

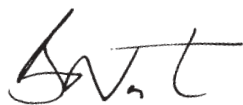
## management's responsibility for financial reporting

The management of the Company is responsible for the preparation of the accompanying consolidated financial statements. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and, where appropriate, include estimates based on careful judgment. Management has determined these amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Financial information contained elsewhere in this annual report is consistent with the consolidated financial statements.

The Company maintains a system of internal accounting and administrative controls that are designed to provide reasonable assurance, at a reasonable cost, that the financial information is accurate and reliable and that the assets are appropriately accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility through an Audit Committee, which includes three non-management Directors, and meets periodically with management and the external auditors, Ernst & Young LLP. The auditors have unrestricted access to the Audit Committee. The Audit Committee reviews the Company's quarterly and annual consolidated financial statements and recommends their approval by the Board. The Committee also recommends the appointment of the external auditors who are appointed at the Company's annual shareholders' meeting.

The consolidated financial statements have been audited by Ernst & Young, on behalf of the shareholders, in accordance with Canadian generally accepted auditing standards.



Brent Norton  
President and CEO



Ron Hosking  
Vice President, Finance, and Chief Financial Officer

Toronto, Canada  
April 30, 2004

## auditors' report

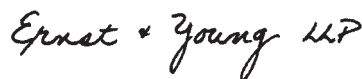
To the Shareholders of **IMI International Medical Innovations Inc.**

We have audited the consolidated balance sheets of **IMI International Medical Innovations Inc.** as at December 31, 2003 and 2002 and the consolidated statements of loss and deficit and cash flows for the years ended December 31, 2003 and 2002 and the 11-month period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years ended December 31, 2003 and 2002 and the 11-month period ended December 31, 2001 in accordance with Canadian generally accepted accounting principles.

As described in note 2 to the consolidated financial statements, the Company changed its method of accounting for stock-based compensation in 2003.



Chartered Accountants

Toronto, Canada  
March 5, 2004

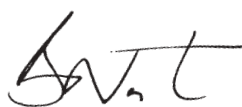
## consolidated balance sheets

(In Canadian dollars)

	AS AT DECEMBER 31,	
	2003 \$	2002 \$
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	61,625	150,451
Short-term investments	6,635,135	9,961,743
Prepaid expenses and other receivables	340,489	237,591
Investment tax credits receivable	180,000	271,000
<b>Total current assets</b>	<b>7,217,249</b>	10,620,785
Capital assets, net (note 3)	403,205	191,632
Acquired technology, net of accumulated amortization of \$693,684 (2002 – \$580,291) (note 4(d)(ii))	453,573	566,966
	<b>8,074,027</b>	11,379,383
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable	139,435	180,303
Accrued liabilities	403,213	409,252
<b>Total current liabilities</b>	<b>542,648</b>	589,555
Deferred revenue (note 6(a))	93,100	100,000
<b>Total liabilities</b>	<b>635,748</b>	689,555
Commitments (note 6)		
<b>Shareholders' equity</b>		
Capital stock (note 4)	24,780,846	23,785,884
Warrants (notes 4(d) and 6(b)(iv))	312,200	496,000
Deficit	(17,654,767)	(13,592,056)
<b>Total shareholders' equity</b>	<b>7,438,279</b>	10,689,828
	<b>8,074,027</b>	11,379,383

SEE ACCOMPANYING NOTES

On behalf of the Board:



Brent Norton  
Director



Stephen A. Wilgar  
Director

## consolidated statements of loss and deficit

(In Canadian dollars)

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003 \$	2002 \$	2001 \$
<b>EXPENSES</b>			
Research and development	1,918,800	2,104,904	2,047,116
General and administration	2,361,602	2,141,207	1,500,434
Amortization	280,777	219,466	215,236
	<b>4,561,179</b>	4,465,577	3,762,786
<b>RECOVERIES AND OTHER INCOME</b>			
Investment tax credits	223,146	189,908	131,000
Interest	275,322	257,407	386,580
	<b>498,468</b>	447,315	517,580
<b>Net loss for the period</b>	<b>(4,062,711)</b>	(4,018,262)	(3,245,206)
Deficit, beginning of period	<b>(13,592,056)</b>	(9,573,794)	(6,328,588)
<b>Deficit, end of period</b>	<b>(17,654,767)</b>	(13,592,056)	(9,573,794)
<b>Basic and diluted loss per share</b>	<b>\$(0.19)</b>	\$(0.20)	\$(0.17)
<b>Weighted average number of common shares outstanding</b>	<b>20,967,677</b>	20,406,733	19,097,390

SEE ACCOMPANYING NOTES

## consolidated statements of cash flows

(In Canadian dollars)

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003	2002	2001
	\$	\$	\$
<b>OPERATING ACTIVITIES</b>			
Net loss for the period	(4,062,711)	(4,018,262)	(3,245,206)
Add items not involving cash			
Amortization	280,777	219,466	215,236
Stock compensation costs included in:			
Research and development expense	189,105	81,905	—
General and administration expense	255,112	36,483	—
Loss on sale of capital asset	3,873	—	1,139
	<b>(3,333,844)</b>	(3,680,408)	(3,028,831)
Net change in non-cash working capital balances related to operations (note 7)	(61,870)	130,841	(209,865)
<b>Cash used in operating activities</b>	<b>(3,395,714)</b>	(3,549,567)	(3,238,696)
<b>INVESTING ACTIVITIES</b>			
Short-term investments	3,326,608	(2,603,943)	642,836
Purchase of acquired technology (note 4(d)(ii))	—	—	(381,507)
Purchase of capital assets	(385,605)	(20,804)	(275,492)
Proceeds on sale of capital asset	2,775	—	2,376
<b>Cash provided by (used in) investing activities</b>	<b>2,943,778</b>	(2,624,747)	(11,787)
<b>FINANCING ACTIVITIES</b>			
Issuance of capital stock, net of issue costs	363,110	5,731,386	1,278,328
<b>Cash provided by financing activities</b>	<b>363,110</b>	5,731,386	1,278,328
<b>Net decrease in cash and cash equivalents during the period</b>	<b>(88,826)</b>	(442,928)	(1,972,155)
Cash and cash equivalents, beginning of period	150,451	593,379	2,565,534
<b>Cash and cash equivalents, end of period</b>	<b>61,625</b>	150,451	593,379
<b>Represented by:</b>			
Cash	61,625	148,270	376,190
Cash equivalents	—	2,181	217,189
	<b>61,625</b>	150,451	593,379

SEE ACCOMPANYING NOTES

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

### 1. NATURE OF THE COMPANY AND BASIS OF PRESENTATION

IMI International Medical Innovations Inc. (the “Company”) operates in a single business segment and is a predictive medicine company dedicated to developing rapid, non-invasive tests for the early detection of life-threatening diseases, particularly cardiovascular disease and cancer. The Company licenses, develops and initiates the commercialization of novel medical technologies developed by various research institutions throughout the world.

The Company currently owns patents for a test used to measure skin cholesterol and has in-licensed the technologies for tests to detect the presence of a cancer-specific marker for use in colorectal, lung and other cancers. In addition, the Company has patents pending for color measurement in biological reactions and has a right of first refusal on certain genomics-related technologies in the predictive medicine field.

In December 2001, the Company changed its fiscal year end from January 31 to December 31, therefore comparative consolidated statements of loss and deficit and cash flows are presented for the 11-month period ended December 31, 2001.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**New pronouncements** Effective January 1, 2003, the Company adopted the guidelines relating to the disclosure by a guarantor in its financial statements about obligations under certain types of guarantees that it has issued as required by The Canadian Institute of Chartered Accountants’ (“CICA”) Accounting Guideline No. 14, “Disclosure of Guarantees.” The adoption of this pronouncement had no effect on the Company’s consolidated financial statements.

Effective January 1, 2004, the Company will adopt CICA Handbook Section 3063, “Impairment of Long-Lived Assets,” that was issued during 2003. Adopting this section will impact the recognition, measurement and disclosure of the impairment of long-lived assets on a prospective basis. A loss is recognized on a long-lived asset held for use when its carrying value exceeds the undiscounted cash flows from its use and disposition. The amount of the loss is determined by deducting the asset’s fair value (based on discounted cash flows) from its carrying value. Previously, the loss was determined by deducting the asset’s net recoverable value (based on undiscounted cash flows) from its carrying value. The

Company has reviewed its policies and determined that there is no impact as a result of the Company adopting this section.

During 2003, the CICA issued Accounting Guideline No. 15, “Consolidation of Variable Interest Entities” (“AcG-15”). AcG-15 sets out the criteria for identifying variable interest entities and criteria for determining what entity, if any, should consolidate them. The Company will adopt the disclosure requirements of AcG-15 effective January 1, 2004 and is currently reviewing the impact of the Guideline.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) consistently applied within the framework of the significant accounting policies summarized below. With respect to the consolidated financial statements of the Company, the significant differences between Canadian and U.S. generally accepted accounting principles (“U.S. GAAP”) are described and reconciled in note 8.

**Basis of consolidation** The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, IMI International Medical Innovations Inc. Berne, incorporated under the laws of Switzerland. All significant intercompany transactions and balances have been eliminated upon consolidation.

**Revenue recognition** License revenue is recognized over the term of the related license.

**Foreign currency translation** Foreign operations are considered integrated and are translated using the temporal method. Monetary items are translated using the exchange rate in effect at the period end and non-monetary items are translated at historical exchange rates. Revenue and expenses are translated at the average rate for the period except for amortization of capital assets, which is translated at the same exchange rates as the assets to which they relate. Exchange gains or losses are included in the determination of net loss for the period.

**Cash and cash equivalents** Cash and cash equivalents comprise cash on hand and highly liquid investments that are readily convertible into cash with maturities of less than 90 days when purchased. Cash equivalents at December 31, 2003 were comprised of money market funds with an average interest rate of 2.6% (2002 – 2.6%).

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

**Short-term investments** Short-term investments are carried at the lower of cost and market. Short-term investments at December 31, 2003 were comprised of bonds and bankers' acceptances with interest rates of approximately 2.6% (2002 – 2.8%). Short-term investments are comprised of highly liquid investments with maturity periods greater than 90 days but less than one year when purchased.

**Capital assets** Capital assets are recorded at acquisition cost less accumulated amortization.

The Company provides for amortization on a declining balance basis at rates which are expected to charge operations with the cost of the assets over their estimated useful lives as follows:

Computer equipment	30%
Furniture and equipment	20%
Research instrumentation	30%
Laboratory equipment	20%
Leasehold improvements	straight-line over the term of the lease

**Acquired technology** Patents and technology acquired by the Company are recorded at acquisition cost and are amortized on a declining balance basis at 20% per year. The Company records a write down in acquired technology when there is a change in circumstances, such as unfavorable clinical trial results, suggesting an impairment has occurred.

**Guarantees** Many of the Company's agreements, specifically those related to financing, research and development and supply arrangements, include indemnification provisions where the Company may be required to make payment to the counterparty. Such payments relate to personal injury resulting from clinical trials and from breach of fundamental representation and warranty terms in the agreements with respect to matters such as corporate status, title of assets, consents to transfer, employment matters, litigation and other potential material liabilities. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is not reasonably quantifiable as certain indemnifications are not subject to a monetary limitation. At December 31, 2003, management believes there is only a remote possibility that the indemnification provisions would require any material cash payment.

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for its directors and officers.

**Financial instruments** The carrying values of cash and cash equivalents, short-term investments, other receivables and accounts payable and accrued liabilities are considered to approximate their respective fair values due to their short-term nature.

**Research and development and related investment tax credits** Research and development expenditures include related salaries, subcontractor fees, product development expenses including patent costs, clinical trials costs and an allocation of administrative expenses and corporate costs specifically attributable to research and development. Research and development excludes any costs associated with the acquisition of capital assets and acquired technology. Research and development expenditures are charged to expenses as incurred unless management believes a development cost meets the generally accepted criteria for deferral. All development costs incurred to date have been expensed. Advance collaboration funding, which is a reimbursement for specific expenditures, has been applied against research and development.

Investment tax credits earned as a result of incurring qualified scientific research and experimental development expenses are recorded when the amounts are readily determinable. The amounts are recorded as follows:

- for capital assets – as a reduction of the cost of the related asset; and
- for operating expenses – as a recovery within the consolidated statements of loss and deficit.

**Income taxes** The Company applies the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are provided if it is more likely than not that some or all of the future tax assets will not be realized.

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

**Loss per share** Loss per share has been calculated on the basis of net loss for the period divided by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method. The inclusion of the Company's stock options and warrants in the computation of diluted loss per share would have an anti-dilutive effect on loss per share. Therefore, stock options and warrants have been excluded from the calculation of diluted loss per share. Consequently, there is no difference between basic loss per share and diluted loss per share.

**Use of estimates** The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ materially from those estimates.

**Stock-based compensation** The Company has two stock-based compensation plans, which are described in notes 4(e) and (f).

Effective January 1, 2002, stock options and other equity instruments issued to non-employees and direct awards of stock granted to employees are accounted for using the fair value method of accounting. Prior to January 1, 2002, there was no recognition of stock options and equity instruments issued to non-employees as it was not prescribed by Canadian GAAP.

On January 1, 2003, the Company prospectively adopted the recommendations in CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments" ("Section 3870"). The new recommendations are generally applicable only to awards granted after the date of adoption.

Section 3870 requires that options issued to employees are accounted for using the fair value method of accounting. Previously, no compensation expense was recognized for stock options granted to employees.

For stock options awarded to employees prior to January 1, 2003 but subsequent to January 1, 2002, pro forma disclosure of net loss and loss per share is provided as if these awards were accounted for using the fair value method.

Consideration paid on the exercise of stock options and warrants is credited to capital stock.

The table below presents pro forma net loss and basic and diluted loss per common share as if stock options granted to employees between January 1, 2002 and December 31, 2002 had been determined based on the fair value method.

Effective January 1, 2002, shares issued to employees under the share purchase plan are accounted for as direct awards of stock and are recognized as an expense in the consolidated statements of loss and deficit (note 4(f)). Shares issued to employees on the exercise of options in exchange for non-recourse loans are accounted for as options.

	2003 \$	2002 \$
Net loss as reported	<b>(4,062,711)</b>	(4,018,262)
Estimated stock-based compensation costs	<b>(250,350)</b>	(713,589)
<b>Pro forma net loss</b>	<b>(4,313,061)</b>	(4,731,851)
<b>Pro forma basic and diluted loss per common share</b>	<b>\$(0.21)</b>	\$(0.23)

The assumptions used to calculate the estimated stock-based compensation costs are consistent with those used for U.S. GAAP reporting purposes (note 8(g)).

## notes to consolidated financial statements

DECEMBER 31, 2003 *(In Canadian dollars, unless otherwise noted)*

### 3. CAPITAL ASSETS

Capital assets consist of the following:

	2003		
	Cost \$	Accumulated amortization \$	Net book value \$
Computer equipment	192,671	111,659	81,012
Furniture and equipment	55,802	38,936	16,866
Research instrumentation	568,753	282,587	286,166
Laboratory equipment	25,456	9,197	16,259
Leasehold improvements	8,705	5,803	2,902
	<b>851,387</b>	<b>448,182</b>	<b>403,205</b>

	2002		
	Cost \$	Accumulated amortization \$	Net book value \$
Computer equipment	126,402	87,037	39,365
Furniture and equipment	55,802	34,719	21,083
Research instrumentation	284,312	159,944	124,368
Laboratory equipment	7,306	5,133	2,173
Leasehold improvements	8,705	4,062	4,643
	482,527	290,895	191,632

### 4. CAPITAL STOCK

**(a) Authorized** The authorized capital stock of the Company consists of an unlimited number of common shares, without nominal or par value, and an unlimited number of preferred shares, issuable in series.

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

### (b) Issued and outstanding shares

COMMON SHARES	Number #	Stated value \$	Contributed surplus \$	Total \$
<b>Balance, January 31, 2001</b>	18,655,199	16,863,108	71,054	16,934,162
Issued on exercise of warrants (note 4(d))	753,358	1,147,611	—	1,147,611
Issued under share purchase plan (note 4(f))	12,087	—	—	—
Issued on exercise of options (note 4(e))	144,750	130,717	—	130,717
<b>Balance, December 31, 2001</b>	19,565,394	18,141,436	71,054	18,212,490
Issued on exercise of warrants	4,202	25,000	—	25,000
Expiry of warrants	—	—	5,000	5,000
Issued pursuant to private placement (note 4(c))	1,200,000	5,282,196	—	5,282,196
Issuance of stock options (note 4(e))	—	—	43,234	43,234
Issued under share purchase plan (note 4(f))	9,764	47,219	—	47,219
Issued on exercise of options (note 4(e))	377,600	425,790	—	425,790
Share purchase loans (note 4(e))	(375,000)	(255,045)	—	(255,045)
<b>Balance, December 31, 2002</b>	20,781,960	23,666,596	119,288	23,785,884
Expiry of warrants	—	—	191,000	191,000
Issuance of stock options (note 4(e))	—	—	413,705	413,705
Issued under share purchase plan (note 4(f))	8,942	27,147	—	27,147
Issued on exercise of options (note 4(e))	290,000	238,070	—	238,070
Repayment of share purchase loans (note 4(e))	180,000	125,040	—	125,040
<b>Balance, December 31, 2003</b>	<b>21,260,902</b>	<b>24,056,853</b>	<b>723,993</b>	<b>24,780,846</b>

### (c) Private placement

#### (i) Year ended December 31, 2002 transactions

During the year ended December 31, 2002, the Company issued, by way of private placement, 1,200,000 common shares at a price of \$5.00 per common share for gross proceeds of \$6,000,000 less issue costs of \$529,404 (net \$5,470,596).

In connection with this offering, the Company granted to the agent compensation warrants to purchase up to 120,000 common shares at an exercise price of \$5.50 per share, exercisable at any time on or before April 2, 2003. The fair value of the warrants at the date of grant was estimated as \$188,400, using the Black-Scholes option pricing model. The assumptions used to calculate the fair value of the warrants are as follows: expected volatility of 49%, risk-free interest rate of 3.42%, and expected warrant life of one year. The warrants expired unexercised on April 2, 2003.

### (d) Warrants

#### (i) Year ended December 31, 2003 transactions

During the year ended December 31, 2003, the Company issued 10,000 warrants, pursuant to a research collaboration agreement dated October 31, 2000, at an estimated fair value of \$7,200. Under the terms of the agreement, the Company granted warrants to purchase up to 50,000 common shares at an exercise price of \$4.50, such warrants to be issued in annual increments of 10,000 warrants exercisable immediately and expiring in one year. During each of the year ended December 31, 2002 and the 11-month period ended December 31, 2001, the Company issued 10,000 of these warrants, which expired unexercised on October 31, 2003 and October 31, 2002, respectively.

For valuation purposes, the Company has applied the Black-Scholes option pricing model to determine the estimated fair value of the warrants. The assumptions used to calculate the fair value of the warrants are as follows: expected volatility of 42%, risk-free interest rate of 3.06%, and expected warrant life of one year.

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

The Company provided loans to two of its executive officers during the year ended December 31, 2002, totaling \$165,000, one executive officer during the 11-month period ended December 31, 2001 (\$60,030) and two executive officers during the year ended January 31, 1999 (\$30,015) in order to exercise options and warrants. The balance of these loans at December 31, 2003 was \$130,005 (2002 – \$255,045). The loans outstanding as at year end bear interest at 5%, are payable on demand and are unsecured. Repayments of \$125,040 were received by the Company during the year, and have been reflected as issuance of capital stock within the statement of cash flows. The amount of all loans outstanding has been deducted from capital stock until such time as the loans are repaid.

### (ii) 11-month period ended December 31, 2001 transactions

During the 11-month period ended December 31, 2001, pursuant to a license agreement, the Company granted warrants to purchase up to 75,000 common shares at an exercise price of \$4.50 which have an estimated fair value of \$108,000. The warrants are exercisable as follows: (a) 37,500 common shares at any time after March 2002 and prior to March 2004, and (b) 37,500 common shares at any time after March 2003 and prior to March 2004. Pursuant to another license agreement, the Company granted warrants to purchase up to 100,000 common shares at exercise prices ranging from \$3.50 to \$4.50, which have an estimated fair value of \$197,000 and expire in 2006. The fair values have been estimated using the Black-Scholes option pricing model.

The technologies acquired through these license agreements relate to the ColorectAlert™ License Agreement and to the Procyon License Agreement (note 6(b)(iii)). Total consideration

paid for these technologies was \$686,507, of which \$381,507 was paid in cash and the balance in warrants, with an estimated fair value of \$305,000.

During the 11-month period ended December 31, 2001, 753,358 common shares were issued for total proceeds of \$1,147,611 in connection with options granted during the years ended January 31, 2001 and 2000 to the agent of the Company's private placements and holders of the purchase warrants.

**(e) Options** Prior to May 1, 1998, the Company granted options to its employees, directors and consultants under a stock option plan, of which none of these options remained outstanding as at December 31, 2003. Under the new 1998 Stock Option Plan, the Company may issue options for up to 3,000,000 common shares. As at December 31, 2003, 2,174,135 options had been issued, of which 1,971,785 remain outstanding under this plan and the remaining 825,865 are eligible to be issued. The exercise price of each option granted may not be less than the market price of the Company's stock at the time of the grant and no option may have a term exceeding 10 years.

Certain of the options vest over a fixed term and others vest based on performance upon the achievement of certain milestones. A summary of the status of the two types of options is presented below.

### Fixed stock options

Fixed stock options vest on an annual basis over a period of up to five years. A summary of the status of fixed stock options as at December 31, 2003, 2002 and 2001 and changes during the years and 11-month period ended on those dates is presented below:

	DECEMBER 31, 2003		DECEMBER 31, 2002		DECEMBER 31, 2001	
	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$
<b>Outstanding, beginning of period</b>	<b>1,310,750</b>	<b>3.44</b>	981,750	2.43	829,000	1.70
Granted	<b>559,285</b>	<b>3.43</b>	714,000	3.59	308,750	3.71
Exercised	<b>(20,000)</b>	<b>2.65</b>	(377,600)	1.13	(144,750)	0.90
Expired or forfeited	<b>(93,000)</b>	<b>3.32</b>	(7,400)	2.02	(11,250)	3.65
<b>Outstanding, end of period</b>	<b>1,757,035</b>	<b>3.45</b>	1,310,750	3.44	981,750	2.43
<b>Options exercisable at period end</b>	<b>973,700</b>		764,350		829,400	

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of exercise prices \$	Number outstanding #	Weighted average remaining life (in years)	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
2.15 – 2.99	755,285	3.43	2.74	376,000	2.66
3.00 – 3.65	248,250	2.16	3.46	212,400	3.47
4.00 – 4.74	733,500	3.47	4.10	381,300	4.19
6.05 – 6.05	20,000	3.43	6.05	4,000	6.05
	<b>1,757,035</b>			<b>973,700</b>	

### Performance stock options

Performance stock options vest immediately upon the achievement of certain milestones as determined by the Board of Directors at the time of issuance. Compensation expense for performance stock options is recorded when it is determined that achievement of the milestone is likely.

The performance stock option milestones include criteria measured by product-related goals and corporate goals. Product-related goals include: product development, completion of clinical trials, regulatory submissions,

regulatory approvals, signing of marketing partners and commercial launch of the Company's products. The corporate goals include: successful investor and public relations activities related to media publications and investor analyst coverage, as well as financial goals including completion of financings and government grants.

A summary of the status of performance stock options as at December 31, 2003, 2002 and 2001 and changes during the years and 11-month period ended on those dates is presented below:

	DECEMBER 31, 2003		DECEMBER 31, 2002		DECEMBER 31, 2001	
	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$	Number of shares #	Weighted average exercise price \$
<b>Outstanding, beginning of period</b>	<b>487,750</b>	<b>1.96</b>	615,250	1.26	560,000	0.99
Granted	—	—	85,500	3.91	70,250	3.74
Exercised	(270,000)	0.69	—	—	—	—
Expired or forfeited	(3,000)	3.55	(213,000)	0.72	(15,000)	3.65
<b>Outstanding, end of period</b>	<b>214,750</b>	<b>3.54</b>	487,750	1.96	615,250	1.26
<b>Options exercisable at period end</b>	<b>111,275</b>		368,075		133,375	

The following table summarizes information about stock options outstanding at December 31, 2003:

Range of exercise prices \$	Number outstanding #	Weighted average remaining life (in years)	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
2.50 – 3.45	79,750	2.27	2.69	45,975	2.65
4.00 – 4.30	135,000	2.77	4.04	65,300	4.07
	<b>214,750</b>			<b>111,275</b>	

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

**(f) Employee share purchase plan** As a result of ongoing interest by its employees and directors to purchase shares of the Company, the Company implemented a share purchase plan effective March 22, 1999, as amended. Pursuant to the terms of the plan, the Company will match the value of the common shares purchased by its employees or directors by issuing from treasury an equal number of common shares, up to a maximum value of the lesser of 50% of the maximum allowable annual contribution for registered retirement savings

plans (being \$7,250 as at December 31, 2003) or 9% of the employee's annual salary. The maximum number of common shares which may be issued by the Company pursuant to the share purchase plan is 350,000. Under the plan, the Company issued 8,942 common shares to employees and directors during the year ended December 31, 2003, and 9,764 and 12,087 shares during the year ended December 31, 2002 and the 11-month period ended December 31, 2001, respectively.

### 5. INCOME TAXES

**(a)** Significant components of the Company's future tax assets and liabilities are as follows:

	2003 \$	2002 \$
<b>Future tax assets</b>		
Federal tax loss carryforwards	<b>1,902,320</b>	1,531,630
Ontario tax loss carryforwards	<b>1,343,618</b>	633,732
Financing and share issue costs	<b>203,430</b>	242,264
SR&ED expenditures	<b>2,169,052</b>	1,365,816
Capital assets	<b>41,876</b>	9,674
Future tax assets before valuation allowance	<b>5,660,296</b>	3,783,116
Valuation allowance	<b>(5,660,296)</b>	(3,783,116)
<b>Net future tax assets (liabilities)</b>	<b>—</b>	<b>—</b>

No net future tax assets have been recognized in the consolidated financial statements as the realization of the net future tax assets does not meet the more likely than not recognition criteria.

**(b)** The Company has accumulated tax losses for federal and provincial purposes in Canada. The Company also has unclaimed federal Canadian scientific research investment tax credits. The losses and investment tax credits can be used to offset future years' Canadian taxable income, the benefit of which has not been recorded in the accounts. The approximate tax losses and investment tax credits expire as follows:

	Federal \$	Ontario \$	Investment tax credits \$
2004	—	147,000	—
2005	351,000	767,000	—
2006	832,000	989,000	—
2007	1,062,000	1,340,000	—
2008	1,562,000	1,562,000	—
2009	2,731,000	2,731,000	—
2010	2,061,000	2,061,000	—
2011	—	—	—
2012	—	—	898,625
2013	—	—	396,292
	<b>8,599,000</b>	<b>9,597,000</b>	<b>1,294,917</b>

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

(c) The Company has available scientific research and experimental development (SRED) expenditures for income tax purposes which may be carried forward indefinitely to reduce future years' taxable income. The total of such expenditures accumulated to December 31, 2003 is approximately \$6,005,000. The potential income tax benefits associated with these expenditures have not been recorded in the accounts.

(d) The Company is entitled to receive provincial investment tax credits relating to scientific research and experimental development costs incurred, the benefits of which have been accrued in the accounts.

### 6. COMMITMENTS

#### (a) Commercialization agreement

On May 10, 2002, the Company entered into an agreement with McNeil Consumer Healthcare ("McNeil") to market and distribute the Company's test for coronary artery disease in Canada. Pursuant to an amendment to this agreement, dated December 20, 2002, and upon payment to the Company of \$100,000, McNeil exercised an option to expand its marketing rights in Canada to include the laboratory field and extend the territory for the insurance testing market to include the U.S. and Mexico. The amended agreement provides McNeil with exclusive rights, in these fields and in this territory, to the professional skin cholesterol test system and all future versions which will be jointly developed by McNeil and the Company. The term of the agreement is 15 years and requires McNeil to purchase the Company's skin cholesterol test and to pay ongoing royalties to the Company on sales, in addition to a series of financial milestone payments of up to \$3,300,000, which will be based on McNeil's achievement of specified annual sales levels of the licensed products. The Company may terminate this agreement if certain minimum levels of sales are not met. Since all future royalties and milestone payments under this agreement are based on sales by McNeil, which sales have not commenced, the Company is unable at this time to estimate the aggregate future payments that could be received under this agreement.

(b) **Research and collaboration agreements** The Company has entered into agreements with various clinical sites to conduct clinical trials on its technologies. The Company is committed upon the progressive completion of the trials to make further payments of approximately \$982,000.

The Company has acquired or is developing in collaboration with others a number of technologies which will require the Company to make payments upon the successful achievement of certain technological milestones. Additionally, in connection with the development of the technologies, the Company has entered into research agreements whereby a minimum fee will be paid for research and development to be carried out by other parties. The Company is committed, upon the successful achievement of future operating performance milestones, to make further payments of approximately \$609,000 and to issue up to 10,000 purchase warrants at an exercise price of \$4.50 (note 4(d)(i)) to these parties.

(i) Pursuant to agreements (the "ColorectAlert™ License Agreements") dated March 27, 1998, May 1, 1998 and October 23, 2001 between the Company and Dr. A.K.M. Shamsuddin (the "ColorectAlert™ Inventor"), the Company acquired a license, including the three existing United States and Japanese patents, for a technology that detects a carbohydrate marker associated with cancerous and pre-cancerous conditions ("ColorectAlert™"). Pursuant to the terms of the agreements, the Company is required to make payments upon achieving certain research and development milestones as well as royalty payments based on revenues from sales of this technology. As at December 31, 2003, the Company has made milestone payments under the ColorectAlert™ License Agreements of approximately \$328,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$165,000. In addition, the Company granted warrants to purchase up to 100,000 common shares at exercise prices ranging from \$3.50 to \$4.50 per share to the ColorectAlert™ Inventor (note 4(d)(ii)). The agreements do not provide for a fixed termination date and may only be terminated by the parties in the event of a material breach by the other party.

(ii) On June 19, 2001, the Company entered into an exclusive agreement with Diagnostic Chemicals Limited ("DCL") to manufacture and supply the Company with Cholesterol 1,2,3™ test kits for the U.S. and Canada. The term of the DCL agreement is five years unless earlier terminated by either party upon the material breach by the other party or by the Company within 180 days notice or by DCL within 12 months notice.

## notes to consolidated financial statements

DECEMBER 31, 2003 *(In Canadian dollars, unless otherwise noted)*

(iii) The Company entered into an agreement with Procyon Biopharma Inc. ("Procyon") dated March 19, 2001, as amended (the "Procyon License Agreement"), whereby the Company has the right to complete the development, clinical trials and regulatory submission for the technology and is entitled to develop, manufacture, market and distribute the ColoPath™ technology exclusively on a global basis. Pursuant to the terms of the Procyon License Agreement, all new patents will be owned by the Company. Procyon is entitled to payments based on the completion of certain research and development milestones as well as a royalty payment based on sales of all mucus-based colorectal cancer tests. As at December 31, 2003, the Company had made milestone payments under the Procyon License Agreement of \$125,000. Future milestone payments, upon completion of specific milestones, could amount to as much as \$225,000. The Procyon License Agreement does not have a fixed termination date and it may be terminated upon written agreement of the parties, if the Company has not at that time engaged in any clinical work or product development in connection with the research and development of ColorectAlert™ or ColoPath™ or met minimum levels of sales of these products. In addition, the Company granted to Procyon warrants to purchase up to 75,000 common shares at an exercise price of \$4.50 per share in connection with this agreement. These warrants expire on March 19, 2004 (note 4(d)(ii)).

(iv) The Company has a research alliance with McMaster University ("McMaster"). This research service agreement, dated October 31, 2000, requires the Company to provide research and development funding to McMaster in an amount of \$120,000 per year in support of the development of gene-based cancer products. The Company also has the right under this agreement for the use of laboratory facilities at McMaster. As at December 31, 2003, the Company has paid \$390,000 to McMaster under this agreement. The Company has granted or will grant warrants to purchase up to 10,000 shares per year at an exercise price of \$4.50 per share to McMaster under this agreement. This agreement has a termination date of October 31, 2005 and may be terminated earlier by the Company upon six months notice.

(v) The Company entered into an agreement with Dr. S. Hakky dated August 30, 2000, as amended (the "Hakky License Agreement"), whereby the Company assumed responsibility for the development, clinical trials and regulatory submission for the technology and is entitled to develop, manufacture, market and distribute this technology exclusively on a worldwide basis. Further development of the technology was discontinued in 2003.

(vi) On May 10, 1999, the Company entered into an agreement with X-Rite, Incorporated ("X-Rite") to develop and supply the Company with a hand-held instrument and related software for Cholesterol 1,2,3™, for use in a professional setting. Pursuant to the terms of the X-Rite Agreement, the Company has agreed to purchase all of the worldwide requirements for color measuring devices and related software for use by the Company in marketing and selling Cholesterol 1,2,3™ systems in point-of-care applications in a professional setting from X-Rite. The term of the X-Rite Agreement is six years unless earlier terminated by either party upon the material breach by the other party or, at the option of X-Rite, if a certain minimum number of X-Rite instruments are not purchased. Further, under specific conditions, the Company may be required to make certain payments to X-Rite if less than a minimum number of X-Rite instruments have been purchased by the Company during a specified period following FDA clearance of Cholesterol 1,2,3™. As at December 31, 2003, other than for purchases of X-Rite instruments in the ordinary course of business, the Company has not made any such payments to X-Rite.

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

**(c) Operating leases** The Company has future minimum annual lease payments under operating leases for its office premises as follows:

	\$
2004	78,000
2005	31,000
	<u>109,000</u>

## 7. CONSOLIDATED STATEMENTS OF CASH FLOWS

Changes in non-cash working capital balances related to operations comprise:

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	<b>2003</b>	2002	2001
	\$	\$	\$
Prepaid expenses and other receivables	<b>(99,063)</b>	(103,452)	(66,935)
Investment tax credits receivable	<b>91,000</b>	(60,000)	(131,000)
Accounts payable and accrued liabilities	<b>(46,907)</b>	230,881	7,070
Advance collaboration funding	<b>—</b>	(36,588)	(19,000)
Deferred revenue	<b>(6,900)</b>	100,000	—
	<b>(61,870)</b>	130,841	(209,865)

Excluded from the consolidated statement of cash flows for the year ended December 31, 2003 is the issuance of warrants paid as consideration for services of \$6,000 as described in notes 4(c) and 4(d)(i).

Excluded from the consolidated statement of cash flows for the year ended December 31, 2002 is the issuance of compensation options issued in connection with the private placement of common shares of \$188,400, the issuance of common shares for consideration of share purchase loans of \$165,000 as described in note 4(d)(i) and the issuance of warrants paid as consideration for services of \$2,165 as described in notes 4(c) and 4(d)(i).

For the 11-month period ended December 31, 2001, excluded is the issuance of warrants paid as consideration in acquiring certain technology of \$305,000 and services of \$5,000. Included as a purchase of capital assets is an amount of \$84,782 that was included in accounts payable and accrued liabilities for the year ended January 31, 2001.

## 8. RECONCILIATION OF CANADIAN TO U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Company prepares its consolidated financial statements in accordance with Canadian GAAP, which, as applied in these consolidated financial statements, conforms in all material respects to U.S. GAAP, except as follows:

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

If U.S. GAAP were followed, the effects on the consolidated statements of loss and deficit would be as follows:

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003	2002	2001
	\$	\$	\$
<b>Net loss for the period (Canadian GAAP)</b>	<b>(4,062,711)</b>	(4,018,262)	(3,245,206)
Adjustments			
Amortization of acquired technology (a)	<b>113,393</b>	141,742	126,138
Acquired technology expense (a)	—	—	(686,507)
Fixed stock options granted to employees (b)	—	(5,625)	(7,500)
Fixed stock options granted to non-employees (c)	—	(57,521)	(48,923)
Performance stock options (d)	—	(931,474)	(254,838)
Share purchase plan (e)	—	—	(45,744)
<b>Net loss and comprehensive loss for the period (U.S. GAAP) (f)</b>	<b>(3,949,318)</b>	(4,871,140)	(4,162,580)
<b>Basic and diluted loss per share (U.S. GAAP)</b>	<b>\$(0.19)</b>	\$(0.24)	\$(0.22)
<b>Weighted average number of common shares outstanding</b>			
Basic and diluted	<b>20,967,677</b>	20,406,733	19,097,390
<b>Excluded from the diluted weighted average number of common shares outstanding are:</b>			
Employee stock options	—	—	533,982
Warrants	—	—	4,188

Basic loss per common share is determined using the weighted average number of common shares outstanding during the periods. As a result of the net losses for the years ended December 31, 2003 and 2002 and the 11-month period ended December 31, 2001, the potential dilutive effect of the exercise of stock options and warrants was anti-dilutive, and therefore, has not been included in the calculation of diluted loss per share.

Consolidated balance sheet items, which would vary under U.S. GAAP, are as follows:

	DECEMBER 31,	DECEMBER 31,	DECEMBER 31,
	2003	2002	2001
	\$	\$	\$
<b>ASSETS</b>			
Acquired technology, net (a)	—	—	—
	<b>7,620,454</b>	10,812,417	8,635,250
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock	<b>28,789,296</b>	28,399,039	22,850,029
Additional paid-in capital	<b>2,855,856</b>	1,705,634	724,250
Warrants	<b>312,200</b>	496,000	310,000
Deferred compensation	<b>(610,608)</b>	(65,091)	(102,711)
Deficit accumulated during the development stage	<b>(24,362,038)</b>	(20,412,720)	(15,541,580)
	<b>6,984,706</b>	10,122,862	8,239,988

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

If U.S. GAAP were followed, the effects on the consolidated statements of cash flows would be as follows:

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003	2002	2001
	\$	\$	\$
<b>OPERATING ACTIVITIES</b>			
Balance under Canadian GAAP	(3,395,714)	(3,549,567)	(3,238,696)
Acquired technology	—	—	(381,507)
<b>Balance under U.S. GAAP</b>	<b>(3,395,714)</b>	<b>(3,549,567)</b>	<b>(3,620,203)</b>
<b>INVESTING ACTIVITIES</b>			
Balance under Canadian GAAP	2,943,778	(2,624,747)	(11,787)
Acquired technology	—	—	381,507
<b>Balance under U.S. GAAP</b>	<b>2,943,778</b>	<b>(2,624,747)</b>	<b>369,720</b>

### Financing activities

Balances under Canadian GAAP of \$363,110 for the year ended December 31, 2003, \$5,731,386 for the year ended December 31, 2002 and \$1,278,328 for the 11-month period ended December 31, 2001 remain unchanged for U.S. GAAP purposes.

Since inception, the Company has not had significant revenue from operations. Accordingly, under Statement of Financial Accounting Standard (“FAS”) No. 7, “Accounting and Reporting by Development Stage Enterprise” (“FAS 7”), the Company is considered to be a development stage enterprise under U.S. GAAP. FAS 7 requires development stage enterprises to disclose additional financial statement information, which is presented in note 8(h).

In accordance with Section 3870 of the CICA Handbook, under Canadian GAAP, stock options and warrants awarded to non-employees in 2002 are accounted for using the fair value method. Under U.S. GAAP, the method of accounting for stock options is dependent upon who the option is issued to and whether the option is fixed or based on certain performance criteria. The Company follows Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees” (“APB 25”) for awards issued to employees and FAS No. 123, “Accounting for Stock-Based Compensation” (“FAS 123”) for awards issued to non-employees. Accounting differences under Canadian GAAP and U.S. GAAP for stock options are described below.

**(a) Acquired technology** Under U.S. GAAP, the Company’s acquired technology, which is primarily comprised of patents and know-how which require regulatory approval to be commercialized and which has no proven alternative future uses, is considered in-process research and development and is immediately expensed upon acquisition in accordance with FAS No. 2, “Accounting for Research and Development Costs.” The Company’s acquired technology does not have an alternative future use given its specialized nature and limited alternative use. Under Canadian GAAP, the acquired technology is considered to be a development asset which is capitalized and amortized over its expected useful life.

**(b) Fixed stock options granted to employees** APB 25 requires the Company to recognize compensation expense relating to the intrinsic value of the options when the market price of the underlying stock is greater than the exercise price of the Company’s employee stock options on the grant date. Under Canadian GAAP, in accordance with Section 3870, the Company was not required to record compensation expense for stock options granted to employees until January 1, 2004. However, the Company elected to record the expense for the year ended December 31, 2003.

## notes to consolidated financial statements

DECEMBER 31, 2003 *(In Canadian dollars, unless otherwise noted)*

On January 1, 2003, the Company prospectively adopted the recommendations of FAS 123. Under the new policy, stock options awarded to employees on or after January 1, 2003 are accounted for using the fair value method. For stock options awarded to employees prior to January 1, 2003, pro forma disclosure of net loss and loss per share is provided below as if these awards were accounted for using the fair value method.

### **(c) Fixed stock options granted to non-employees**

During the course of developing the Company's products, stock options were granted to consultants, researchers and advisors who are classified as non-employees. Stock options issued to non-employees are accounted for at fair value under the provisions of FAS 123. For options granted during 2002, this treatment is consistent with the provisions of CICA Section 3870. However, a Canadian-U.S. GAAP difference still arises on the amortization of fixed options granted to non-employees prior to January 1, 2002 as no compensation expense is recorded under Canadian GAAP for stock options granted to non-employees prior to January 1, 2002.

Fair value is determined using the Black-Scholes option pricing model, using assumptions as disclosed in note 8(g).

**(d) Performance stock options** The Company granted performance stock options to employees that vest upon the achievement of certain milestones. In accordance with APB 25, such stock options are accounted for using the variable method of accounting until the performance milestone is achieved. Under variable accounting, if it is likely that the milestone will be met, the associated compensation is recalculated at each reporting date based on the current intrinsic value and amortized over the remaining vesting period. Under FAS 123, the fair value associated with these performance stock options is presented as part of the pro forma disclosure. The only Canadian-U.S. GAAP difference arises on the amortization of performance stock options granted to non-employees prior to January 1, 2002 as no compensation expense is recorded under Canadian GAAP for stock options granted to non-employees prior to January 1, 2002.

**(e) Share purchase plan** As discussed in note 4(f), effective March 22, 1999, the Company implemented a share purchase plan whereby the Company will match the value of the common shares purchased by its employees or directors by issuing from treasury an equal number of common shares. For purposes of U.S. GAAP, the fair value of common shares issued from treasury under the share purchase plan, as determined by the quoted market price, has been recorded as compensation expense. Under Canadian GAAP, the fair value of shares issued under the share purchase plan on or after January 1, 2002 has been recorded as compensation expense as they represent direct awards of stock.

**(f) Comprehensive income** FAS 130, "Reporting Comprehensive Income," establishes standards for the reporting and display of comprehensive income and its components in general purpose financial statements. Comprehensive income is defined as the change in net assets of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, and includes all changes in equity during a period. For the periods presented, the Company did not have any material transaction that would otherwise have had an impact on comprehensive income. As such, net loss for the period under U.S. GAAP is consistent with comprehensive income.

**(g) FAS 123 pro forma disclosures** FAS 123 requires pro forma disclosures of net loss and loss per share, as if the fair value method, as opposed to the intrinsic value based method, of accounting for employee stock options had been applied.

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

The following table presents the Company's net loss and loss per share on a pro forma basis using the fair value method as determined by using the Black-Scholes option pricing model:

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003	2002	2001
	\$	\$	\$
<b>Net loss for the period</b>			
U.S GAAP – as reported	<b>(3,949,318)</b>	(4,871,140)	(4,162,580)
Pro forma stock-based compensation expense	<b>(428,226)</b>	(1,012,476)	(284,321)
<b>Net loss under U.S. GAAP – pro forma</b>	<b>(4,377,544)</b>	(5,883,616)	(4,446,901)
<b>Basic and diluted loss per share (U.S. GAAP)</b>			
As reported	<b>\$(0.19)</b>	\$(0.24)	\$(0.22)
Pro forma	<b>\$(0.21)</b>	\$(0.29)	\$(0.23)

The assumptions used to calculate the fair value of stock compensation expense using the Black-Scholes option pricing model are approximately as follows:

	YEAR ENDED DECEMBER 31,	YEAR ENDED DECEMBER 31,	11-MONTH PERIOD ENDED DECEMBER 31,
	2003	2002	2001
Expected volatility	<b>54.3%</b>	55.5%	59.1%
Risk-free interest rate	<b>4.06%</b>	4.56%	5.14%
Expected option life	<b>5 years</b>	5 years	5 years

Dividend yield assumption used for all periods presented was nil.

The Black-Scholes option pricing model, used by the Company to calculate option values, as well as other accepted option valuation models were developed to estimate fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated values. Accordingly, management believes that these models do not necessarily provide a reliable single measure of the fair value of the Company's stock option awards.

## notes to consolidated financial statements

DECEMBER 31, 2003 *(In Canadian dollars, unless otherwise noted)*

**(h) Development-stage disclosures** FAS 7 requires development-stage companies to disclose, in addition to the same basic financial statements as presented in these consolidated financial statements, the following information:

(i) Consolidated statement of loss:

	CUMULATIVE FROM INCEPTION ON NOVEMBER 9, 1992
	\$
<b>EXPENSES</b>	
Research and development	10,405,436
General and administration	8,802,953
Acquired technology	1,147,257
Stock option compensation	6,816,303
Amortization	473,828
	<u>27,645,777</u>
<b>RECOVERIES AND OTHER INCOME</b>	
Investment tax credits	1,670,856
Interest	1,549,063
Government grants	63,820
	<u>3,283,739</u>
<b>Cumulative net loss from inception</b>	<u>(24,362,038)</u>

(ii) Consolidated statement of cash flows:

	CUMULATIVE FROM INCEPTION ON NOVEMBER 9, 1992
	\$
Cash used in operating activities	(15,895,441)
Cash used in investing activities	(8,352,320)
Cash provided by financing activities	24,309,386
<b>Cumulative increase in cash and cash equivalents from inception</b>	<u>61,625</u>

## notes to consolidated financial statements

DECEMBER 31, 2003 (In Canadian dollars, unless otherwise noted)

(iii) The following represents the Company's cumulative statement of shareholders' equity determined in accordance with U.S. GAAP from inception:

	Series I Preferred stock		Common stock		Additional paid-in capital	Warrants	Deferred compensation	Deficit incurred in the development stage	Total
	# (000s)	\$	# (000s)	\$					
Balance, November 9, 1992	—	—	—	—	—	—	—	—	—
Net loss for the period	—	—	—	—	—	—	—	(374,703)	(374,703)
Issued for cash	—	—	6,420	255,004	—	—	—	—	255,004
Balance, January 31, 1994	—	—	6,420	255,004	—	—	—	(374,703)	(119,699)
Net loss for the year	—	—	—	—	—	—	—	(174,296)	(174,296)
Issued to extinguish a liability	—	—	720	240,000	—	—	—	—	240,000
Redemption	—	—	(2,337)	(130,695)	71,054	—	—	—	(59,641)
Balance, January 31, 1995	—	—	4,803	364,309	71,054	—	—	(548,999)	(113,636)
Net loss for the year	—	—	—	—	—	—	—	(325,193)	(325,193)
Issued for cash	—	—	528	264,000	—	—	—	—	264,000
Issued on exercise of warrants	—	—	450	150,000	—	—	—	—	150,000
Issued for services	—	—	90	45,000	—	—	—	—	45,000
Issuance of stock options	—	—	—	—	2,420	—	(2,420)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	202	—	202
Balance, January 31, 1996	—	—	5,871	823,309	73,474	—	(2,218)	(874,192)	20,373
Net loss for the year	—	—	—	—	—	—	—	(497,576)	(497,576)
Issued for cash	—	—	839	559,500	—	—	—	—	559,500
Issued on exercise of warrants	—	—	300	100,000	—	—	—	—	100,000
Issued for services	—	—	30	15,000	—	—	—	—	15,000
Issuance of stock options	—	—	—	—	23,736	—	(23,736)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	3,217	—	3,217
Balance, January 31, 1997	—	—	7,040	1,497,809	97,210	—	(22,737)	(1,371,768)	200,514
Net loss for the year	—	—	—	—	—	—	—	(809,216)	(809,216)
Issued on exercise of warrants	—	—	502	205,000	—	—	—	—	205,000
Issued on conversion of debenture	—	—	2,000	500,000	—	—	—	—	500,000
Issued for cash	—	—	2,267	1,478,942	—	—	—	—	1,478,942
Issued on exercise of options	—	—	72	54,000	(53,880)	—	—	—	120
Issuance of stock options	—	—	—	—	53,880	—	(53,880)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	65,144	—	65,144
Balance, January 31, 1998	—	—	11,881	3,735,751	97,210	—	(11,473)	(2,180,984)	1,640,504

## notes to consolidated financial statements

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	Series I Preferred stock		Common stock		Additional paid-in capital	Warrants	Deferred compensation	Deficit incurred in the development stage	Total
	# (000s)	\$	# (000s)	\$					
Balance, January 31, 1998	—	—	11,881	3,735,751	97,210	—	(11,473)	(2,180,984)	1,640,504
Net loss for the year	—	—	—	—	—	—	—	(1,331,199)	(1,331,199)
Issued on exercise of warrants	—	—	269	179,001	—	—	—	—	179,001
Issued on purchase of technology	—	—	134	235,000	—	—	—	—	235,000
Issued for cash	1,104	11	—	—	—	—	—	—	11
Issued on exercise of options	—	—	132	78,480	(1,440)	—	—	—	77,040
Issuance of stock options	—	—	—	—	47,460	—	(47,460)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	48,905	—	48,905
Balance, January 31, 1999	1,104	11	12,416	4,228,232	143,230	—	(10,028)	(3,512,183)	849,262
Net loss for the year	—	—	—	—	—	—	—	(2,416,063)	(2,416,063)
Conversion of Series I Preferred Shares	(559)	(6)	—	—	—	—	—	—	(6)
Issued on conversion of Series I Preferred Shares	—	—	559	932,436	—	—	(932,430)	—	6
Issued under Special Warrants	—	—	1,200	1,034,159	—	—	—	—	1,034,159
Issued on exercise of warrants	—	—	342	256,500	—	—	—	—	256,500
Issued under share purchase plan (note 4(f))	—	—	56	112,059	—	—	—	—	112,059
Issued on exercise of options	—	—	172	119,853	(24,228)	—	—	—	95,625
Issuance of stock options	—	—	—	—	117,600	—	(117,600)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	1,017,913	—	1,017,913
Balance, January 31, 2000	545	5	14,745	6,683,239	236,602	—	(42,145)	(5,928,246)	949,455
Net loss for the year	—	—	—	—	—	—	—	(5,450,754)	(5,450,754)
Conversion of Series I Preferred Shares	(545)	(5)	—	—	—	—	—	—	(5)
Issued on conversion of Series I Preferred Shares	—	—	545	3,504,845	—	—	(3,504,840)	—	5
Issued under Special Warrants	—	—	3,158	11,134,901	—	—	—	—	11,134,901
Issued on exercise of warrants (note 4(d))	—	—	180	150,000	—	—	—	—	150,000
Issued under share purchase plan (note 4(f))	—	—	7	29,472	—	—	—	—	29,472
Issued on exercise of options (note 4(e))	—	—	20	19,000	—	—	—	—	19,000
Issuance of stock options	—	—	—	—	187,210	—	(187,210)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	3,625,162	—	3,625,162
Balance, January 31, 2001	—	—	18,655	21,521,457	423,812	—	(109,033)	(11,379,000)	10,457,236

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	Series I Preferred stock		Common stock		Additional paid-in capital	Warrants	Deferred compensation	Deficit incurred in the development stage	Total
	# (000s)	\$	# (000s)	\$					
Balance, January 31, 2001	—	—	18,655	21,521,457	423,812	—	(109,033)	(11,379,000)	10,457,236
Net loss for the period	—	—	—	—	—	—	—	(4,162,580)	(4,162,580)
Issued on exercise of warrants (note 4(d)(ii))	—	—	753	1,147,611	—	—	—	—	1,147,611
Issued under share purchase plan (note 4(f))	—	—	12	45,744	—	—	—	—	45,744
Issued on exercise of options (note 4(e))	—	—	145	135,217	(4,500)	—	—	—	130,717
Issued on purchase of technology (note 4(d)(ii))	—	—	—	—	—	305,000	—	—	305,000
Issued for services (note 4(d)(i))	—	—	—	—	—	5,000	—	—	5,000
Issuance of stock options	—	—	—	—	304,938	—	(304,938)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	311,260	—	311,260
Balance, December 31, 2001	—	—	19,565	22,850,029	724,250	310,000	(102,711)	(15,541,580)	8,239,988
Net loss for the year	—	—	—	—	—	—	—	(4,871,140)	(4,871,140)
Issued on exercise of warrants (note 4(d))	—	—	4	25,000	—	—	—	—	25,000
Issued under share purchase plan (note 4(f))	—	—	10	47,219	—	—	—	—	47,219
Issued pursuant to private placement (note 4(c))	—	—	1,200	5,282,196	—	188,400	—	—	5,470,596
Issued on exercise of options (note 4(e))	—	—	378	449,640	(23,850)	—	—	—	425,790
Issued for services (note 4(d)(i))	—	—	—	—	—	(2,400)	—	—	(2,400)
Issuance of stock options	—	—	—	—	1,005,234	—	(68,760)	—	936,474
Share purchase loans	—	—	(375)	(255,045)	—	—	—	—	(255,045)
Amortization of deferred compensation	—	—	—	—	—	—	106,380	—	106,380
Balance, December 31, 2002	—	—	20,782	28,399,039	1,705,634	496,000	(65,091)	(20,412,720)	10,122,862
Net loss for the year	—	—	—	—	—	—	—	(3,949,318)	(3,949,318)
Issued under share purchase plan (note 4(f))	—	—	9	27,147	—	—	—	—	27,147
Issued on exercise of options (note 4(e))	—	—	290	238,070	—	—	—	—	238,070
Expiry of warrants	—	—	—	—	191,000	(191,000)	—	—	—
Issuance of warrants	—	—	—	—	—	7,200	—	—	7,200
Issuance of stock options	—	—	—	—	959,222	—	(959,222)	—	—
Repayment of share purchase loans	—	—	180	125,040	—	—	—	—	125,040
Amortization of deferred compensation	—	—	—	—	—	—	413,705	—	413,705
<b>Balance, December 31, 2003</b>	<b>—</b>	<b>—</b>	<b>21,261</b>	<b>28,789,296</b>	<b>2,855,856</b>	<b>312,200</b>	<b>(610,608)</b>	<b>(24,362,038)</b>	<b>6,984,706</b>

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Since the Company's inception on November 9, 1992 up until the year ended January 31, 1994, in lieu of repaying liabilities of \$255,004, the Company issued 6,420,000 common shares. The shares were issued to the original founders of the Company.

During the year ended January 31, 1995, the Company issued 720,000 common shares for aggregate cash proceeds of \$240,000 and redeemed 2,337,000 common shares for total cash consideration of \$59,641. The paid-up capital amount of the shares redeemed was \$130,695, thus resulting in a contributed surplus of \$71,054.

During the year ended January 31, 1996, the Company issued in total 1,068,000 common shares. Of the total issuance, 528,000 of these common shares were issued for cash consideration of \$264,000 and 90,000 were issued for management services. The fair value of the services received was approximately \$45,000 and was expensed. In addition to the above issuance, the Company also issued 450,000 common shares upon the exercise of warrants at an exercise price of \$0.33 per warrant for total proceeds of \$150,000.

During the year ended January 31, 1997, the Company issued in total 1,169,250 common shares. Of the total issuance, 839,250 were issued for cash consideration of \$559,500 and 30,000 were issued for management services. The fair value of the services received was approximately \$15,000 and was expensed. During the year, the Company also issued 300,000 common shares for total proceeds of \$100,000 in connection with warrants exercised. The exercise price of the warrants was \$0.33 per warrant.

During the year ended January 31, 1998, in June 1997, in connection with discussions to initiate a public offering of its common shares, the Company obtained bridge financing in the form of a \$500,000 convertible debenture. Subsequently, on October 31, 1997, upon closing of the initial public offering, the debenture was converted into 2,000,000 common shares of the Company. On October 31, 1997, pursuant to a prospectus filed with the Ontario Securities Commission, the Company issued 2,266,667 common shares for net proceeds of \$1,478,942 after deducting agents' commissions, fees and other costs associated with the offering totaling \$221,059. The Company also granted the agent of the initial public offering options to purchase an additional 342,000

common shares at a price of \$0.75 per share. In addition, during the year, 72,000 options were exercised at a price of \$0.00167 and 360,000 options expired upon termination of employment. In connection with the Company's warrants, 502,000 common shares were issued for total proceeds of \$205,000 at an average exercise price of \$0.41 per warrant.

During the year ended January 31, 1999, 268,372 warrants were exercised at a price of \$0.667 and 128,750 warrants expired. Pursuant to the exercise of 45,000 of these warrants, share purchase demand loans of \$30,015 were made to two executive officers of the Company, bearing interest at 5% per annum and collateralized by 45,000 common shares. The Company also issued 132,000 common shares related to the exercise of stock options at an average exercise price of \$0.58. In addition, during the year, the Company created Series I Preferred Shares which are non-voting, carry no dividend rights, are convertible at the holder's option prior to October 31, 2002 on a one for one basis into common shares, upon achievement of certain predetermined corporate milestones, and are redeemable by the Company after October 31, 2002 for \$0.00001 per share. The Company issued 1,104,000 Series I Preferred Shares in replacement of stock options with the same rights and privileges. The Company has considered these Series I Preferred Shares as equivalent to performance-based stock options and, accordingly, has recorded a compensation expense in the period when the performance milestones were met.

On May 27, 1998, the Company purchased an additional patent relating to a test to measure skin cholesterol, for a combination of cash and 14,286 common shares valued at \$1.75 per share, for total consideration of \$50,000. In addition, in connection with the purchase of the remaining 11% of 2860601 Canada Inc. ("2860601") that it did not already own, the Company paid a combination of cash and 120,000 common shares valued at \$1.75 per share, for total consideration of \$260,750. As the only significant asset held by 2860601 was technology, the entire value of the incremental purchase was ascribed to acquired technology.

During the year ended January 31, 2000, the Company issued 342,000 common shares for total proceeds of \$256,500 in connection with options granted in October 1997 to the agent of the Company's initial public offering. The Company issued an aggregate of 55,774 common shares

## notes to consolidated financial statements

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to employees under the Employee Share Purchase Plan for no additional consideration, which were valued at \$112,059 and included as a compensation expense. In addition, upon the successful achievement of performance milestones, the Company issued 559,000 common shares to employees for no additional consideration pursuant to the conversion of previously issued Series I Preferred Shares. Subsequent to January 31, 2000, on March 17, 2000, the remaining milestones relating to the Series I Preferred Shares were achieved and the 545,000 preferred shares were converted into common shares for no additional consideration. For accounting purposes, a compensation expense of \$932,430 and \$2,896,740 was recorded in each respective period. On September 30, 1999, pursuant to a prospectus filed with the Ontario Securities Commission, the Company issued

(iv) Common Stock:

1,200,000 common shares and 600,000 common share purchase warrants for net proceeds of \$1,034,159 after deducting agents' commissions, fees and other costs associated with the offering totaling \$165,841. Each common share purchase warrant entitled the holder to acquire one common share at a price of \$1.25 per share. The Company also granted the agent and sub-agent compensation options to purchase up to 120,000 common shares at an exercise price of \$1.25. Total stock options exercised during the year was approximately 172,000 for \$119,853, of which \$95,625 was received in cash.

For the years ended December 31, 2003 and 2002 and the 11-month period ended December 31, 2001, see note 4 for a description of the Canadian-U.S. GAAP differences.

	CUMULATIVE FROM INCEPTION ON NOVEMBER 9, 1992	
	Number of shares #	\$
Shares issued for cash	12,153,917	8,204,682
Shares issued for services	124,202	85,000
Shares issued on purchase of technology	134,286	235,000
Exercise of stock options	761,850	839,215
Shares issued under the share purchase plan for no cash consideration	93,522	261,641
Warrants exercised for cash	2,868,230	2,188,112
Special warrants exercised for cash	4,357,895	12,169,060
Shares redeemed for cash	(2,337,000)	(130,695)
Shares issued on conversion of debenture	2,000,000	500,000
Shares issued on conversion of Series I Preferred Shares	1,104,000	4,437,281
	<u>21,260,902</u>	<u>28,789,296</u>

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### (i) Additional consolidated balance sheet information

Accounts payable and accrued liabilities consisted primarily of accruals related to clinical trials of \$142,000 (2002 – \$211,886; 2001 – \$204,739) and amounts owing to trade creditors of \$302,435 (2002 – \$276,303; 2001 – \$116,959).

In accordance with Canadian GAAP, the Company's cash and cash equivalents and short-term investments are carried at the lower of cost or market based on quoted market prices. Under U.S. GAAP, these investments would have been classified as held-to-maturity and would be recorded at amortized cost. There is no significant difference between cost under Canadian GAAP and amortized cost under U.S. GAAP. Accrued interest is included in the short-term investments balance, which in total approximates fair value.

**(j) Recent accounting developments** In November 2002, FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Interpretation 45"). Interpretation 45 requires disclosure by a guarantor regarding its obligations under certain guarantees it has issued, effective December 31, 2002. As at December 31, 2003, the Company had no guarantees requiring disclosure. Interpretation 45 also requires recognition of a liability for the fair value of its obligations under guarantees issued after December 31, 2002. The Company has reviewed its policies and determined there is no impact as a result of the Company adopting these pronouncements.

In December 2002, FASB issued FAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure" ("FAS 148"). FAS 148 amends FAS 123 to provide alternative methods of transition to FAS 123's fair value method of accounting for stock-based compensation. The Company has reviewed its policies and determined there is no impact as a result of the Company adopting these pronouncements.

FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("Interpretation 46") in December 2003. Similar to AcG-15 in Canadian GAAP, Interpretation 46 provides criteria and guidelines to determine whether an entity is a variable interest entity to the Company for consolidation purposes. The Company will adopt the requirements of Interpretation 46 and is currently reviewing its impact.