



**ProSep Inc.**  
**Consolidated Financial Statements**  
**For the years ended**  
**December 31, 2010 and 2009**



# Raymond Chabot Grant Thornton

## Independent Auditor's Report

To the Shareholders of  
ProSep Inc

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We have audited the accompanying consolidated financial statements of ProSep Inc, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of loss and comprehensive loss, 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 Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's 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 auditor's 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 ProSep Inc as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

### **Emphasis of matter**

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company incurred a net loss of \$4,402,198 during the year ended December 31, 2010 and, as of that date, the Company's deficit amounts to \$69,987,683. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

*Raymond Chabot Grant Thornton LLP<sup>1</sup>*

Montréal, March 9, 2011

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<sup>1</sup> Chartered accountant auditor permit no. 22865

ProSep Inc.  
Consolidated statements of loss and comprehensive loss  
For the years ended December 31

Statement of loss

	2010	2009
	\$	\$
Revenue	34 664 542	41 418 738
Cost of goods sold	24 336 221	28 097 666
<b>Gross margin</b>	<b>10 328 321</b>	<b>13 321 072</b>
<b>Expenses</b>		
Sales and marketing	2 105 968	2 170 875
Research and development	181 877	130 400
General and administrative	9 974 815	10 879 418
	<b>12 262 660</b>	<b>13 180 693</b>
<b>Loss before the following items:</b>	<b>(1 934 339)</b>	<b>140 379</b>
Impairment of goodwill	-	6 500 000
Increase in fair value of long-term investments (Note 8)	(375 000)	(400 000)
Net financial charges (Note 17)	2 120 099	3 794 586
Loss on debt settlement	-	2 071 544
Amortization (Note 17)	1 760 179	1 578 540
Loss on disposal of property and equipment	25 468	-
<b>Loss before income taxes</b>	<b>(5 465 085)</b>	<b>(13 404 291)</b>
Current tax provision (Note 15)	(192 772)	(76 066)
Future tax provision (Note 15)	(870 115)	550 158
<b>Income taxes</b>	<b>(1 062 887)</b>	<b>474 092</b>
<b>Net loss</b>	<b>(4 402 198)</b>	<b>(13 878 383)</b>
<i>Weighted average number of shares (basic and diluted)</i>	<i>180 912 158</i>	<i>106 085 384</i>
<i>Basic and diluted loss per share (Note 14)</i>	<i>(0,02)</i>	<i>(0,13)</i>

Statement of Comprehensive Loss

	2010	2009
	\$	\$
<b>Net loss</b>	<b>(4 402 198)</b>	<b>(13 878 383)</b>
Cumulative foreign currency translation adjustment	-	2 102 242
Foreign currency translation adjustment	(107 945)	(201 731)
<b>Comprehensive loss</b>	<b>(4 510 143)</b>	<b>(11 977 872)</b>

The accompanying notes are an integral part of these consolidated financial statements

**ProSep Inc.**  
**Consolidated balance sheets**  
**As at December 31**

	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Assets</b>		
Current assets		
Cash	3 703 155	7 689 695
Restricted cash (Note 19)	226 046	-
Receivables (Note 3)	12 938 294	12 807 205
Inventories (Note 4)	282 346	392 709
Prepaid expenses	585 068	665 162
Income tax recoverable (Note 15)	617 600	544 177
Future income tax assets (Note 15)	426 501	207 698
	<b>18 779 010</b>	<b>22 306 646</b>
Restricted cash (Note 19)	-	2 022 940
Long-term investment (Notes 8 and 11)	3 729 775	3 425 000
Property and equipment (Note 5)	2 472 720	1 526 561
Goodwill (Note 7)	14 644 186	15 195 645
Intangible assets (Note 6)	6 851 132	8 918 517
	<b>46 476 823</b>	<b>53 395 309</b>
<b>Liabilities</b>		
Current liabilities		
Bank credit facilities (Note 9)	4 666 327	5 006 206
Accounts payable and accrued liabilities (Note 10)	8 055 157	12 836 057
Deferred revenue	71 164	71 796
Current portion of long term debt (Note 11)	1 636 295	1 672 602
	<b>14 428 943</b>	<b>19 586 661</b>
Long-term debt (Note 11)	10 437 101	11 689 450
Future income tax liabilities (Note 15)	981 501	1 661 127
Pension obligation (Note 12)	805 932	495 440
	<b>26 653 477</b>	<b>33 432 678</b>
<b>Shareholders' equity</b>		
Share capital (Note 13)	75 725 324	72 010 934
Contributed surplus	12 293 139	11 499 512
Accumulated other comprehensive income	1 792 566	1 900 511
Deficit	<b>(69 987 683)</b>	<b>(65 448 326)</b>
	<b>19 823 346</b>	<b>19 962 631</b>
	<b>46 476 823</b>	<b>53 395 309</b>

**Approved by the Board**

" **Jacques L. Drouin** " ..... Jacques L. Drouin, Director

" **David H. Laidley** "..... David H. Laidley FCA, Director

The accompanying notes are an integral part of these consolidated financial statements

**ProSep Inc.**  
**Consolidated statements of changes in shareholders' equity**  
**For the years ended December 31**

	Number of Common Shares	Common Shares \$	Contributed Surplus \$	Deficit \$	Accumulated Other Comprehensive Income \$	Total Shareholders' equity \$
<b>Balance on January 1, 2009</b>	<b>64 443 451</b>	<b>55 488 839</b>	<b>12 527 139</b>	<b>(48 485 076)</b>	<b>-</b>	<b>19 530 902</b>
Net loss	-	-	-	(13 878 383)	-	(13 878 383)
Transaction costs net of future tax asset of \$238,460 has been totally devaluated	-	-	-	(886 470)	-	(886 470)
Cumulative translation adjustment as at October 1, 2009	-	-	-	-	2 102 242	2 102 242
Foreign currency translation adjustment	-	-	-	-	(201 731)	(201 731)
Stock-based compensation	-	-	360 722	-	-	360 722
Induced conversion and settlement of convertible debentures	37 749 998	8 583 975	(1 559 909)	(2 198 397)	-	4 825 669
Issuance of new convertible debentures	-	-	171 560	-	-	171 560
Conversion of accrued interest	5 131 693	667 120	-	-	-	667 120
Conversion of unsecured debentures due 2013	17 469 230	2 271 000	-	-	-	2 271 000
Issued pursuant to the exercise of rights	38 461 538	5 000 000	-	-	-	5 000 000
<b>Balance on December 31, 2009</b>	<b>163 255 910</b>	<b>72 010 934</b>	<b>11 499 512</b>	<b>(65 448 326)</b>	<b>1 900 511</b>	<b>19 962 631</b>
Net loss	-	-	-	(4 402 198)	-	(4 402 198)
Issuance of shares	28 465 385	3 700 501	-	-	-	3 700 501
Share issue costs net of future tax asset of \$36,896 has been totally devaluated	-	-	-	(137 159)	-	(137 159)
Change in cumulative translation adjustments	-	-	-	-	(107 945)	(107 945)
Issuance of new convertible debenture	-	-	393 950	-	-	393 950
Stock based compensation	-	-	482 236	-	-	482 236
Vested restricted share units settled in cash	-	-	(68 670)	-	-	(68 670)
Vested restricted share units	76 713	13 889	(13 889)	-	-	-
<b>Balance on December 31, 2010</b>	<b>191 798 008</b>	<b>75 725 324</b>	<b>12 293 139</b>	<b>(69 987 683)</b>	<b>1 792 566</b>	<b>19 823 346</b>

At December 31, 2010, the sum of Deficit and Accumulated other comprehensive income is \$68,195,117 (In 2009, the amount was \$63,547,815).

The accompanying notes are an integral part of these consolidated financial statements

**ProSep Inc.**  
**Consolidated statements of cash flows**  
**For the years ended December 31**

	2010	2009
	\$	\$
<b>Operating activities</b>		
Net loss	(4 402 198)	(13 878 383)
Interest received on long-term investment	-	390 000
Items not affecting cash		
Stock-based compensation	468 347	360 722
Amortization of property and equipment	1 038 109	909 966
Amortization of intangible assets	722 071	668 574
Loss on disposal of property and equipment	25 468	-
Accretion on long-term debt	61 273	432 738
Impairment of goodwill	-	6 500 000
Increase in fair value of long-term investment	(375 000)	(400 000)
Loss on debt settlement	-	2 071 544
Periodic pension cost in excess of contribution	310 490	186 607
Future income taxes	(870 115)	550 158
Unrealized exchange loss (gain)	705 128	(353 347)
	<b>(2 316 427)</b>	<b>(2 561 421)</b>
Changes in operating working capital items	<b>(5 223 522)</b>	<b>(935 090)</b>
	<b>(7 539 949)</b>	<b>(3 496 511)</b>
<b>Investing activities</b>		
Restricted cash	1 788 861	(985 094)
Proceeds from disposal of property and equipment	1 355	-
Subsidies on intangible assets	78 927	-
Acquisition of property and equipment	(991 421)	(701 041)
Investment in technology	-	(1 208 214)
	<b>877 722</b>	<b>(2 894 349)</b>
<b>Financing activities</b>		
Restricted cash released	-	3 158 986
Bank credit facilities	(20 355)	856 980
Increase in long term debt	969 050	67 906
Shares issued (net of expenses)	3 577 233	4 113 530
Repayment of long-term debt	(1 607 810)	(1 931 254)
	<b>2 918 118</b>	<b>6 266 148</b>
<b>Decrease in cash</b>	<b>(3 744 109)</b>	<b>(124 712)</b>
<b>Effect of exchange rate on cash</b>	<b>(242 431)</b>	<b>199 294</b>
<b>Cash, beginning of period</b>	<b>7 689 695</b>	<b>7 615 113</b>
<b>Cash, end of period</b>	<b>3 703 155</b>	<b>7 689 695</b>

Additional information see Note 18

The accompanying notes are an integral part of these consolidated financial statements

**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**1. Financial Statement Presentation, Description of Business and Going Concern**

ProSep Inc. ("The Company") is incorporated under the Canada Business Corporations Act. Its shares are traded on the Toronto Stock Exchange ("TSX") under the symbol PRP.

The Company designs, develops, manufactures and commercializes process solutions to treat produced water, oil and gas for the upstream Oil & Gas industry.

The accompanying consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which assumes the Company will be able to realize the carrying value of its assets and discharge its liabilities in the normal course of operations.

The Company incurred a loss of \$4,402,198 for the year ended December 31, 2010, has an accumulated deficit of \$69,987,683 and has not, so far, generated positive cash flows from operations. In addition, the Company is also subject to certain restrictive covenants that are met. Accordingly, there exists significant doubt that the Company would be able to continue as a going concern as at December 31, 2010. These conditions require that the Company seeks non operational sources of financing, and achieves profitable operations in the future. In May 2010, the Company completed a private placement under which it issued a total of 28,465,385 common shares at a price of \$0.13 per common shares for gross proceeds of \$3,700,501. At December 31, 2010, the Company had a cash balance of \$3,703,155 and a restricted cash balance of \$226,046, the restrictions on which expire on February 4, 2011. The Company believes that it has sufficient funds to meet its obligations for the next twelve months.

While management believes the use of going-concern assumptions is appropriate, the consolidated financial statements do not include any adjustments or disclosures that may be necessary should the Company not be able to continue as a going concern. If this were the case, these adjustments could be material.

**2. Accounting Policies**

**2.1 Accounting Change - Foreign Currency Translation**

***Self-Sustaining Foreign Operations***

Effective October 1, 2009, all foreign subsidiaries are considered financially and operationally self-sustaining and the current rate method of translation of foreign currencies is used. Under this method, assets and liabilities are translated into Canadian dollars at the rate in effect at the balance sheet date and revenues and expenses are translated at the average monthly exchange rates during the year. All gains and losses arising from the translation of the financial statements of these foreign subsidiaries are included in the 'Foreign currency translation adjustment' account under 'Accumulated Other Comprehensive Income' within Shareholders' Equity.

During the year 2009, the Company experienced several significant changes that resulted in a reconsideration of the functional currency of each of the Company's domestic and foreign operations. The primary indicators of changes were related to the release of the amounts held in escrow with DnB NOR into the foreign subsidiaries, the refinancing of the Asset Backed Commercial Paper (ABCP) facility, the subsequent restructuring of the indebtedness, the closing of the new rights issue, the transfer of the manufacturing activities for the TORR systems from Montreal to Houston, and the relocation of the head office to smaller premises.

Consequently, upon reconsideration in 2009, the Company concluded that all foreign subsidiaries were self-sustaining. The underlying changes in measurement currencies of the foreign subsidiaries was accounted for prospectively from October 1, 2009, with no change to previously reported results or balances.

As a result of the re-measurement of the foreign subsidiaries' non-monetary assets at October 1, 2009, the Company's non-monetary assets and liabilities and Shareholders' Equity increased by \$2,102,242.

	<b>\$</b>
Property, plant and equipment	<b>(23,516)</b>
Intangible assets	<b>708,230</b>
Goodwill	<b>1,641,713</b>
Future tax liabilities	<b>(191,674)</b>
Pension obligation	<b>(32,511)</b>
Net change in Shareholders' Equity	<u><u><b>2,102,242</b></u></u>

**2.2 Future Accounting Standards**

As at March 9, 2011, certain new primary sources of Canadian generally accepted accounting principles (standards) had been published but were not yet in effect. These standards should not have a significant impact on the Company's consolidated financial statements.

**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**2.3 Significant Accounting Policies**

**a) Principles of Consolidation**

The consolidated financial statements include the accounts of ProSep Inc. and its wholly owned subsidiaries TORR Acquisition Norway AS, TORR Finance Group LLC, ProSep Technologies, Inc., ProPure AS, ProSep AP Sdn Bhd, and ProPure ME.

**b) Use of Estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. These estimates include those related to the degree of completion of contracts for revenue recognition, the relative fair value of long-term debt and equity component convertible instruments, the capitalized portion, if any, of research and development expenses, the fair value of intangible assets, the useful lives of assets and intangible assets, the establishment of warranty provisions, the impairment of goodwill and intangible assets, the determination of pension costs, future taxes as well as fair value estimates of stock options, restricted share units and the valuation of long-term investments. All the estimates are based on management's best knowledge of current events and actions that the Company might consider in the future. Actual results could differ from these estimates.

**c) Revenue Recognition**

The Company's revenues are derived from various sources, principally manufacturing contracts, field trials and other related services.

The Company offers complete and integrated solutions to meet customer needs. These solutions may involve the delivery of multiple services and products occurring at different points in time and/or over different periods in time. As appropriate, these multiple element arrangements are separated into their units of accounting based upon their relative fair values when the delivered item has value to the customer on a stand-alone basis, and there is objective and reliable evidence of the fair value of each deliverable. Each element is accounted for in accordance with the Company's revenue recognition policies.

The Company recognizes revenue when realized, which is when the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; sales price is fixed or determinable and collectability is reasonably assured.

*Manufacturing Contracts*

Revenue related to long-term manufacturing contracts is recognized based on the degree of completion. Under this method, revenue is recognized over the duration of the contract. Completion is measured in the value of tasks completed. Cost of goods sold is also based on the degree of completion. Any excess between cost of goods sold over cost incurred to date is reported as a liability on the balance sheet under accrued liabilities (Note 10). If the degree of completion of a project cannot be established reliably, only revenue corresponding to expenses incurred will be recognized. Any loss on projects is fully recognized when it is ascertained that the project will incur a loss.

Warranty provision is accounted for in cost of goods sold when the product is delivered in accordance with the terms of the contract. When relevant, the warranty provision is calculated based on the contract terms and/or based on the data available during field trials, and is reversed progressively when relevant data is available and when the guarantee period ends.

*Field Trials and Other Related Services*

Field trials are services rendered by technicians and/or engineers operating demonstration products at the client's site, with the ultimate objective of selling such products. The duration of these demonstrations can vary from days to months. Revenue derived from these services is recognized on the basis of services rendered in line with agreements with clients. Revenue derived from the rental of demonstration equipment is recognized on the basis of services rendered.

**d) Forward Exchange Contracts**

From time to time, the Company enters into forward exchange contracts to manage portions of its currency risk exposure. The Company does not account for these forward contracts using hedge accounting and they are therefore recorded at their estimated fair value. Gains or losses resulting from changes in fair values are included in net financial charges in the Consolidated Statements of Loss.

**e) Government Grants**

Government grants are recorded when received or when it is reasonably certain a grant will be received. Grants are presented as a deduction from the expense or assets to which the grant relates.

**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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**f) Research and Development ("R&D") Investment Tax Credits**

R&D investment tax credits are recorded as earned to the extent they are realizable, and recorded as a reduction of related costs or the relevant assets. As such credits must be examined and approved by the tax authorities, it is possible that the amounts granted will differ from the amounts recorded.

**g) Deferred Contract Costs**

Deferred contract costs, including direct and incremental costs relating to signed contracts, are deferred and recognized in line with the revenue recognition policy.

**h) Inventories**

Raw materials and finished goods are valued at the lower of cost and net realizable value. Cost is determined using the weighted average cost method.

**i) Property and Equipment**

Property and equipment are recorded at cost, net of related investment tax credits, and amortized over the estimated useful lives using the straight-line method as follows:

Computer equipment	3 to 5 years
Furniture and fixtures	3 to 10 years
Research and development equipment	3 to 5 years
Demonstration units	3 years
Leasehold improvements	term of lease of 5 years
Equipment	5 years
Plant equipment under capital lease	5 years
Moulds - Cartridges	3 years
Vehicles	3 to 5 years

**j) Financial Instruments – Recognition and Measurement**

All financial instruments are initially recorded on the balance sheet at fair value. After initial recognition, the financial instruments are measured at their fair values, except for held-to-maturity investments, loans and receivables and other financial liabilities, which are measured at amortized cost. The effective interest related to the financial liabilities and the gain or loss arising from the change in the fair value of a financial asset or liability classified as held-for-trading is included in net income for the period in which it arises. If a financial asset is classified as available-for-sale, the gain or loss is recognized in Accumulated Other Comprehensive Income until the financial asset is derecognized by way of sale or depreciation arising from the change in fair value and all cumulative gain or loss is then recognized in Net loss.

The Company has made the following classifications:

- i) Cash and the embedded put options are classified as held-for-trading. Restricted cash and long-term investments are designated as held-for-trading. They are measured at fair value and any gains or losses resulting from subsequent measurements at the end of each period are recognized in Net loss.
- ii) Trade accounts receivable are classified as loans and receivables. They are initially recorded at cost which is equal to their fair value. Subsequent measurement of trade accounts receivable is at amortized cost, which corresponds to the amount initially recorded less any allowance for doubtful accounts.
- iii) Accounts payable, accrued liabilities, bank credit facilities and long-term debt are classified as other financial liabilities. They are initially measured at fair value and the gains and losses resulting from their subsequent measurement at amortized cost at the end of each period are recognized in Net loss.

**k) Goodwill**

Goodwill represents the excess of the purchase price of an acquired business over the fair value of the identifiable assets acquired and liabilities assumed. Management tests for impairment of goodwill on an annual basis and at any other time if events occur or circumstances change that would indicate that it is more likely than not that the fair value of a reporting unit has been reduced below its carrying amount.

Factors considered important which could trigger an impairment review include, but are not limited to, significant underperformance relative to expected historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for the overall business, a downturn in the Canadian and international economies, significant negative industry or economic trends, a significant decline in the stock price for a sustained period and the Company's market capitalization relative to net book value.

**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

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The goodwill impairment test is a two-step process. Step one consists of a comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to the reporting unit. Measurement of the fair value of a reporting unit may be based on one or more fair value measures including present value techniques of estimated future cash flows and estimated amounts at which the unit as a whole could be bought or sold in a current transaction between willing parties. If the carrying amount of a reporting unit exceeds the fair value, step two requires the fair value of the reporting unit to be allocated to the underlying assets and liabilities of that reporting unit, resulting in an implied fair value of goodwill.

This process is identical to a purchase price allocation process upon a business combination. It accordingly requires the identification of all significant assets and liabilities of the reporting unit, whether previously recognized or not, and the estimation of the fair value of such assets and liabilities. This process consequently requires the exercise of significant judgment by management in terms of identification and measurement. Should the carrying amount of the goodwill of the reporting unit exceed the implied fair value of that goodwill, an impairment loss equal to the excess will be recorded in net loss.

***l) Intangible Assets***

An intangible asset arising from developed technology is recognized if, and only if, the Company has demonstrated all of the following:

- a) The technical feasibility of completing the intangible asset so that it will be available for use or sale;
- b) its intention to complete the intangible asset and use or sell it;
- c) its ability to use or sell the intangible asset;
- d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
- e) the availability of adequate technical, financial or other resources to complete the development and to use or sell the intangible asset;
- f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Intangible assets are classified depending on as to whether the asset has a specific or indefinite service life. Intangible assets with a specific service life are amortized over such life and are tested for impairment if there are indications of loss of value. Intangible assets with an indefinite service life are not amortized but are tested for loss of value at least annually.

Depreciable intangible assets are amortized over the following estimated useful lives:

Customer relationships	10 years
Trade names	15 years
Acquired and Developed technology	13 to 15 years
Patents	13 years
Intranet	5 years

***m) Impairment of Long-Lived Assets***

Depreciable long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposal. The amount of the impairment loss is measured as the excess of the carrying value of the asset over its fair value. The recoverability has been reviewed at December 31, 2010 and no impairment charge was required.

***n) Post-Employment Benefit Plans***

The Company accrues its obligations under employee defined pension benefit plan, net of the fair value of plan assets. In order to do so, the Company has adopted the following policies:

- The actuarial determination of the accrued benefit obligations for pensions and other retirement benefits uses the projected benefit method prorated on service. This determination incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors;
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;
- Actuarial gain or loss arises from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service period of active employees.

**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

**o) Stock-based Compensation**

The Company accounts for stock-based compensation using the fair value method of accounting. The stock-based compensation cost is recorded as an expense on the consolidated statements of loss and credited to contributed surplus on the consolidated balance sheets. For employee grants, the cost is recorded over the vesting period of the options and restricted share units. For non-employees, the cost is recorded over the service period. When stock options are exercised, any consideration paid by employees is credited to share capital in addition to the amount previously recorded in contributed surplus. Issued shares under the restricted share units are added to the share capital.

**p) Loss Per Share**

The loss per share is determined using the weighted average number of outstanding shares during the period. The treasury stock method is used to calculate the dilutive effect of stock-based compensation instruments and warrants. This method assumes that the proceeds would be used to purchase common shares at the average market price during the year. The "If-Converted" method is used for convertible instruments.

**q) Income Taxes**

The Company recognizes a current tax liability or asset for current taxes payable or recoverable. A future tax liability or asset is recognized for the estimated future tax effects of temporary differences between the carrying value of assets and liabilities for financial reporting purposes and their tax basis. The Company records a valuation allowance for future income tax assets if they are more likely than not to be realized.

**3. Receivables**

	2010	2009
	\$	\$
Trade accounts receivable	3,996,447	3,430,318
Unbilled receivables*	8,890,924	8,868,456
Sales taxes and other	50,923	508,431
	<u>12,938,294</u>	<u>12,807,205</u>

\*Unbilled receivables represent revenue recorded in accordance with revenue recognition criteria for which the amounts have not yet been invoiced.

**4. Inventories**

	2010	2009
	\$	\$
Raw materials	58,192	48,872
Finished goods	57,872	192,685
Spare parts	174,587	151,152
	<u>282,346</u>	<u>392,709</u>

During the years ended December 31, 2010 and 2009 there was no write-down of inventories recorded and no reversal of write-down.

**5. Property and Equipment**

	2010		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	826,407	696,697	129,710
Furniture and fixtures	480,370	349,963	130,407
Research & Development Equipment	2,039,765	637,795	1,401,971
Demonstration units	1,108,381	954,381	154,000
Leasehold improvements	596,667	306,807	289,860
Equipment	578,007	345,518	232,489
Plant equipment under capital lease	186,359	123,501	62,859
Vehicles	82,645	58,275	24,370
Moulds - Cartridges	179,618	176,895	2,723
Construction in progress	44,331	-	44,331
	<u>6,122,550</u>	<u>3,649,830</u>	<u>2,472,720</u>

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	2009		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	696,410	470,902	225,508
Furniture and fixtures	371,652	164,643	207,009
Research & Development Equipment	333,858	333,858	-
Demonstration units	1,150,435	771,737	378,698
Leasehold improvements	439,216	119,218	319,998
Equipment	325,908	87,547	238,361
Plant equipment under capital lease	142,225	31,234	110,991
Vehicles	46,906	9,277	37,629
Moulds - Cartridges	179,618	171,251	8,367
	<b>3,686,228</b>	<b>2,159,667</b>	<b>1,526,561</b>

**6. Intangible Assets**

	2010		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patents and Acquired Technology	<b>4,657,054</b>	<b>1,085,231</b>	<b>3,571,823</b>
Developed Technology *	-	-	-
Customer relationships	<b>2,948,080</b>	<b>897,878</b>	<b>2,050,202</b>
Trade names	<b>1,581,362</b>	<b>361,421</b>	<b>1,219,941</b>
Intranet	<b>10,000</b>	<b>834</b>	<b>9,166</b>
	<b>9,196,496</b>	<b>2,345,364</b>	<b>6,851,132</b>

	2009		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patents and Acquired Technology	4,637,266	763,863	3,873,403
Developed Technology	1,208,214	-	1,208,214
Customer relationships	3,102,041	671,900	2,430,141
Trade names	1,632,718	235,959	1,396,759
Intranet	10,000	-	10,000
	<b>10,590,239</b>	<b>1,671,722</b>	<b>8,918,517</b>

\*Developed technology is stated at cost and includes the expenditures incurred at ProPure AS during 2009. In 2010, this amount and additional costs incurred in 2010 was transferred to Research and Development Equipment as commercialization had started.

**7. Goodwill**

	2010	2009
	\$	\$
Balance, beginning of the year	<b>15,195,645</b>	20,407,126
Impairment *	-	(6,500,000)
Cumulative foreign currency translation adjustment at October 1, 2009	-	1,641,713
Foreign currency translation adjustment	<b>(551,459)</b>	(353,194)
<b>Balance, end of year</b>	<b>14,644,186</b>	<b>15,195,645</b>

\*In July 2009, in light of the Company's market capitalization and the balance sheet restructuring initiative, the Company performed an impairment testing of the goodwill valuation. Based on this process, the Company determined that the value of ProSep as of July 2009 was below its carrying amount and that an impairment loss of goodwill was required. Management completed a goodwill impairment test which resulted in an aggregate impairment of \$6.5 million of which \$1.8 million, \$3.7 million and \$1.0 million is attributable to the US, European and Middle-East and Asia Operations, respectively. Recoverability of Goodwill was reviewed in 2010 and no impairment charge was required.

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**8. Long Term Investments and Related Credit Facility**

The Company's long term investments are as follows:

	2010	2009
	\$	\$
Class A-1 Notes:	<b>283,500</b>	258,500
Class A-2 Notes:	<b>3,069,275</b>	2,703,500
Class B Notes:	<b>359,000</b>	436,000
Class C Notes:	<b>18,000</b>	27,000
Total	<b><u>3,729,775</u></b>	<u>3,425,000</u>

At December 31, 2010, the Company held Master Asset Vehicle II ("MAV 2") Notes which were exchanged from asset-backed commercial paper ("ABCP") initially acquired on July 12, 2007, with a nominal value of \$9,000,000. During the month of August 2007, the ABCP market experienced liquidity problems. The maturity date of the ABCP held by the Company was August 14, 2007, and the amount due was not repaid.

The restructuring efforts of the Pan Canadian Restructuring Committee under the Companies' Creditors Arrangement Act led to a final restructuring, the closing of which occurred on January 21, 2009. The restructuring plan led to the replacement of the ABCP held by the Company by new floating rate notes with maturities based on the maturities of the underlying assets. The key elements of the plan relevant to the Company are as follows:

- Creation of a new trust named "Master Asset Vehicle II" ("MAV 2");
- MAV 2 groups the so-called 100% synthetic transactions, which is a combination of assets provided as collateral, credit default swaps and hybrid transactions, comprised of a combination of synthetic and traditional assets
- MAV 2 also includes the ineligible (subprime) assets originally associated with these transactions
- Creation of five categories of notes for MAV 2 (A-1, A-2, B, C and IA)
- The IA notes are subdivided in multiple series of tracking notes that pass the cash flows generated by the underlying assets through to the holders.

In accordance with the restructuring plan, the Company received in long-term floating rate MAV 2 notes (the "Notes") in January 2009. The nominal amount of the Notes initially received by the Company and held as of December 31, 2010 and 2009 are as follows:

	December 31, 2010	December 31, 2009	January 21, 2009
	\$	\$	\$
Class A-1 Notes:	370,745	370,970	371,936
Class A-2 Notes:	4,291,318	4,291,318	4,291,318
Class B Notes:	778,993	778,993	778,993
Class C Notes:	168,316	168,316	168,316
Class IA, series 1 and 2 Notes:	-	1,869,479	3,365,062
Total	<b><u>5,609,372</u></b>	<b><u>7,479,076</u></b>	<b><u>8,975,625</u></b>

The MAV 2 A-1, A-2, B and C Notes legally mature in 2056, however the expected maturity date is in 2016. The Class A-1 and A-2 Notes were originally rated A (sf) by DBRS. However, the Class A-2 Notes were downgraded to BBB (low) and placed under review with negative implications by DBRS on August 11, 2009. On February 9, 2010, DBRS confirmed the BBB (low)(sf) rating and removed the Under Review with Negative Implications status citing the passage of time and the stability in the credit environment. On June 22, 2010 DBRS placed the Class A-1 Notes under review with positive implications and confirmed the "BBB (low)" rating of the Class A-2 Notes. On September 21, 2010, DBRS upgraded the Class A-1 Notes to A (high)(sf), replaced the rating Under Review with Positive Implications and confirmed the BBB (low)(sf) rating of the Class A-2 Notes. The Class B and C Notes have not been rated, nor have the Class IA Notes received by the Company. Further to credit events that have occurred in the underlying assets, the outstanding principal amount Class IA series 1 and 2 Notes was reduced to zero during 2010 and 2009, respectively. However, they remain eligible to the sales mechanism described under Credit facility related to IA notes below.

The Notes are designated as held-for-trading and are classified as long-term investments.

During 2009, the Company received cash payments totaling \$425,678 representing accrued interest on the ABCP for the period from August 2007 to January 2009, net of the estimated restructuring costs incurred by the Pan-Canadian Restructuring Committee. Interest and principal payments received on the Notes amounted to \$8,561 and \$225 in 2010 (\$17,292 and \$966 in 2009).

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In connection with the restructuring of the ABCP, the Company arranged two credit facilities with the National Bank of Canada ("National Bank") in March 2009.

*Credit facility related to IA Notes*

This credit agreement provides for a \$2,523,797 revolving credit facility representing an amount equal to 75% the original nominal amount of such Notes. This credit facility expires on March 10, 2011 and bears interest at the prime rate less 1%. The agreement also grants the Company the right to transfer to National Bank the IA Notes on March 10, 2011, in full payment of the loan which the Company has elected to exercise.

*Credit Facility related to Eligible notes*

This credit agreement provides for a \$4,656,542 revolving credit facility representing an amount equal to 83% of the total nominal amount of the MAV II Class A- 1, A-2, B and C Notes (collectively the "Eligible Notes"). This credit facility expires in March 2012 and also bears interest at the prime rate less 1%. The agreement provides for borrowings to be made in two tranches: a first tranche representing 45% of the nominal amount of the Eligible Notes and a second tranche representing 38% of the nominal amount of the Eligible Notes. It also grants the Company the right to sell the Eligible Notes to National Bank in March 2012 at their fair market value. The proceeds from the sale of the Eligible Notes must be used to settle the first tranche and then the second tranche of the credit facility. Any remaining balance under the first tranche of the credit facility is without recourse to the Company, thus indirectly providing the Company with a guaranteed minimum sales price of 45% of the nominal amount of such Eligible Notes.

The Company has granted a first ranking hypothecation to National Bank on the Notes. Subsequent to the decision to take advantage of the right to sell the ineligible Notes to the bank in settlement of the credit facility related to the IA Notes, the credit facility related to the Eligible Notes continues to provide the Company with \$4,656,542 in long-term financing facilities in replacement of the previous term loan that was secured with the ABCP which matured on April 30, 2009. As mentioned above, except for the second tranche of the Eligible Notes facility, the bank's recourse with respect to these new credit facilities will be limited to the Notes.

The repayment arrangements of the two credit facilities are considered embedded derivatives representing put options held by the Company. These put options are classified as assets held-for-trading and are recorded at fair value and are presented in reduction of the related credit facility under Long-term debt.

Estimation of fair value

During 2010, increased trading of the MAV 2 notes was seen on the secondary market allowing for more liquidity than during the previous exercise, even though the notes held by the Company have not traded in an active market since the restructuring.

The fair value of the Notes as of December 31, 2010 and 2009, was determined based on management's judgment using available information and assumptions market participants would use in pricing such Notes at the balance sheet date. In considering the fair value of the investment, the Company reviewed information provided by DBRS and BlackRock, the administrator of MAV 2, including current and anticipated credit ratings, composition and valuation estimates of the underlying assets, the estimate of the extent of leverage in the transactions underlying the MAV 2 Notes and general economic conditions.

The Company estimated the fair value of the Notes using the discounted cash flow evaluation technique based on observable market assumptions to the extent possible. The main assumptions are comprised of the anticipated interest coupons, anticipated maturity of the Notes and an appropriate discount rate considering the underlying risks. The estimated discount rate was determined based on observable market assumptions for similar securities. The Company used the following discount factors to evaluate the Notes:

Replacement Notes	2010		2009	
	Expected Yield	Market-related Discount Factors (Canada Bond Rate Plus)	Expected Yield	Market-related Discount Factors (Canada Bond Rate Plus)
Class A-1	186 basis points*	480 basis points	283 basis points**	590 basis points
Class A-2	186 basis points*	570 basis points	283 basis points**	705 basis points
Class B	0 basis points	1080 basis points	283 basis points**	850 basis points
Class C	0 basis points	3580 basis points	0 basis points	2350 basis points
Ineligible	0 basis points	135 basis points	0 basis points	203 basis points

\* December 31, 2010 bankers' acceptance swap rate of 2.36% minus 50 basis points

\*\* December 31, 2009 bankers' acceptance swap rate of 3.33% minus 50 basis points

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The risk premiums added to the basic bankers' acceptance Canadian government bond rates reflect the liquidity, credit and other risks.

The fair value of the put options at December 31, 2010 and 2009 was estimated using a valuation technique that incorporates a probability-weighted approach applied to discounted future cash flows of the underlying IA and Eligible Notes while considering: (i) the fair value of such Notes, (ii) the maximum amount that can be drawn under the respective credit facilities, (iii) the recourse features of such drawings, and (iv) the discount rate relating to National Bank.

At December 31, 2010, the fair values of the embedded derivatives were established based on the following significant assumptions:

	Embedded Put Options	
	IA Notes March 2011	Eligible Notes March 2012
Maturity	nil	nil
Fair value of underlying Notes	nil	\$3,729,775 (\$3,425,000 in 2009)
Discount rate	2.75% (3.50% in 2009)	3.50% (3.50% in 2009)
Estimated fair value of put options	\$2,470,000 (\$2,400,000 in 2009)	nil (nil in 2009)

At December 31, 2009, the implicit value of the put option was considered in the estimation of the value of the IA Notes.

Based on its assessment of fair values of the Notes and the embedded put option, the Company recognized a \$375,000 increase in fair value of its investment in Notes during the year ended December 31, 2010 (a \$400,000 increase in value for the year ended December 31, 2009). The cumulative impairment charge represents \$2,800,225 since the acquisition of the original ABCP (31.1% of the nominal value).

The above estimated fair values may not be indicative of the ultimate net realizable value or the future fair value. Because of the uncertainty in the market, numerous reasonable assumptions exist. While management believes that its valuation technique is appropriate under the circumstances, changes in significant assumptions, especially those relating to the probability of the scenarios, returns, credit risk and liquidity risk could significantly affect the value ascribed to the replacement notes in the future. Following the analysis, the Company identified that the discount rate related to Classes A-1 and A-2 of MAV 2 and the embedded put option on the IA Notes generate the vast majority of the volatility in the valuation model of the Notes and embedded put options fair value. For example, a 50-basis-point increase or decrease in the discount rate for A-1 and A-2 notes and the IA Notes put option would result in a \$94,313 change in the aggregate fair value.

**9. Bank Credit Facilities**

The Company has a bank credit facility with DnB NOR consisting of a senior overdraft facility of 30,000,000 NOK (\$5,121,027 at December 31, 2010) and a guarantee facility of 15,000,000 NOK (\$2,560,513 at December 31, 2010) to be used to provide customer guarantees against advances received or performance under sales contracts. The bank credit facility outstanding is 27,336,277 NOK (\$4,666,327) at December 31, 2010 (27,719,866 NOK (\$5,006,206) at December 31, 2009) and is secured by the assets of the Company. The interest rate of 4.47% (3.96% in 2009) is the one-month Norwegian Interbank Offered Rate (NIBOR) of 2.47% (1.96% in 2009), plus 2% (plus 2% in 2009) per annum on the overdraft facility.

The letters of guarantee outstanding amount to \$2,136,600 at December 31, 2010 (\$2,083,112 at December 31, 2009).

**10. Accounts Payable and Accrued Liabilities**

	2010	2009
	\$	\$
Accounts payable	3,606,224	3,081,803
Warranty provision	340,429	484,590
Accrued liabilities and interest payable	4,108,504	9,269,664
	<b>8,055,157</b>	12,836,057

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**11. Long-term Debt**

	<b>2010</b>	2009
	<b>\$</b>	\$
	<b>Loan</b>	Loan
Convertible unsecured subordinated debenture in the nominal amount of \$3,953,500, bearing interest at 13.25% payable every six months and maturing on July 16, 2014. (a)	<b>3,658,498</b>	3,600,526
Revolving credit facilities with National Bank of Canada bearing interest at prime rate (3% at December 31, 2010 and 2.25% in December 31, 2009) minus 1% payable monthly (Note 8)		
- IA Notes facility, maturing in March 2011	<b>2,523,797</b>	2,523,797
- Less embedded put options (Notes 8 and 20)	<b>(2,470,000)</b>	(2,400,000)
- Eligible Notes facility, first tranche, maturing in March 2012	<b>2,524,528</b>	2,524,753
- Eligible Notes facility, second tranche, maturing in March 2012	<b>2,132,014</b>	2,132,014
Credit facility with DnB NOR: The interest rate of 5.58% (5.11% in 2009) is the three month Norwegian Interbank Offered Rate (NIBOR) + 3.00% and the principal amount is payable in 10 equal installments of 4,500,000 NOK (\$768,154 as of December 31, 2010) every 6 months. Expiration date is October 25, 2012. (b)	<b>3,072,616</b>	4,876,198
Convertible unsecured subordinated debenture in the nominal amount of \$1,009,300, bearing interest at 5% per annum and maturing on December 7, 2015. Interest will compound automatically each year. (c)	<b>578,400</b>	-
Obligations under capital leases	<b>53,543</b>	104,764
	<b>12,073,396</b>	13,362,052
Current portion of long-term debt	<b>(1,636,295)</b>	(1,672,602)
<b>Long-term debt</b>	<b>10,437,101</b>	11,689,450

a) In connection with the rights issue described in Note 13, the Company completed a significant restructuring of its indebtedness on July 16, 2009. Pursuant to this restructuring, the secured convertible loans (principal amount of \$1.5 million maturing in October 2009), \$667,120 of accrued interest on these loans, the unsecured debentures (principal amount of US\$4 million maturing in June 2013) and the convertible unsecured subordinated debentures (principal amount of \$5.1 million maturing in April 2013) were modified and partly converted into an aggregate of 60,350,921 common shares. The remaining debenture is unsecured and subordinated with a principal amount of \$3,953,500 and convertible into common shares at a price of \$0.30 per share. The effective interest rate on this debenture is 15.57%.

These transactions were accounted for as either inducements to convert or settlements of the previous liabilities and a loss on debt settlement totaling \$2,071,544 was recognized in the consolidated statement of loss and an inducement for debt conversion of \$2,198,397 was charged to deficit.

For accounting purposes, the new convertible debentures of \$3,953,500 include a liability component and an equity component (the holders' conversion option). The initial fair value of the liability component of \$3,781,940 has been determined by discounting the future repayments at a discount rate that represents the estimated borrowing rate available to the Company for similar debentures with no conversion rights. The residual of the gross proceeds over the estimated initial fair value of the liability component was attributed to the conversion option (\$171,560).

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Transaction costs of \$200,829 were allocated to the liability component of the debenture issue and accounted for as a reduction thereof.

- b) In order to finance the repurchase of the preferred shares of Pure Group as well as the current working capital requirements of the subsidiaries of Pure Group, TORR Acquisition Norway obtained a credit facility with DnB NOR in October 2007. This facility is secured by the assets of the Company. The credit facility consists of a five-year senior acquisition facility in an amount of 18,000,000 NOK (\$3,072,616) at December 31, 2010 (27,000,000 NOK (\$4,876,198) at December 31, 2009). The Company has financial covenants to respect under this facility which were respected as at December 31, 2010.
- c) On December 7, 2010, the Company concluded a private placement with Kolon Glotech Inc. (Kolon), a wholly owned subsidiary of Kolon Group Inc. based in the Republic of Korea. The private placement consists of a five year convertible unsecured subordinated debenture (the "Debenture") in the principal amount of \$1,009,300 bearing interest at a rate of 5% per annum. The Debenture will mature on December 7, 2015 (the "Maturity Date") and will be convertible at the holder's option into common shares of the Company at any time prior to the Maturity Date at a conversion price of \$0.13 per share. The effective interest rate of the debenture is 17.31%.

Interest will compound automatically each year, unless the Company elects to pay it in cash. Accrued interest is also convertible into common shares at \$0.13 per share. However, such conversion is subject to TSX/regulatory approval.

The conversion price is subject to customary anti-dilution provisions and the Company has the option to prepay in whole or in part the debenture at par at any time, with advance notice between 30 and 60 days before such prepayment. Kolon retains its ability to convert in common shares if the Company makes a call for prepayment.

The liability and equity components are \$598,987 and \$410,313 respectively. The liability component was determined by discounting the future repayments at a discount rate which represent the estimated borrowing rate available to the Company for similar debentures having no conversion rights. The residual was attributed to the conversion option and is presented in shareholders' equity.

The transaction costs amounted to \$40,250 and were paid in cash. The transaction costs were split between the liability and equity components for \$23,887 and \$16,363 respectively.

- d) Long-term debt installments and obligations under capital leases for the next five years are:

	\$
2011	1,636,295
2012	6,200,203
2013	-
2014	3,658,498
2015	578,400

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**12. Pension Obligation**

The Company's pension plan related to the Norwegian operations required by local laws, grants the right to defined future benefits. These are mainly dependent on the number of years the employee has been part of the plan, salary level at retirement age and the amount received by the state pension arrangement. The pension scheme is managed by and funded through Storebrand Livsforsikring (a trustee in Norway).

The Company measures its accrued benefit obligation and the fair value of the plan assets for accounting purposes at December 31 of each year. The last actuarial evaluation of the plan was done on December 31, 2010.

The information relating to the pension plans is as follows:

	2010	2009
	\$	\$
<b>Change in benefit obligation</b>		
Benefit obligation, beginning of year	1,301,584	1,442,632
Service cost	278,760	329,956
Interest cost	54,592	54,541
Benefits paid	(4,947)	-
Payroll tax of employer contribution	(6,824)	(12,100)
Foreign exchange rate changes	(71,217)	6,683
Actuarial gain	(109,355)	(520,128)
<b>Benefit obligation, end of year</b>	<b>1,442,593</b>	<b>1,301,584</b>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	983,548	1,096,530
Actual return on plan assets	(56,810)	(175,904)
Employer contribution	70,739	57,792
Benefits paid	(4,947)	-
Foreign exchange rate changes	(53,905)	5,130
<b>Fair value of assets, end of year</b>	<b>938,625</b>	<b>983,548</b>

Reconciliation of the funded status of the benefits plan to amounts recorded in the consolidated financial statements.

Accrued benefit obligation	1,442,593	1,301,584
Fair value of plan assets	938,625	983,548
Funded status of plan - deficit	503,968	318,036
Unamortized actuarial gain	301,964	177,404
Pension obligation	805,932	495,440

The Company's benefit costs recognized for the period is determined as follows:

Net periodic benefit cost	2010		
	Incurred	Adjustments (a)	Recognized
	\$	\$	\$
Current service cost	278,760	-	278,760
Interest cost	54,592	-	54,592
Actual return on plan assets	56,810	(94,171)	(37,361)
Actuarial gain	(109,355)	109,355	-
<b>Net periodic benefit cost</b>	<b>280,807</b>	<b>15,184</b>	<b>295,991</b>

	2009		
	Incurred	Adjustments (a)	Recognized
	\$	\$	\$
Current service cost	329,956	-	329,956
Interest cost	54,541	-	54,541
Actual return on plan assets	175,904	(221,777)	(45,873)
Actuarial gain	(520,128)	472,991	(47,137)
<b>Net periodic benefit cost</b>	<b>40,273</b>	<b>251,214</b>	<b>291,487</b>

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a) Adjustments to recognize the long-term nature of employee future benefit costs.

Total cash payments

Total cash payments for employee future benefits, consisting of cash contributed by the Company to its funded pension plans, was \$70,739 in 2010 and \$57,792 in 2009.

**Plan asset components**

The Company's pension funds are managed by an independent life-insurance company that invests the Company's funds according to Norwegian law. The law requires a low risk profile hence the majority of the funds are invested in government bonds and high-rated corporate bonds in Norway. The average remaining service period for active employees covered by the pension plan amounts to 15 years.

The plan assets are segregated in the following categories:

	<b>2010</b>	<b>2009</b>
	%	%
Equity securities	<b>17</b>	12
Bonds	<b>55</b>	55
Real estate	<b>16</b>	16
Money market	<b>9</b>	10
Other	<b>3</b>	7

**Significant assumptions:**

The significant assumptions used are as follows (weighted average):

**Accrued benefit obligations**

Discount rate	<b>4.0</b>	4.4
Rate of compensation increase	<b>4.0</b>	4.3

**Benefit costs**

Discount rate	<b>4.4</b>	3.8
Expected long-term rate of return on plan assets	<b>5.0</b>	5.6
Rate of compensation increase	<b>4.3</b>	4.0

**13. Share Capital**

Authorized  
 Unlimited common shares without par value

Stated

	<b>2010</b>		<b>2009</b>	
	<b>Number of shares</b>	<b>\$</b>	Number of shares	\$
Balance, beginning of year	<b>163,255,910</b>	<b>72,010,934</b>	64,443,451	55,488,839
Issued pursuant to the private placement (a)	<b>28,465,385</b>	<b>3,700,501</b>	-	-
Induced conversion of long term debt (c)	-	-	37,749,998	8,583,975
Conversion of accrued interest (c)	-	-	5,131,693	667,120
Conversion of unsecured debentures due 2013 (c)	-	-	17,469,230	2,271,000
Issued pursuant to the exercise of rights (c)	-	-	38,461,538	5,000,000
Issued shares pursuant to the vesting of RSU (b)	<b>76,713</b>	<b>13,889</b>	-	-
Balance, end of year	<b>191,798,008</b>	<b>75,725,324</b>	163,255,910	72,010,934

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(a) Pursuant to a private placement closed on May 18, 2010, the Company issued a total of 28,465,385 common shares at a price of \$0.13 per common share for gross proceeds of \$3,700,501.

The transaction costs of \$137,159 were accounted for as an increase in the deficit (share issue expenses).

(b) The Company issued a total of 76,713 common shares pursuant to vested restricted share units that were exercised.

(c) Pursuant to a short form prospectus dated July 14, 2009 and in conjunction with the debt restructuring described in note 11 (a), the Company issued to its shareholders rights to subscribe for up to 76,923,077 common shares at a price of \$0.13 per common share. On August 24, 2009, the Company closed the rights offering and issued a total of 38,461,538 common shares for gross proceeds of \$5 million.

The transaction costs of \$886,470 allocated to the shares issued pursuant to the debt restructuring and the exercise of rights have been accounted for as an increase to the deficit.

**Stock Option Plan**

The Company grants incentive stock options to its directors, officers, employees and others providing services to it in accordance with the regulations set by the TSX, subject to its approval. The total number of common shares that may be issued pursuant to this plan is limited to 10% of the issued shares. Options may be exercised at a price equal to the quoted market value as at the date of grant. Options expire five years from the date of grant.

Options may be granted to directors, officers, consultants and employees. Options vest over a three-year period; 25% are vested when granted, 25% after 12 months, 25% after 24 months, and 25% after 36 months. The fair value of the options is amortized over the vesting period.

No stock options were granted during the years ended December 31, 2010 and 2009.

Changes in the number of options are as follows:

	December 31, 2010		December 31, 2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	420,000	\$ 0.31	449,000	0.32
Expired	-	-	-	-
Forfeited	-	-	(29,000)	0.43
Cancelled	-	-	-	-
Balance, end of year	420,000	0.31	420,000	0.31
Exercisable	420,000	0.31	315,000	0.31

The table below presents additional information regarding the Company's stock option program as at December 31, 2010:

Range of exercise price	Number of options	Weighted-average remaining life (years)	Number of options exercisable
\$0.31	420,000	1.97	420,000

The amount expensed and recorded in contributed surplus for option costs granted to employees is \$ 23,385 for the year ended December 31, 2010 (\$23,385 for the year ended December 31, 2009).

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*Warrants*

Changes in the number of warrants are as follows:

	December 31, 2010		December 31, 2009	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Balance, beginning of period	4,460,242	\$ 0.44	27,635,027	\$ 0.61
Expired	-	-	(23,174,785)	0.64
Balance, end of period	4,460,242	0.44	4,460,242	0.44
Warrants exercisable	4,460,242	0.44	4,460,242	0.44

Range of exercise price	Number of warrants	Weighted-average remaining life (years)
\$0.30 - \$0.55	4,460,242	2.04

*Restricted Share Units*

The Company grants restricted share units to attract, retain and motivate key personnel and reward officers and employees for significant performance and distributable cash flow growth. Each restricted share unit is equal in value to one common share of the Company. The Company has the option to settle the awards by issuing shares from the treasury or paying the value awards in cash. The number of shares reserved at any time must not exceed 5% of the aggregate number of shares. The fair value is amortized over the vesting period of 2 or 3 years.

During the year ended December 31, 2010, the Company granted 3,860,000 restricted share units at a weighted average value of \$0.17 (rounded) per share for a total of \$645,100 (2,415,000 were issued for the year ended December 31, 2009 at \$0.20 (rounded) per share for a total value of \$483,925). The expense recorded in the consolidated statements of loss and credited to contributed surplus was \$458,851 for the year ended December 31, 2010 (\$337,337 for the year ended December 31, 2009).

	2010	2009
	Number of restricted share units	Number of restricted share units
Balance, beginning of period	4,161,778	1,851,500
Granted	3,860,000	2,415,000
Forfeited	(373,565)	(104,722)
Vested	(458,213)	-
Balance, end of period	7,190,000	4,161,778

**14. Basic and Diluted Loss Per Share**

Basic and diluted loss per share was calculated using the weighted-average number of common shares outstanding during the period: 180,912,158 shares for the year ended December 31, 2010 (106,085,684 shares for the year ended December 31, 2009).

As a result of the loss for the year ended December 31, 2010, 4,460,242 potentially dilutive warrants, 420,000 potentially dilutive options and 7,190,000 potentially dilutive restricted units as well as the convertible feature of the loan were not included in the calculation of diluted loss per share because the effect would have been anti-dilutive. For the year ended December 31, 2009, 4,460,242 potentially dilutive warrants, 420,000 potentially dilutive options and 4,161,778 potentially dilutive restricted share units were not included in the calculation for the same reason. The debenture and secured loans convertible features were not taken into consideration because they would have had the same anti-dilutive effect (Note 11).

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**15. Income Taxes**

**Income Tax Recoverable**

Income tax recoverable are related to American operating losses carried back to prior years and to state refundable installments.

**Future Income Tax**

Temporary differences and tax losses carried forward which give rise to future income tax assets and liabilities are as follows:

	<u>2010</u>	<u>2009</u>
	\$	\$
Provisions & reserves	<b>330,082</b>	239,143
Tax losses carried forward	<b>9,329,401</b>	8,554,303
Capital loss	<b>405,512</b>	436,817
Intangible assets	<b>109,654</b>	108,426
Foreign exchange difference	<b>100,610</b>	42,105
Research and development expenses	<b>597,307</b>	597,307
Property and equipment	<b>459,461</b>	393,619
Pension obligation	<b>408,467</b>	384,722
Financing fees	<b>229,556</b>	317,626
Sub-total	<u><b>11,970,050</b></u>	<u>11074,068</u>
Property and equipment	<b>(6,062)</b>	(105,988)
Intangible assets	<b>(2,102,669)</b>	(2,462,733)
Sub-total	<u><b>(2,108,731)</b></u>	<u>(2,568,721)</u>
Valuation allowance	<u><b>(10,416,320)</b></u>	<u>(9,958,777)</u>
Net future tax liabilities	<u><b>(555,001)</b></u>	<u>( 1,453,429)</u>
Future tax assets	<b>426,501</b>	207,698
Future tax liabilities	<b>(981,502)</b>	(1,661,127)
	<u><b>(555,001)</b></u>	<u>(1,453,429)</u>

The valuation allowances are largely related to the benefits resulting from the operating losses carried forward for which the realization is not considered more likely than not.

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**Tax Expense**

The reconciliation of the tax expense is as follows:

	<u>2010</u>	<u>2009</u>
	\$	\$
Loss before income taxes	<b>(5,465,085)</b>	(13,404,291)
Expected income tax recovery based on statutory rate (December 31, 2010 statutory tax rate is 29.9%, December 31, 2009 it was 30.9%)	<b>(1,634,061)</b>	(4,141,926)
Change in statutory rate	<b>(69,920)</b>	108,147
Unrecorded tax benefits	<b>565,749</b>	806,343
Impairment of goodwill	-	2,008,500
Expiry of non capital losses	-	277,268
Other	<b>(163,529)</b>	120,313
Effect due to refinancing	-	620,207
Permanent differences	<b>(22,225)</b>	-
Effect of foreign tax rate	<b>173,310</b>	(293,321)
Effect caused by foreign exchange on foreign subsidiaries	-	820,926
Non deductible stock-based payments	<b>69,451</b>	111,463
Non deductible financing fees	<b>18,338</b>	36,172
Tax provision	<b>(1,062,887)</b>	474,092
Current tax provision	<b>(192,772)</b>	(76,066)
Future tax provision	<b>(870,115)</b>	550,158
	<b>(1,062,887)</b>	474,092

*Tax Losses Carried Forward*

At December 31, 2010, the Company had the following unclaimed deductions and non-capital losses carried forward available to reduce taxable income in the future and Investment Tax Credit carried forward to reduce income tax payable:

	<b>2010</b>		
	\$	\$	\$
	<b>Canada</b>	<b>Norway</b>	<b>Malaysia</b>
Canadian Scientific Research & Experimental Development and expenses without limitation	<b>1,890,856</b>	-	-
Non capital losses carried forward, expiring in		-	-
2013	<b>1,912,304</b>	-	-
2014	<b>2,698,776</b>	-	-
2026	<b>8,112,742</b>	-	-
2027	<b>3,138,918</b>	-	-
2028	<b>2,423,245</b>	-	-
2029	<b>1,576,226</b>	-	-
2030	<b>548,143</b>	-	-
Non capital losses carried forward without limitation	-	<b>11,879,286</b>	<b>1,958,823</b>
Total	<b>20,410,354</b>	<b>11,879,286</b>	<b>1,958,823</b>

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Investment tax credits, expiring in	Canada
2019	33,031
2020	47,956
2021	42,511
2022	93,655
2023	111,895
2024	58,245
2025	74,673
2026	66,862
2027	29,084
Total	<b>557,912</b>

**16. Cost of Goods Sold**

	2010	2009
	\$	\$
Products & services sold	24,418,634	28,058,017
Warranty provision	(82,413)	39,649
	<b>24,336,221</b>	<b>28,097,666</b>

**17. Other Supplemental Information**

	2010	2009
	\$	\$
Financial (income) charges, net		
Other financial liabilities		
Interest on long-term debt	753,898	1,334,716
Accretion on long-term debt	61,273	432,738
Interest charges	547,115	455,597
Sub-total	<b>1,362,286</b>	2,223,051
Held-for-trading		
Interest revenue on held for trading financial assets	(46,696)	(110,076)
Sub-total	<b>(46,696)</b>	(110,076)
Loss on foreign exchange	<b>804,509</b>	1,681,611
	<b>2,120,099</b>	3,794,586

	2010	2009
	\$	\$
Amortization		
Property and equipment	1,038,109	909,966
Intangible assets	722,071	668,574
	<b>1,760,180</b>	1,578,540

**ProSep Inc.**  
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**18. Supplemental Cash Flow Information**

	<u>2010</u>	<u>2009</u>
	\$	\$
Interest paid	1,098,242	1,562,306
Income taxes paid	119,349	405,205

**19. Restricted Cash**

	<u>2010</u>	<u>2009</u>
	\$	\$
Restricted cash, short term	226,046	-
Restricted cash, long term	-	2,022,940
	<u>226,046</u>	<u>2,022,940</u>

As of December 31, 2010, \$226,046 in cash was restricted for the issuance of letters of guarantee (\$2,022,940 in 2009) maturing on February 4, 2011 with DnB Nor. Of this amount, \$158,232 was deposited for a letter of guarantee issued on January 3<sup>rd</sup>, 2011.

**20. Commitments and Contingencies**

The Company has entered into lease agreements, over various terms up to a maximum of 10 years, for the leasing of commercial spaces and office equipment. The annual commitments for the next five years and thereafter are as follows:

2011	816,075
2012	748,698
2013	749,898
2014	652,659
2015	627,130
Thereafter	2,221,079
Total	5,816,539

In addition to the letters of guarantee disclosed in Note 9, the Company has an amount of \$324,670 (\$3,643,958 in 2009) of letters of guarantee outstanding with Export Development Canada and \$67,814 issued by DnB Nor and guaranteed by cash deposits (see Note 19).

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**21. Financial Instruments**

The table below summarizes the Company's financial assets and financial liabilities:

Cash and the embedded put options (Note 8) are classified as held-for-trading. Restricted cash and long-term investments are designated as held-for-trading. They are measured at fair value and any gains or losses resulting from subsequent measurements at the end of each period are recognized in net loss.

	December 31, 2010		December 31, 2009	
	\$ Book value	\$ Fair value	\$ Book value	\$ Fair value
<b>Financial assets:</b>				
<b>Held-for-trading:</b>				
Cash	<b>3,703,155</b>	<b>3,703,155</b>	7,689,695	7,689,695
Derivative financial instrument (Note 8)	<b>2,470,000</b>	<b>2,470,000</b>	2,400,000	2,400,000
Sub-total classified as held-for-trading	<b>6,173,155</b>	<b>6,173,155</b>	10,089,695	10,089,695
Restricted cash	<b>226,046</b>	<b>226,046</b>	2,022,940	2,022,940
Long-term investment	<b>3,729,775</b>	<b>3,729,775</b>	3,425,000	3,425,000
Sub-total designated as held-for-trading	<b>3,955,821</b>	<b>3,955,821</b>	5,447,940	5,447,940
<b>Total</b>	<b>10,128,976</b>	<b>10,128,976</b>	15,537,635	15,537,635
<b>Loans and receivables:</b>				
Trade accounts receivable	<b>3,996,447</b>	<b>3,996,447</b>	3,430,318	3,430,318
<b>Financial liabilities:</b>				
<b>Other financial liabilities:</b>				
Bank credit facilities	<b>4,666,327</b>	<b>4,666,327</b>	5,006,206	5,006,206
Accounts payable and accrued liabilities	<b>8,055,157</b>	<b>8,055,157</b>	12,836,057	12,836,057
Long-term debt, including current portion	<b>14,543,396</b>	<b>14,281,857</b>	15,762,052	15,862,445
	<b>27,264,880</b>	<b>27,003,341</b>	33,604,315	33,704,708

**Fair Value**

The carrying values of trade accounts receivables, bank credit facilities and accounts payable and accrued liabilities approximate their fair values due to their relatively short periods to maturity.

The fair value of long-term debts was determined by discounting the cash flows using current interest rates for financial instruments with similar characteristics and maturities.

The following table summarizes the fair value hierarchy under which the Company's financial instruments are valued.

Level 1 of the fair value hierarchy includes unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 includes inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 includes inputs for the asset or liability that are not based on observable market data. For those fair value measurements included in Level 3 of the fair value hierarchy, reconciliation from the beginning balances to the ending balances has been provided.

	Level 1	Level 2	Level 3
	\$	\$	\$
Cash	<b>3,703,155</b>	-	-
Restricted Cash	<b>226,046</b>	-	-
Long Term Investments	-	-	<b>3,729,775</b>
Embedded Put Options	-	<b>2,470,000</b>	-

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Reconciliation of instruments measured at  
fair value based on Level 3 inputs

	<b>2010</b>
	<b>Long term Investments</b>
	<b>\$</b>
Opening balance	<b>3,425,000</b>
Fair value adjustments included in net loss	<b>305,000</b>
Principal repayment	<b>(225)</b>
Closing balance	<b>3,729,775</b>

2009

	Level 1	Level 2	Level 3
	\$	\$	\$
Cash	7,689,695	-	-
Restricted Cash	2,022,940	-	-
Long Term Investments	-	-	3,425,000
Embedded Put Options	-	2,400,000	-

Reconciliation of instruments measured at  
fair value based on Level 3 inputs

	<b>2009</b>
	<b>Long term Investments</b>
	<b>\$</b>
Opening balance	5,815,000
Reclassification of embedded put options	(2,400,000)
Fair value adjustments included in net loss	400,000
Principal repayment	(966)
Interest income received	<u>(389,034)</u>
Closing balance	<b>3,425,000</b>

*Liquidity risk*

Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities such as the settlement of financial debts and lease obligations and payment to suppliers as they become due. The Company manages liquidity risk by continuously monitoring forecast and actual cash flows for all of its business units and taking the necessary actions to maintain enough liquidity for operations and growth objectives.

The table below presents the contractual maturities of financial liabilities at December 31, 2010:

	Less than six months	Between six and twelve months	Between one and five years
	\$	\$	\$
Bank credit facilities	<b>104,292</b>	<b>4,770,619</b>	-
Accounts payable and accrued liabilities	<b>8,055,157</b>	-	-
Long term debt (including current portion)	<b>1,265,521</b>	<b>1,209,466</b>	<b>12,776,028</b>
Total	<b>9,424,970</b>	<b>5,980,085</b>	<b>12,776,028</b>

Amounts presented above in foreign currencies or subject to variable interest rates are measured at the spot rate at December 31, 2010.

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*Credit Risk*

Financial instruments which potentially subject the Company to a concentration of credit risk principally consist of cash, restricted cash, trade accounts receivable and unbilled receivables. The maximum exposure of the Company is limited to the carrying amounts. The Company has its cash placed with high-quality financial institutions. As part of its cash management process, the Company performs periodic evaluations of the relative credit standing of these institutions. The Company has not experienced any losses related to this concentration of credit risk.

The Company grants credit to its customers in the normal course of business and performs ongoing evaluations of their relative credit standing. A significant portion of the Company's sales were to a limited number of customers and consequently the Company is exposed to a concentration of credit risk. Amounts receivable from four customers represent 58% of trade accounts receivable at December 31, 2010 (two customers represent 61% at December 31, 2009). In addition, four customers represent 65% of unbilled receivables at December 31, 2010 (five customers represent 85.3% at December 31, 2009).

At December 31, 2010, \$591,299 in trade accounts receivable had been outstanding for more than 60 days. Of this amount, \$192,234 has been received in January and February 2011. At December 31, 2009, \$1,310,427 of trade accounts receivables had been outstanding for more than 90 days. An amount of \$222,935 trade accounts receivables is past due for more than one year but is not impaired as at December 31, 2010.

*Currency Risk*

The Company maintains cash, trade accounts receivable, unbilled receivable, accounts payable and accrued liabilities in foreign currencies, and is therefore exposed to currency risk on these funds. The balances in Canadian dollars are as follows:

	<b>2010</b>				
	<b>NOK Functional Currency Unit (European and Middle-East and Product Development Operations)</b>				
	<b>USD</b>	<b>EURO</b>	<b>GBP</b>	<b>SGD</b>	<b>NOK</b>
Cash	488,311	-	-	-	-
Trade accounts and unbilled receivables	221,844	-	-	-	-
Accounts payable and accrued liabilities	(29,678)	-	-	-	-
<b>Total in CAD</b>	<b>680,477</b>	-	-	-	-

	<b>MYR Functional Currency Unit (Asia Pacific Operations)</b>				
	<b>USD</b>	<b>EURO</b>	<b>GBP</b>	<b>SGD</b>	<b>NOK</b>
Trade accounts and unbilled receivables	1,703,332	-	-	-	-
Accounts payable and accrued liabilities	(271,867)	-	-	(51,407)	-
<b>Total in CAD</b>	<b>1,431,465</b>	-	-	<b>(51,407)</b>	-

	<b>CAD Functional Currency Unit (Corporate Office)</b>				
	<b>USD</b>	<b>EURO</b>	<b>GBP</b>	<b>SGD</b>	<b>NOK</b>
Cash	1,152,838	-	-	-	-
Intercompany receivables	4,092,000	-	-	-	240
Restricted cash short-term	226,046	-	-	-	-
Accounts payable and accrued liabilities	(16,269)	-	-	-	-
Intercompany payables	(501,828)	-	-	-	(394,645)
<b>Total in CAD</b>	<b>4,952,787</b>	-	-	-	<b>(394,405)</b>

USD= US dollar; EURO = EURO; GBP = Sterling Pound; SGD = Singapore Dollar; MYR = Malaysian Ringgit; NOK = Norwegian Kroner

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	2009				
	USD Functional Currency Unit (US Operations)				
	USD	EURO	GBP	SGD	NOK
Accounts payable and accrued liabilities	-	-	-	-	(354,150)
Total in CAD	-	-	-	-	(354,150)

	2009				
	NOK Functional currency unit (European and Middle-East and Product Development Operations)				
	USD	EURO	GBP	SGD	NOK
Cash	221,174	-	-	-	-
Trade accounts and unbilled receivables	233,429	42,402	-	-	-
Accounts payable and accrued liabilities	(34,662)	(18,407)	-	-	-
Total in CAD	419,940	23,995	-	-	-

	2009				
	MYR Functional Currency Unit (Asia Pacific Operations)				
	USD	EURO	GBP	SGD	NOK
Cash	5,350	-	-	-	-
Trade accounts and unbilled receivables	-	141,095	-	-	-
Accounts payable and accrued liabilities	(76,655)	(102,615)	(8,716)	(127,116)	-
Total in CAD	(71,305)	38,480	(8,716)	(127,116)	-

	2009				
	CAD Functional Currency Unit (Corporate Office)				
	USD	EURO	GBP	SGD	NOK
Cash	180,787	-	-	-	-
Intercompany receivables	2,010,423	-	-	-	784
Restricted cash long- term	2,022,935	-	-	-	-
Accounts payable and accrued liabilities	(141,084)	-	-	-	(2,874)
Intercompany payables	(243,271)	-	-	-	(374,276)
Total in CAD	3,829,790	-	-	-	(376,366)

USD= US dollar; EURO = EURO; GBP = Sterling Pound; SGD = Singapore Dollar; MYR = Malaysian Ringgit; NOK = Norwegian Kroner

Based on the financial instruments outstanding at December 31, 2010, a 1% increase in exchange rates of the respective foreign currencies on that date would have resulted in a loss of \$31,655 before income taxes.

*Exchange rate risk and derivative financial instruments*

The Company has operations in, and exports its products to several countries. A substantial portion of the Company's revenues are received in, and expenses incurred in foreign currencies, and it is therefore exposed to risks related to foreign exchange fluctuations. To reduce these risks, it may use derivative financial instruments such as forward exchange contracts. The Company does not hold or issue any derivative financial instruments for commercial or speculative purposes. The Company may periodically arrange financial instruments with major financial institutions to manage foreign exchange risk related to future cash flows. The derivative financial instruments are subject to normal credit terms and conditions, financial controls and management and risk monitoring procedures. The Company has not designated its derivatives as hedges and accordingly records the derivatives at their value on the consolidated balance sheets with the corresponding gains or losses included in the consolidated statements of loss.

At December 31, 2010, no foreign exchange forward contracts were outstanding. There were also no foreign exchange forward contracts at December 31, 2009.

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*Interest rate risk*

In addition to the interest rate risk on the Long-term investment described in Note 8, the Company is exposed to interest rate fluctuation on a portion of its long-term debt and on bank credit facilities. The Company manages its interest rates exposure and could potentially enter and swap agreements consisting of exchanging variable rates for fixed rates. An increase of 1% in the interest rates would have an impact of \$149,193 (before income taxes) on the basis of the outstanding debt and bank credit facilities on the balance sheet at December 31, 2010.

**22. Capital Management**

The Company is not a capital intensive corporation, but is working capital intensive. Over the past years the Company has accumulated a large deficit. The Company's objective is to achieve and maintain positive earnings and cash flow from operating activities as soon as possible and to have sufficient credit facilities to support growth.

During the year ended December 31, 2010, the Company closed a private placement for aggregate gross proceeds of \$3,700,501 for which it issued a total of 28,465,385 common shares at a purchase price of \$0.13 and a five-year convertible unsecured subordinated debenture in the principal amount of \$1,009,300 bearing interest at a rate of 5% per annum (Note 11c).

The Company defines capital as being equity plus debt, plus bank indebtedness, less cash. The Company is not subject to externally imposed capital requirements.

	<u>2010</u>	<u>2009</u>
	\$	\$
Bank credit facilities	4,666,327	5,006,206
Long-term debt, including current portion and interest payable	<u>11,297,599</u>	<u>13,792,737</u>
	<u>15,963,926</u>	<u>18,798,943</u>
Less cash	<u>3,703,155</u>	<u>7,689,695</u>
<b>Net debt</b>	<b>12,260,771</b>	11,109,248
<b>Shareholders' equity</b>	<u>19,823,346</u>	<u>19,962,631</u>
<b>Total capital</b>	<b>32,084,117</b>	31,071,879
Net debt as a percentage of total capital	<b>38%</b>	36%

**23. Segmented Information**

*Operating segment*

The Company designs, develops and manufactures process solutions to treat produced water, oil and gas for the upstream Oil and Gas industry. Segments are based on geographical locations except for Product Development and Corporate Office which were separated based on their distinct operations. US Operations, European & Middle-East and Asia Pacific relate to manufacturing and commercialization of process solutions. Product Development relates to research and development activities. Corporate Office relates to head office activities to other segments.

The accounting policies that apply to the reportable segments are the same as those described in accounting policies.

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*Revenue and expenses by business units*

2010						
	US operations	European & Middle-East operations	Asia Pacific operations	Corporate Office	Consolidation & Inter segment eliminations	Consolidated operations
	\$	\$	\$	\$	\$	\$
Revenue	21 276 832	5 910 095	7 477 615	-	-	34 664 542
Revenue inter-segment*	195 400	9 750	-	-	(205 150)	-
Total revenue	21 472 232	5 919 845	7 477 615	-	(205 150)	34 664 542
Cost of goods sold	15 702 330	2 338 080	6 500 961	-	(205 150)	24 336 221
Gross margin	5 769 902	3 581 765	976 654	-	-	10 328 321
Operating expenses	5 159 188	3 111 283	744 638	3 247 551	-	12 262 660
EBITDA**	610 714	470 482	232 016	(3 247 551)	-	(1 934 339)

2009						
	US operations	European & Middle-East operations	Asia Pacific operations	Corporate Office	Consolidation & Inter segment eliminations	Consolidated operations
	\$	\$	\$	\$	\$	\$
Revenue	26 723 377	4 866 615	9 828 746	-	-	41 418 738
Revenue inter-segment*	74 683	166 223	174 010	-	(414 916)	-
Total revenue	26 798 060	5 032 838	10 002 756	-	(414 916)	41 418 738
Cost of goods sold	18 696 982	1 965 755	7 849 845	-	(414 916)	28 097 666
Gross margin	8 101 078	3 067 083	2 152 911	-	-	13 321 072
Operating expenses	5 815 266	3 058 352	1 014 435	3 292 640	-	13 180 693
EBITDA**	2 285 812	8 731	1 138 476	(3 292 640)	-	140 379

\* These transactions were carried out at exchange amount which is the value established and accepted by the parties.

\*\*EBITDA is a non-GAAP measure and the Company defines it as earnings or loss from operations excluding depreciation and amortization, financial charges and income taxes.

Two clients of the US Operations represented 27% and 10.5% of the Company's revenue for the year ended December 31, 2010.

Three clients of US Operations represented 14.1%, 11.5% and 10.5% of the Company's revenue and one client from Asia Pacific Operations represented 14.4% of the Company's revenue for the year ended December 31, 2009.

*Assets*

2010

	US Operations	European & Middle-East Operations	Asia Pacific Operations	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$
Total assets	24,704,574	6,662,774	9,440,147	5,669,328	-	46,476,823

2009

Total assets	27,998,154	8,049,673	9,026,821	8,320,661	-	53,395,309
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**ProSep Inc.**  
**Notes to the Consolidated Financial Statements**  
**For the years ended December 31, 2010 and 2009**

*Geographical information*

	2010	2009
	\$	\$
Sales to customers situated in:		
North America (USA, Canada)	6,896,209	13,277,868
Central and South America (Venezuela, Columbia, Argentina, Mexico, Ecuador)	12,674,706	8,451,544
Middle- East (Kuwait, Saudi Arabia, Oman)	962,769	5,110,671
South-East Asia (Malaysia, Singapore)	7,299,664	9,077,529
Europe (Norway, Spain, Italy, UK, France, Switzerland)	5,401,811	4,246,487
Other countries	1,429,383	1,254,639
	<b>34,664,542</b>	<b>41,418,738</b>

*Selected long-term assets*

	2010				
	United States	Norway	Malaysia	Canada	Consolidated Operations
	\$	\$	\$	\$	\$
Property and equipment	708,970	1,558,754	56,977	148,019	2,472,720
Goodwill	10,785,757	1,724,420	2,134,009	-	14,644,186
Intangibles	2,835,687	1,666,212	2,178,528	170,705	6,851,132
	<b>14,330,414</b>	<b>4,949,386</b>	<b>4,369,514</b>	<b>318,724</b>	<b>23,968,038</b>

  

	2009				
	United States	Norway	Malaysia	Canada	Consolidated Operations
	\$	\$	\$	\$	\$
Property and equipment	932,533	360,940	86,989	146,100	1,526,561
Goodwill	11,349,031	1,824,421	2,022,193	-	15,195,645
Intangibles	3,360,544	3,120,587	2,240,462	196,924	8,918,517
	<b>15,642,108</b>	<b>5,305,948</b>	<b>4,349,644</b>	<b>343,024</b>	<b>25,640,723</b>

**24. Comparative Figures**

Certain comparative figures for the consolidated financial statements as at December 31, 2009 have been reclassified to conform to the December 31, 2010 presentation.

**25. Subsequent Events**

In early January 2011, the Company invested \$1 million into a joint venture agreement with the chairman and controlling shareholder of Kolon Group, a large South Korean-based integrated construction, chemical, advanced materials and water treatment company.