,896,146	16,880,173
Cost of goods sold	12	11,788,751	10,884,760
Gross profit		4,107,395	5,995,413
Expenses (income)			
Sales and marketing		1,882,514	1,907,170
Research and development		387,278	444,357
General and administration		1,369,725	1,798,044
Other income	6	(357,047)	(352,202)
Total operating expenses		3,282,470	3,797,369
Earnings from operations		824,925	2,198,044
Finance costs	7	277,650	509,193
Net earnings		547,275	1,688,851
Earnings per share, basic	9	\$ 0.04	\$ 0.13
Earnings per share, diluted	9	\$ 0.02	\$ 0.06

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of comprehensive earnings Years ended December 31, 2016 and 2015

In Canadian dollars	Notes	2016	2015
		\$	\$
Net earnings		547,275	1,688,851
Other comprehensive earnings (loss)			
Item that will be not reclassified into profit or loss:			
Foreign currency translation differences on foreign operations		(120,286)	146,582
Total comprehensive earnings		426,989	1,835,433

See accompanying notes to consolidated financial statements.

Biorem Inc.

Consolidated statements of changes in shareholders' equity Years ended December 31, 2016 and 2015

In Canadian dollars	Notes	Common shares	Share purchase warrants	Contributed surplus	Accumulated other comprehensive income(loss)	Deficit	Total
		\$	\$	\$	\$	\$	\$
Balance, as at December 31, 2014		13,352,462	67,723	2,366,293	160,851	(16,205,416)	(258,087)
Earnings for the year		-	-	-	-	1,688,851	1,688,851
Foreign currency translation differences on foreign operations		-	-	-	146,582	-	146,582
Total comprehensive earnings for the year		-	-	-	146,582	1,688,851	1,835,433
Conversion of debentures	17	189,044	-	-	-	-	189,044
Warrants exercised	18	169,025	(13,577)	-	-	-	155,448
Stock options exercised	18	13,269	-	(4,902)	-	-	8,367
Stock-based compensation	19	-	-	3,200	-	-	3,200
		371,338	(13,577)	(1,702)	-	-	356,059
Balance, as at December 31, 2015		13,723,800	54,146	2,364,591	307,433	(14,516,565)	1,933,405
Earnings for the year		-	-	-	-	547,275	547,275
Foreign currency translation differences on foreign operations		-	-	-	(120,286)	-	(120,286)
Total comprehensive earnings for the year		-	-	-	(120,286)	547,275	426,989
Conversion of debentures	17	37,989	-	-	-	-	37,989
Warrants exercised	18	27,292	(2,795)	-	-	-	24,497
Stock options exercised	18	-	-	-	-	-	-
Stock-based compensation	19	-	-	4,068	-	-	4,068
		65,281	(2,795)	4,068	-	-	66,554
Balance, as at December 31, 2016		13,789,081	51,351	2,368,659	187,147	(13,969,290)	2,426,948

Biorem Inc.

Consolidated statements of cash flows Years ended December 31, 2016 and 2015

In Canadian dollars	Notes	2016 \$	2015 \$
Operating activities			
Net earnings		547,275	1,688,851
Items not involving cash:			
Depreciation	13	50,969	94,550
Amortization of intangible assets		-	27,057
Finance costs	7	277,650	509,193
Stock based compensation	18	4,068	3,200
Foreign exchange gain		(152,597)	(75,759)
		727,365	2,247,092
Change in non-cash operating working capital			
Restricted cash and cash equivalents		187,144	290,000
Accounts receivable		(4,474,330)	314,675
Unbilled revenue		389,248	(698,227)
Inventories		233,086	(139,172)
Prepaid expenses and deposits		(62,723)	245,141
Investment tax credits recoverable		(27,023)	-
Accounts payable		1,191,608	158,570
Accrued liabilities		(441,271)	(56,189)
Provisions		133,023	27,046
Unearned revenue		1,366,095	(239,549)
Cash provided by (used in) operating activities		(777,778)	2,149,387
Investing activities			
Proceeds from disposal of equipment	13	-	6,560
Purchase of equipment	13	(11,960)	(6,464)
Cash provided by (used in) investing activities		(11,960)	96
Financing activities			
Repayment of 12.75% debenture	16	(885,000)	(770,000)
Repayment of 8% convertible debenture	16	(10,000)	-
Proceeds from issuance common shares on exercise of stock options and warrants	17	24,497	163,814
Interest paid	7	(53,507)	(181,429)
Cash provided by (used in) financing activities		(924,010)	(787,615)
Foreign exchange gain (loss) on foreign denominated cash and cash equivalents		107,002	151,214
Increase (decrease) in cash and cash equivalents		(1,606,746)	1,513,082
Cash and cash equivalents, beginning of year		2,725,043	1,211,961
Cash and cash equivalents, end of year	10	1,118,297	2,725,043

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

1. General information

BIOREM Inc. ("BIOREM") is a company with its head office domiciled in Canada.

The address of BIOREM's registered office is 7496 Wellington Road 34, Puslinch, Ontario. The Company's common shares are listed on the TSX Venture Exchange and trade under the symbol BRM.V. The consolidated financial statements of BIOREM comprise BIOREM and its subsidiaries (together referred to as "the Company"). The Company is primarily 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").

The consolidated financial statements were approved by the Board of Directors and authorized for issuance on April 4, 2017.

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, and share based payments, both of which are measured 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 and the functional currency of BIOREM's subsidiaries located in China is the Chinese renminbi.

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.

i) *Critical judgments in applying accounting policies*

The following are the critical judgments, apart from those involving estimations, that management has made in the process of applying the Company's accounting policies and that have the most significant effects on the amounts recognized in the consolidated financial statements.

Indicators of impairment

IAS 36, *Impairment of assets*, requires management to assess the carrying values of the Company's non-financial assets, excluding inventory, at each reporting period and determine whether indicators of impairment exist. The determination of the existence of indicators of impairment requires judgment. Management also exercises judgment to determine whether there are factors that would indicate a cash generating unit ("CGU") is impaired. Some indicators of impairment that management may consider include changes in the current and expected future use of the asset, external valuations of the asset, and obsolescence or physical damage to the asset.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

2. Basis of presentation (continued)

d) Use of estimates and judgements (continued)

ii) *Key sources of estimation uncertainty*

The following are the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the consolidated financial statements within the next twelve months.

Estimation of contract costs

The Company recognizes revenue on its construction contracts using the percentage-of-completion method, under which contract revenue is recognized in proportion to the contract costs incurred in relation to the total costs estimated to complete the contract, as indicated in note 3(b). The determination of estimated costs to complete contracts requires management to make estimates regarding future material and labour costs. Differences between actual contract costs incurred and estimated contract costs could materially affect the timing of the recognition of contract revenues.

Determination of recoverable amount of equipment, leasehold improvements and intangible assets

Under IAS 36, Impairment of Assets, when indicators of impairment of the Company's non-financial assets, excluding inventory, exist, management is required to estimate the recoverable amount of the asset, as discussed in note 3(i). The determination of the recoverable amount of the asset involves estimates of the future cash flows attributable to the asset, the time-value of money, the life of the asset and/or the fair value of the asset. Differences between the actual amounts of these variables and the estimated amounts could materially affect the consolidated financial statements, both in determining the existence of any impairment and in determining the amount of any impairment.

Determination of useful lives and residual values of long-lived assets

The Company's leasehold improvements, equipment and intangible assets are depreciated or amortized to their residual values over their estimated useful lives. On an annual basis, management assesses the estimated useful lives and the residual values of these long-lived assets to determine whether they are still appropriate. In the determination of useful lives, management may consider changes in the current and expected use of the asset, changes to the asset's physical condition, or the acquisition of new assets which render existing assets obsolete. In the determination of residual values, management may consider changes in the asset's physical condition, its anticipated use, and external valuations of the asset. Differences between these estimates and the actual lives and residual values of the Company's long-lived assets could materially affect both the timing and amounts of depreciation and amortization expense.

Provisions

The Company recognizes provisions relating to warranties and termination benefits. As indicated in note 3(k), the determination of the warranty provision is based on historical warranty data, the time-value of money, as well as management's assessment of specific warranty claims, if any. Termination benefits are measured based on management's assessment of the merits of the claim and ultimate estimated settlement cost. Estimates are also made regarding the timing of the cash outflows relating to any termination benefits and warranty claims. Differences between the timing and amount of estimated expenses relating to these claims could differ materially from the actual expenses incurred.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, unless otherwise indicated. The accounting policies have been consistently applied by the Company's subsidiaries.

a) Basis of Consolidation

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., Biorem Environmental Inc., Biorem Hong Kong, Biorem (Beijing) Environmental Technologies Company Limited and Tianjin Biqing Environmental Technology Co., Ltd in addition to those of BIOREM. All significant inter-company transactions and balances have been eliminated.

b) Revenue recognition

The Company generates revenues from the sale of standard products, from construction projects for specialized products and from services for repairs and maintenance.

Revenue is measured at the fair value of the consideration received or receivable, net of returns and trade discounts.

i) Standard products

Revenue for standard products is recognized when persuasive evidence of an arrangement 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 products can be estimated reliably, there is no continuing management involvement with the products, 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 of the product to the end user.

ii) Construction contracts

The Company derives revenue from construction contracts which require performance over a time span which may extend beyond one or more accounting periods. The Company recognizes revenue on construction contracts using the percentage-of-completion method, based on costs incurred relative to the estimated total contract costs.

Contract revenue includes the initial amount agreed in the contract plus any variations in contract 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 of a contract is determined by reference to actual costs of work performed and estimates of remaining 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 contracts 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.

Unbilled revenue represents revenue earned in excess of amounts billed on uncompleted contracts.

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

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

b) Revenue recognition (continued)

iii) Services

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

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 and expenses 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 in the statement of operations at each reporting period.

ii) Foreign operations

On consolidation, assets and liabilities of BIOREM's subsidiaries are translated into the Canadian dollar 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. Foreign currency differences arising on the translation of foreign operations are recognized and presented in other comprehensive earnings (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
- Accounts receivable are classified as loans and receivables
- Accounts payable and accrued liabilities are classified as other liabilities
- Long-term and short-term debt are classified as other liabilities
- 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 or 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 method less any impairment losses. 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.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

e) Financial assets and financial liabilities (continued)

ii) Other liabilities

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

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 in the statement of operations.

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.

vi) Compound financial instruments

The financial liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component, representing the holders' option to convert into common shares, is recognized as the difference between the proceeds received or receivable from issuance of the instrument, and the amount determined to represent the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is included within contributed surplus and is not re-measured subsequent to initial recognition.

Interest, and any gains and losses relating to the financial liability are recognized in profit or loss.

f) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the weighted average 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. When circumstances which previously caused inventories to be written down to its net realizable value no longer exist, the previous impairment is reversed.

g) Equipment and leasehold improvements

Equipment and leasehold improvements 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.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

g) Equipment and leasehold improvements (continued)

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

Depreciation is recognized so as to write off the cost 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	Straight-line or declining balance	3 years or 20%
Leasehold improvements	Straight-line	lesser of term of lease and useful life

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 at the time of disposal.

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
- the development cost of the asset can be measured reliably.

To date no development expenditures have been capitalized.

ii) Other 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 cost and are amortized on a straight-line basis to their estimated residual values. These intangible assets are amortized on a straight-line basis over ten years, representing their estimated useful lives.

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

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

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 pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

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

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating 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 end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Provisions are determined by discounting the cash flows estimated to settle the obligation at a pre-tax rate that reflects current market assessment of the time value of money and risks specific to the Company. The unwinding of the discount is recognized as finance cost.

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 options

The grant-date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in contributed surplus, 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.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

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.

n) Finance costs

Finance costs comprise interest expense on borrowings, accretion of provisions 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 common shares. Basic earnings (loss) per share is calculated by dividing the earnings (loss) attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is determined by adjusting the earnings (loss) attributable to common shareholders and the weighted average number of common shares outstanding adjusted for the effects of all dilutive potential common shares, which comprise warrants and stock options granted to employees and convertible debentures. The number of additional shares is calculated by assuming that outstanding warrants, share options and convertible debentures were exercised and that proceeds from such exercises along with the unamortized stock based compensation were used to acquire common shares 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.

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 and reports its results as one operating segment.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

3. Significant accounting policies (continued)

r) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and short-term deposits with original maturities of less than three months.

s) Statements of cash flows

Cash paid for interest is presented as a financing activity.

t) Investment tax credits

The Company applies for investment tax credits relating to qualified expenditures under available government incentive programs including the Scientific Research and Experimental Development program. The benefit of investment tax credits is recognized when the applicable eligible expenditures generating the investment tax credits are incurred and are recorded as other income. Investment tax credits related to the acquisition of equipment are deducted from the costs of the related assets.

u) New accounting pronouncements not yet adopted

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 and the Company is currently assessing the impact of these new standards.

Financial instruments

IFRS 9 Financial Instruments ("IFRS 9") was issued by the IASB in its final form in July 2014, and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 replaces the multiple rules in IAS 39 with a single approach to determine whether a financial asset is measured at amortized cost or fair value and a new mixed measurement model for debt instruments having only two categories: amortized cost and fair value. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The Company intends to adopt IFRS 9 on its effective date and has not reviewed the effects of this future policy change.

Revenue from Contracts with Customers

IFRS 15 Revenue from Contracts with Customers ("IFRS 15") was issued by the IASB in May, 2014. IFRS 15 provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standards on leases, insurance contracts and financial instruments. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018 and is to be applied retrospectively. Early adoption is permitted. The Company intends to adopt IFRS 15 on its effective date and has not reviewed the effects of this future policy change.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

4. Revenue

	2016	2015
	\$	\$
Standard products and services	953,054	901,215
Construction contracts	14,943,092	15,978,958
	<u>15,896,146</u>	<u>16,880,173</u>
Costs and estimated earnings on uncompleted contracts		
	2016	2,015
	\$	\$
Costs incurred on uncompleted contracts	19,543,579	17,499,303
Estimated earnings on uncompleted contracts, net of recognized losses	11,952,460	11,382,874
	<u>31,496,039</u>	<u>28,882,177</u>
Less: billings to date	<u>(32,304,339)</u>	<u>(27,998,551)</u>
	<u>(808,300)</u>	<u>883,626</u>
Unbilled revenue	1,762,979	2,155,649
Unearned revenue	<u>(2,571,279)</u>	<u>(1,272,023)</u>
	<u>(808,300)</u>	<u>883,626</u>

5. Segmented information

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

Management has determined that the Company operates in one dominant industry segment, which involves the manufacture and sale of high efficiency air pollution control systems.

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

	Revenue		Capital assets (1)	
	2016	2015	2016	2015
	\$	\$	\$	\$
Canada	6,896,770	4,958,214	55,654	71,205
United States	5,030,941	6,160,461	32,445	46,455
China	686,872	2,664,752	16,449	30,049
Other international	3,281,563	3,096,746	-	-
Total	<u>15,896,146</u>	<u>16,880,173</u>	<u>104,548</u>	<u>147,709</u>

(1) Includes equipment and leasehold improvements.

In 2016, two customers accounted for 28% of total revenue (2015 – one customer accounted for 16% of total revenue). One customer accounted for 31% of accounts receivable at December 31, 2016 (2015 - two customers accounted for 31%).

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

6. Other income

	2016	2015
	\$	\$
Foreign exchange loss (gain)	(152,597)	(75,759)
Government funding	(175,315)	(214,363)
Investment tax credits	(29,135)	(62,080)
	<u>(357,047)</u>	<u>(352,202)</u>

Investment tax credits

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 and, accordingly, no recognition of Federal amounts has been reflected in the statement of financial position.

Government funding

The Company has been approved for funding through the Industrial Research Assistance Program (IRAP). The funding is to support the Company's research into advanced biological technologies for the control of odour and volatile organic compounds. The Company receives contributions of 50% of the eligible costs. The Company has recorded \$147,095 as other income during the year (2015 - \$191,863).

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 bore interest at 3.97% per annum, payable at maturity, and was due June 30, 2015. The Company was in compliance with all conditions of the loan agreement and the loan was forgiven on June 30, 2015.

7. Finance costs

	2016	2015
	\$	\$
Short term interest	(10,292)	1,880
Long-term debt interest	<u>287,942</u>	<u>507,313</u>
	<u>277,650</u>	<u>509,193</u>

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

8. Income taxes

a) Income tax recognized in net earnings

	2016	2015
	\$	\$
Net earnings	547,275	1,688,851
Income tax expense calculated at 26.5% (2015 - 26.5%)	145,028	447,545
Effect of tax rate differential in foreign operations	58,943	21,133
Effect of expenses that are not deductible in determining taxable profit	4,367	4,033
Effect of losses (utilized) carried forward	(208,338)	(472,711)
Income tax expense recognized in net earnings	-	-

b) Unrecognized deferred tax assets

	2016	2015
	\$	\$
Tax assets		
Benefit of tax losses to be carried forward	1,338,000	1,643,000
Scientific research and experimental development expenditures available in future years	2,064,000	1,033,000
Provisions not yet deducted for tax	832,000	765,000
Capital assets - difference in accounting book value and undepreciated tax capital cost	318,000	326,000
	4,552,000	3,767,000

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

8. Income taxes (continued)

c) Income tax losses

As at December 31, 2016, the Company has income tax losses available to reduce future years' taxable income, which expire as follows:

	Canada	U.S.	Total
	\$	\$	\$
2027	-	149,000	149,000
2028	-	154,000	154,000
2029	-	96,000	96,000
2030	-	65,000	65,000
2031	509,000	413,000	922,000
2032	956,000	106,000	1,062,000
2033	-	-	-
2034	1,466,000	-	1,466,000
Indefinite	3,219,000	-	3,219,000
	<u>6,150,000</u>	<u>983,000</u>	<u>7,133,000</u>

In addition, the Company has Canadian investment tax credits available to be applied against future income taxes payable in the amount of approximately \$1,648,000 which expire as follows:

2024	133,000
2025	261,000
2026	148,000
2027	207,000
2028	261,000
2029	161,000
2030	224,000
2031	68,000
2032	61,000
2033	86,000
2034	38,000
	<u>1,648,000</u>

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

9. Earnings per share

	2016	2015
Basic earnings per share	\$ 0.04	\$ 0.13
Calculated as:		
Net earnings	\$ 547,275	\$ 1,688,851
Weighted average number of shares outstanding	15,391,098	13,596,735
Diluted earnings per share	\$ 0.04	\$ 0.06
Calculated as:		
Net earnings	\$ 547,275	\$ 1,688,851
Interest on convertible debentures	227,664	301,270
Diluted earnings	\$ 774,939	\$ 1,990,121
Reconciliation of weighted average diluted shares outstanding:		
Weighted average common shares outstanding	15,391,098	13,596,735
Share options	20,667	44,789
Special warrants	2,762,916	3,981,252
Dilutive shares on conversion of convertible debentures	17,254,654	16,620,885
Weighted average number of shares outstanding used to calculate diluted earnings per share	35,429,335	34,243,661

10. Cash and cash equivalents

	2016	2015
	\$	\$
Cash and cash equivalents:		
Cash	1,118,297	2,725,043
Restricted cash and cash equivalents:		
Cash	-	200,000
Short-term investments	528,023	515,167
	528,023	715,167
	1,646,320	3,440,210

Restricted cash relates to \$528,023 (2015 - \$515,167) deposited as collateral for letters of credit issued to customers for performance security and the restricted short-term investments is related to a performance bond. The Company was subject to a debt covenant in connection with its 12.75% debenture, as described in note 17, which required the Company to maintain an unrestricted cash balance (2015 - \$200,000) at the end of each quarter. Given this amount was required to be on hand and otherwise unencumbered at each reporting period, the Company had presented this balance within restricted cash.

The restricted cash and short-term investments are not available for general use by the Company.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

11. Accounts receivable

The aging of the trade receivables as at December 31 was as follows:

	2016		2015	
	\$		\$	
0-30 days	2,959,966	42%	459,515	17%
31-60 days	1,422,234	20%	933,469	35%
61-90 days	1,071,006	15%	156,123	6%
91-120 days	956,702	13%	244,742	9%
Over 120 days	714,457	10%	905,091	33%
	7,124,365	100%	2,698,940	100%

Accounts receivable in the amount of \$437,031 (2015 - \$905,091) (net of allowance for doubtful debts) relate to holdbacks associated with project completion and commissioning.

The gross amount due from customers for construction contracts at December 31, 2016 is \$7,033,531 (2015 - \$2,629,344).

Allowance for doubtful debts	2016	2015
	\$	\$
Balance at beginning of the year	856,618	433,359
Impairment losses recognized	201,322	425,481
Amounts written off during the year as uncollectible	(184,440)	(47,182)
Amounts recovered during the year	(199,957)	44,960
	673,543	856,618

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.

12. Inventories

	2016	2015
	\$	\$
Raw materials	43,283	91,619
Finished goods	421,032	609,561
	464,315	701,180

The total amount of inventories included in cost of goods sold for the year was \$8,448,605 (2015 - \$8,009,126).

The cost of inventories recognized as an expense includes \$nil (2014 - \$nil) in respect of write-downs of inventories to net realizable value.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

13. Equipment and leasehold improvements

	Research & production equipment	Office equipment	Leasehold improvements	Total
	\$	\$	\$	\$
Cost				
At December 31, 2014	1,440,488	694,434	352,701	2,487,623
Additions	6,464	-	-	6,464
Disposals	(6,560)	-	-	(6,560)
Exchange differences	91,661	19,908	3,439	115,008
At December 31, 2015	1,532,053	714,342	356,140	2,602,535
Additions	11,960	-	-	11,960
Disposals	-	-	-	-
Exchange differences	(16,666)	(3,620)	(625)	(20,911)
At December 31, 2016	1,527,347	710,722	355,515	2,593,584
Accumulated depreciation				
At December 31, 2014	1,309,303	596,937	343,020	2,249,260
Charge for the year	74,315	17,706	2,529	94,550
Disposals	-	-	-	-
Exchange differences	89,038	18,538	3,440	111,016
At December 31, 2015	1,472,656	633,181	348,989	2,454,826
Charge for the year	29,842	18,638	2,489	50,969
Disposals	-	-	-	-
Exchange differences	(13,246)	(2,888)	(625)	(16,759)
At December 31, 2016	1,489,252	648,931	350,853	2,489,036
Carrying amount				
At December 31, 2015	59,397	81,161	7,151	147,709
At December 31, 2016	38,095	61,791	4,662	104,548

Depreciation of \$40,503 (2015 - \$36,767) has been recognized in cost of goods sold, \$3,339 (2015 - \$46,890) has been recognized in research and development expenses and \$7,127 (2015 - \$10,893) has been recognized in general and administration expenses.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

14. Provisions

<i>Warranty</i>	2016	2015
	\$	\$
Balance, beginning of year	379,411	352,365
Provisions used during the year	(95,258)	(253,791)
Provisions made during the year	219,899	280,837
	504,052	379,411

15. Contingency

The Company along with multiple other defendants is subject to a claim for \$12 million for damages related to an explosion at a waste water treatment plant in Ontario in 2014. The Company believes that the allegations contained in the statement of claim are without merit and plans to vigorously defend itself. Consequently no provision has been made for this claim.

16. Long-term debt

	2016	2015
	\$	\$
12.75% debenture (maturity amount - \$885,000; 2014 - \$1,655,000)	-	885,000
8% convertible debentures Series 1 (maturity amount; \$671,080; 2014 - \$798,094)	700,370	671,081
8% convertible debentures Series 2 (maturity amount \$1,413,585; 2014 - \$1,366,632)	1,465,199	1,318,335
	2,165,569	2,874,416
Less: Current Portion	(2,165,569)	(2,874,416)
Long-term debt	-	-

a) 12.75% Debenture

In 2008, the Company issued a debenture which bears interest at 12.75% per annum, payable monthly.

The debenture was secured by a general security agreement covering all assets of the Company was subject to meeting certain financial covenants each quarter. In relation to the issuance of the debenture, the Company issued 1,153,846 special warrants which are exercisable into 1,153,846 share purchase warrants, each of which was exercisable to acquire one common share of the Company upon payment of the exercise price of \$0.65 per share. The share purchase warrants expired October 31, 2013 and no warrants had been exercised to that date.

2015 activities

In March 31, 2015, the Company signed an amendment to the 12.75% debenture agreement, amending the repayment terms. Under the revised terms, \$200,000 of principal was due March 31, 2015, \$50,000 on July 31, 2015, \$200,000 on August 31, 2015, \$50,000 on each of September, October and November 2015 and the balance on December 31, 2015.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

16. Long-term debt (continued)

a) 12.75% Debenture (continued)

2016 activities

On January 29, 2016 the Company signed an amendment to the 12.75% debenture agreement, amending the repayment terms. Under the revised terms, \$75,000 of principal was due each month until the debenture was repaid.

The entire amount of the 12.75% debenture was repaid in 2016 in accordance with the amended repayment terms.

During the year ended December 31, 2016, the Company paid \$885,000 (2015 – \$770,000) in principal and \$60,278 (2015 - \$177,042) in interest on the debenture.

b) 8% convertible debentures

Series 1

On May 4, and June 4, 2012, the Company issued 8% convertible secured subordinated debentures (the “Debentures”) for combined proceeds of \$659,000. The Debentures had a maturity date of two years from the date of issuance and are 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.

The Debentures can be prepaid in full at any time without penalty by the Company upon giving holders 15 days’ notice of prepayment. Interest on the Debentures accrues at a rate of 8% per annum and is payable at maturity. Due to the conversion feature, the Debentures were accounted for as compound financial instruments.

The convertible debentures contain an extension clause that allows the Company to extend the maturity date of the convertible debentures by up to five years if holders of not less than 66 2/3% of the outstanding principal amount agree to such an extension. Similarly, the convertible debentures contain a conversion clause that requires all holders to convert their convertible debentures into common shares at the rates set out above, if holders of not less than 66 2/3% of the outstanding principal amount agree to such a conversion.

In conjunction with the issue of the Debentures, 1,850,472 common share purchase warrants were issued. 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. (see note 18)

A discount rate of 15% was used to calculate the fair value of the liability portion of the Debentures with the difference between the fair value and proceeds being ascribed to the share purchase warrants and conversion feature, on a relative fair value basis. The difference between the contractual amount of the Debentures and the fair value of the liability portion of the Debentures was calculated to be \$74,994 and has been recognized as share purchase warrants and contributed surplus issued within shareholders’ equity for the amounts of \$24,992 and \$50,002 relating to the warrants and conversion feature respectively. The difference between the contractual amount of the debentures and the fair value of the liability portion of the Debentures were recognized as a finance cost with a corresponding increase in the carrying amount of the Debentures using the effective interest method over 24 months. Finance costs of \$54,983 were recorded with the Debentures and were recognized as an expense using the effective interest method over 24 months.

On April 21, 2014 the holders of the Series 1 2012 convertible debentures agreed to extend the maturity date of the debentures to May 5, 2015. All other terms of the convertible debentures remain the same.

The net present value of the future cash flows under the extended term were greater than 10% different than the net present value of the remaining cash flows immediately prior to the extension consequently under IFRS the extension represents a significant modification to the original instrument and is therefore considered to be an extinguishment of debt and reissuance of new debt. A discount rate of 15% was used to calculate the fair value and the carrying value was ascribed to the conversion feature and recorded to contributed surplus.

On May 5, 2015 the holders of the Series 1 2012 convertible debentures agreed to extend the maturity date of the debentures to August 16, 2016. All other terms of the convertible debentures remained the same.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

16. Long-term debt (continued)

b) 8% convertible debentures (continued)

The net present value of the future cash flows under the extended term were less than 10% different than the net present value of the remaining cash flows immediately prior to the extension consequently under IFRS the extension did not represent a significant modification to the original instrument and is therefore not considered to be an extinguishment of debt and reissuance of new debt.

2016 Activities

On August 2, 2016 the maturity date of the Series 1 convertible debentures was extended to November 16, 2016.

On November 10, 2016 the maturity date of the Series 1 convertible debentures, was extended to December 16, 2016.

On December 6, 2016 the maturity date of the Series 1 convertible debentures, was extended to January 6, 2017.

On January 5, 2017 the maturity date of the Series 1 convertible debentures, was extended to January 16, 2017.

On January 16, 2017 the maturity date of the Series 1 convertible debentures, was extended to January 30, 2017.

During the year debenture holders converted \$9,000 (2015 – \$140,000) of principal and \$2,683 (2015 - \$36,756) of accrued interest into 65,633 (2015 - 993,021) common shares.

As at December 31, 2016 the outstanding principal amounts plus accrued interest of the convertible debentures have been classified as a current liability due to their maturity on January 6, 2017.

In January 2017 all of the outstanding 8% Series 1 convertible debentures plus accrued interest were converted into common shares. See note 23. Subsequent events.

Series 2

On July 25, and August 16, 2012, the Company issued 8% convertible secured subordinated debentures ("Series 2") for combined proceeds of \$1,116,000. The Series 2 Debentures had a maturity date of two years from the date of issuance and are 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 \$0.11 per common share.

The Series 2 Debentures can be prepaid in full at any time by the Company upon giving holders 15 days' notice of prepayment. Interest on the Series 2 Debentures accrues at a rate of 8% per annum and is payable at maturity. Due to the conversion feature, the Series 2 Debentures were accounted for as compound financial instruments.

The Series 2 convertible debentures contain an extension clause that allow the Company to extend the maturity date of the Series 2 convertible debentures by up to five years if holders of not less than 66 2/3% of the outstanding principal amount agree to such an extension. Similarly, the Series 2 convertible debentures contain a conversion clause that requires all holders to convert their convertible debentures into common shares at the rates set out above, if holders of not less than 66 2/3% of the outstanding principal amount agree to such a conversion.

In conjunction with the issue of the Series 2 Debentures, 5,072,220 common share purchase warrants were issued. Each warrant entitles the holder to purchase one common share at a price of \$0.11 per share for a period of two years from issuance. (See note 18)

A discount rate of 15% was used to calculate the fair value of the liability portion of the Series 2 Debentures with the difference between the fair value and proceeds being ascribed to the share purchase warrants and conversion feature. The difference between the contractual amount of the Series 2 Debentures and the fair value of the liability portion of the Series 2 Debentures was calculated to be \$127,000 and was recognized as share purchase warrants and contributed surplus issued within shareholders' equity for the amounts of \$42,331 and \$84,669 relating to the warrants and conversion factor respectively. The difference between the contractual amount of the Series 2 Debentures and the fair value of the liability portion of the Series 2 Debentures were recognized as a finance cost with a corresponding increase in the carrying amount of the Series 2 Debentures using the effective interest method over 24 months. Finance costs of

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

16. Long-term debt (continued)

b) 8% convertible debentures (continued)

\$32,744 were recorded with the Series 2 Debentures and were recognized as an expense using the effective interest method over 24 months.

On July 25, 2014 the holders of the Series 2 2012 convertible debentures agreed to extend the maturity date of the debentures to August 16, 2016. All other terms of the convertible debentures remain the same.

The net present value of the future cash flows under the extended term were greater than 10% different than the net present value of the remaining cash flows immediately prior to the extension consequently under IFRS the extension represents a significant modification to the original instrument and is therefore considered to be an extinguishment of debt and reissuance of new debt. A discount rate of 15% was used to calculate the fair value and the carrying value was ascribed to the conversion feature and recorded to contributed surplus.

2016 Activities

During the year \$10,000 (2015 – nil) of debenture were repaid and holders converted \$20,000 (2015 - \$10,000) of principal and \$6,306 (2015 – \$2,288) of accrued interest into 239,143 (2015 - 111,711) common shares.

On August 2, 2016 the maturity date of the Series 2 convertible debentures was extended to November 16, 2016.

On November 10, 2016 the maturity date of the Series 2 convertible debentures, was extended to December 16, 2016.

On December 6, 2016 the maturity date of the Series 2 convertible debentures, was extended to January 6, 2017.

On January 5, 2017 the maturity date of the Series 2 convertible debentures, was extended to January 16, 2017.

On January 16, 2017 the maturity date of the Series 2 convertible debentures, was extended to January 30, 2017.

As at December 31, 2016 the outstanding principal amounts plus accrued interest of the convertible debentures have been classified as a current liability due to their maturity on January 6, 2017.

In January 2017 all of the outstanding 8% Series 2 convertible debentures plus accrued interest were converted into common shares. See note 23. Subsequent events.

17. Issued capital

	2016		2015	
Common shares	#	\$	#	\$
Balance, beginning of year	15,169,046	13,723,800	12,989,064	13,352,462
Issued:				
Conversion of debentures	304,776	37,989	1,104,723	189,044
Exercise of options	-	-	69,999	13,269
Exercise of warrants	207,072	27,292	1,005,260	169,025
Balance, end of year	15,680,894	13,789,081	15,169,046	13,723,800

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.

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

17. Issued capital (continued)

Share purchase warrants 2012 Series 1

In connection with the May 2012 issue of Series 1 8% convertible secured subordinated debentures, the Company issued 1,850,472 share purchase warrants which entitle the holder to purchase one common share at a price of \$0.178 per share.

On May 5, 2015 in conjunction with the extension of the maturity date of the Series 1 convertible debentures, the expiry date of the 1,850,472 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, was extended to August 16, 2016.

On August 2, 2016 in conjunction with the extension of the maturity date of the Series 1 convertible debentures, the expiry date of the 1,222,240 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, was extended to November 16, 2016.

On November 10, 2016 in conjunction with the extension of the maturity date of the Series 1 convertible debentures, the expiry date of the 1,222,240 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, was extended to December 16, 2016.

On December 6, 2016 in conjunction with the extension of the maturity date of the Series 1 convertible debentures, the expiry date of the 1,222,240 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, was extended to January 6, 2017.

On January 5, 2017 in conjunction with the extension of the maturity date of the Series 1 convertible debentures, the expiry date of the 1,222,240 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, was extended to January 16, 2017.

During the year 25,272 (2015- 602,960) 2012 Series 1 share purchase warrants were exercised for common shares.

Share purchase warrants 2012 Series 2

In July 2012, the Company issued 5,072,220 share purchase warrants in connection with the issue of Series 2 8% convertible secured subordinated debentures. These share purchase warrants entitle the holder to purchase one common share at a price of \$0.11 per share.

On July 25, 2014, in conjunction with the extension of the maturity date of the Series 2 convertible debentures, the expiry date of the 5,072,220 outstanding common share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, was extended to August 16, 2016.

On August 2, 2016 in conjunction with the extension of the maturity date of the Series 2 convertible debentures, the expiry date of the 4,488,210 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, was extended to November 16, 2016.

On November 10, 2016 in conjunction with the extension of the maturity date of the Series 2 convertible debentures, the expiry date of the 4,488,210 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, was extended to December 16, 2016.

On December 6, 2016 in conjunction with the extension of the maturity date of the Series 2 convertible debentures, the expiry date of the 4,488,210 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, was extended to January 6, 2017.

On January 5, 2017 in conjunction with the extension of the maturity date of the Series 2 convertible debentures, the expiry date of the 4,488,210 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, was extended to January 16, 2017.

During the year 181,800 (2015 – 402,300) 2012 Series 2 share purchase warrants were exercised for common shares.

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December 31, 2016 and 2015

17. Issued capital (continued)

8% convertible debentures (note 17)

\$659,000 8% convertible debentures Series 1 were issued in May 2012. \$510,000 plus accrued interest of these debentures are convertible at the option of the holder to common shares at a conversion price of \$0.178 per share prior to the maturity date of the debenture on January 16, 2017.

During the year \$9,000 (2015-\$140,000) of Series 1 convertible debentures plus accrued interest were converted to common shares.

\$1,116,000 8% convertible debentures Series 2 were issued in July 2012. \$1,076,000 plus accrued interest of these debentures are convertible at the option of the holder to common shares at a conversion price of \$0.11 per share prior to the maturity date of the debenture on January 16, 2017.

During the year \$20,000 (2015-\$10,000) of Series 2 convertible debentures plus accrued interest were converted to common shares.

18. Stock-based compensation

The Company uses an equity settled employee share 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 share 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.

a) Share options granted under the employee share option plan

As at December 31, 2016, executives and employees held options for 457,000 common shares (of which 75,244 were unvested), in aggregate, which expire over the period from March 4, 2017 to July 13, 2026. As at December 31, 2015, executives and employees held options for 447,000 common shares, in aggregate, which expire over the period from December 18, 2016 to June 23, 2025. Share options granted under the employee share option plan carry no rights to dividends and no voting rights.

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

	2016	2015
		\$
Weighted average fair value of each option	0.25	0.27
Assumptions		
Weighted average share price	0.28	0.30
Weighted average exercise price	0.28	0.30
Expected volatility	100%	100%
Risk free interest rate	1%	2%
Expected life in years	10 years	10 years
Forfeiture rate	18%	18%
Expected dividend yield	0%	0%

Expected volatility was determined based on historical volatility over the expected life of the options.

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December 31, 2016 and 2015

18. Stock-based compensation (continued)

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

	2016		2015	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
		\$		\$
Outstanding, beginning of year	447,000	0.76	1,075,666	1.13
Options forfeited	-	-	-	-
Options expired	(50,000)	1.50	(608,667)	1.48
Options exercised	-	-	(69,999)	0.14
Granted	60,000	0.28	50,000	0.30
Outstanding, end of year	457,000	0.62	447,000	0.76

ii) Options outstanding and exercisable at December 31, 2016:

Number outstanding	Exercise price	Remaining life in years	Number exercisable	average exercise price
	\$			\$
17,500	1.75	0.2	17,500	1.75
22,000	1.70	0.4	22,000	1.70
50,000	1.11	1.0	50,000	1.11
22,000	0.90	1.4	22,000	0.90
74,500	0.68	3.4	74,500	0.68
75,000	0.48	2.0	75,000	0.48
22,000	0.33	2.4	22,000	0.33
20,000	0.34	4.5	20,000	0.34
12,000	0.19	6.5	8,000	0.19
12,000	0.11	4.5	12,000	0.11
20,000	0.10	5.5	20,000	0.10
50,000	0.30	8.5	8,674	0.30
60,000	0.28	9.5	9,369	0.28
457,000	0.76	4.1	361,043	0.62

19. Employee benefits

	2016	2015
	\$	\$
Wages and salaries	2,772,298	2,732,550
Compulsory social security contributions	162,526	180,072
Contributions to defined contribution plans	183,122	176,047
Stock-based compensation	4,068	3,200
	3,122,014	3,091,869

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

20. Related party transactions

Compensation of key management personnel

The remuneration of directors and other members of key management, all of which was incurred in the normal course of operations during the year was as follows:

	2016	2015
	\$	\$
Short-term benefits	596,897	541,172
Stock-based compensation	4,068	3,200
	<u>600,965</u>	<u>544,372</u>

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, and bonuses.

21. Commitments

The Company is a party to operating leases which relate to leases of a building, property and computer equipment with lease terms of between 1 and 5 years. The Company does not have an option to purchase the leased property at the expiry of the lease periods.

i) Payments recognized as an expense

	2016	2015
	\$	\$
Minimum lease payments	<u>231,919</u>	<u>219,561</u>

ii) Non-cancellable operating lease commitments

	2016	2015
	\$	\$
Not later than 1 year	135,772	132,164
Later than 1 year and not later than 5 years	223,222	319,724
More than 5 years	-	-
	<u>358,994</u>	<u>451,888</u>

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Notes to the consolidated financial statements

December 31, 2016 and 2015

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. The Company's credit risk and related risk management practice remain unchanged from the prior year.

The carrying amount of financial assets 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 subsidiary in the US. US operations are conducted primarily in US 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 and compared with operating budgets and forecasts. The Company's sales are primarily in Canadian and US dollars. The Company's objective of managing foreign currency risk is to mitigate or eliminate the losses incurred. There have been no changes to the objective or the related risk exposure from the prior year.

At December 31, 2016 and 2015, the Company held no forward exchange contracts.

The carrying amounts of the Company's foreign currency denominated monetary assets and monetary liabilities at the balance sheet date are as follows:

	Assets		Liabilities	
	2016	2015	2016	2015
	\$	\$	\$	\$
United States dollars	3,495,043	2,913,666	3,112,494	655,336
Chinese renminbi	1,390,274	1,887,847	456,224	818,513

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

22. Financial instruments (continued)

a) Financial and capital risk management (continued)

ii) Market risks (continued)

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 positive number below indicates an increase in profit and other comprehensive income 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 profit and other comprehensive income, and the balances below would be negative.

	United States dollar impact	
	2016	2015
	\$	\$
Profit or loss	38,255	291,367
Other comprehensive income	3,245	4,646

iii) Interest rate risk

The Company is not exposed to short-term fluctuations in interest rates as the Company has no short-term borrowings and the interest rate on the Company's long-term debt is fixed. The Company is currently accruing a fixed rate of interest of 8% on the convertible debentures. The Company's series 1 and series 2 8% convertible debentures are scheduled to mature in January 2017. 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 Company's sensitivity to interest rates has been significantly reduced from the prior year.

iv) 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. There have been no changes to the Company's objectives during the year. The Company's financial liabilities include accounts payable and accrued liabilities, unearned revenue and contract advances as well as debentures.

A maturity analysis as at December 31, 2016 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.

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Notes to the consolidated financial statements

December 31, 2016 and 2015

23. Financial instruments (continued)

a) Financial and capital risk management (continued)

iv) Liquidity risk (continued)

	Carrying Amount	Contractual Cash Flow	Less than 1 month	1-3 months	3 months to 1 year	1+ years	Total
	\$	\$	\$	\$	\$	\$	\$
2016							
Accounts payable	2,963,576	2,963,576	2,963,576	-	-	-	2,963,576
Accrued liabilities	711,949	711,949	711,949	-	-	-	711,949
Current portion LTD	2,165,571	2,171,131	2,171,131	-	-	-	2,171,131
Long-term debt	-	-	-	-	-	-	-
	<u>5,841,096</u>	<u>5,846,656</u>	<u>5,846,656</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>5,846,656</u>
2015							
Accounts payable	1,794,540	1,794,540	1,794,540	-	-	-	1,794,540
Accrued liabilities	1,040,870	1,040,870	1,040,870	-	-	-	1,040,870
Current portion LTD	2,874,416	3,102,873	-	283,319	2,819,555	-	3,102,874
Long-term debt	-	-	-	-	-	-	-
	<u>5,709,826</u>	<u>5,938,283</u>	<u>2,835,410</u>	<u>283,319</u>	<u>2,819,555</u>	<u>-</u>	<u>5,938,284</u>

v) 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 is managed by evaluating shareholders' equity and long-term debt of the Company.

Shareholders' equity and long-term debt at end of the reporting period was as follows:

	2016	2015
	\$	\$
Shareholders' equity	2,426,948	1,933,405
Long-term debt including current portion	2,165,169	2,874,416
<u>Total shareholders' equity and long-term debt</u>	<u>4,592,117</u>	<u>4,807,821</u>

Biorem Inc.

Notes to the consolidated financial statements

December 31, 2016 and 2015

22. Financial instruments (continued)

b) Financial instruments

Categories and fair value of financial instruments

	2016		2015	
	Carrying amount	Fair value	Carrying amount	Fair value
	\$	\$	\$	\$
Financial assets				
Cash and cash equivalents	1,118,297	1,118,297	2,725,043	2,725,043
Restricted cash and cash equivalents	528,023	528,023	715,167	715,167
Accounts receivable	7,124,365	7,124,365	2,698,940	2,698,940
	8,770,685	8,770,685	6,139,150	6,139,150
Financial liabilities				
Accounts payable and accrued liabilities	3,675,525	3,675,525	2,835,411	2,835,411
Long term-debt including current portion	2,165,569	2,165,569	2,874,416	2,969,665
	5,841,094	5,841,094	5,709,827	5,805,076

The Company has determined that the fair value of its short-term financial assets and liabilities approximates their respective carrying amounts because of the short-term maturity of those instruments. The fair value of long-term debt has been determined using a discounted cash flow model based on discount rates ranging from 15.0% to 17.5 %, representing interest rates in effect as at the year-end date available to the Company for the same or similar debt instruments.

23. Subsequent Events

- i) On January 5, 2017, the maturity dates of the Series 1 and 2 convertible debentures were extended to January 16, 2017.

In conjunction with the extension of the maturity dates of the Series 1 and 2 convertible debentures, the expiry dates of the 1,222,240 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, and the 4,488,210 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, were extended to January 16, 2017.

- ii) On January 16, 2017, the maturity dates of the Series 1 and 2 convertible debentures were extended to January 30, 2017.

In conjunction with the extension of the maturity dates of the Series 1 and 2 convertible debentures, the expiry dates of the 1,165,320 outstanding share purchase warrants that were issued in 2012 with the Series 1 convertible debentures as a unit, and the 4,545,000 outstanding share purchase warrants that were issued in 2012 with the Series 2 convertible debentures as a unit, were extended to January 30, 2017.

- iii) In January 2017 \$2,159,929 of convertible debentures including accrued interest were converted into common shares resulting in the issuance of 17,203,304 common shares.

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Notes to the consolidated financial statements

December 31, 2016 and 2015

23. Subsequent Events (continued)

- iv) In January 2017 1,165,320 share purchase warrants were exercised at \$0.11 resulting in cash proceeds to the Company of \$223,165 and the issuance of 1,165,320 common shares.
- v) In January 2017 4,545,000 share purchase warrants were exercised at \$0.178 resulting in net cash proceeds to the Company of \$495,241 and the issuance of 4,545,000 common shares.
- vi) On January 27, 2017 the Company received conditional approval to amend the stock option plan to increase the number of reserves for issuance under the plan to 5,300,000 shares. The amendment to the Plan must receive disinterested shareholder approval at the shareholders meeting to be held in June 2017.
- vii) On January 31, 2017 the Company granted incentive stock options to employees and officers to purchase an aggregate 3,130,000 common shares of the Company, subject to approval of the amended and restated plan and such options at the next annual meeting of the shareholders.

The stock options have an exercise price of \$0.345 per share, and vest over three years with a ten year expiry date of January 31, 2027. Upon granting of the options the Company will have 3,607,000 options outstanding.