

**ProSep Inc.**  
**Consolidated Financial Statements**  
**For the years ended**  
**December 31, 2009 and 2008**



# Raymond Chabot Grant Thornton

## Auditors' Report

To the Shareholders of  
ProSep Inc.

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We have audited the consolidated balance sheets of ProSep Inc. as at December 31, 2009 and 2008 and the consolidated statements of loss, comprehensive loss, deficit, contributed surplus, accumulated other comprehensive income and cash flows for the years ended December 31, 2009 and 2008. 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 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years ended December 31, 2009 and 2008 in accordance with Canadian generally accepted accounting principles.

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

Montréal, February 16, 2010

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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

	2009	2008
	\$	\$
Revenue	41,418,738	51,604,379
Cost of goods sold (Note 17)	28,097,666	35,734,236
Gross margin	13,321,072	15,870,143
<b>Expenses</b>		
Sales and marketing	2,170,875	1,854,230
Research and development (Note 18)	130,400	1,155,612
General and administrative	10,879,418	9,840,399
	13,180,693	12,850,241
Income before the following items:	140,379	3,019,902
Impairment of goodwill (Note 8)	6,500,000	-
Decrease (increase) in fair value of long-term investments (Note 9)	(400,000)	1,385,000
Net financial charges (Note 18)	3,794,586	602,455
Loss on debt settlement (Note 12 (a))	2,071,544	-
Amortization (Note 18)	1,578,540	1,480,667
Loss before income taxes	(13,404,291)	(448,220)
Current tax provision (recovery) (Note 16)	(76,066)	1,341,831
Future tax provision (recovery) (Note 16)	550,158	(164,994)
Income taxes	474,092	1,176,837
Net loss	(13,878,383)	(1,625,057)
<i>Weighted average number of shares (basic and diluted)</i>	<i>106,085,384</i>	<i>62,877,078</i>
<i>Basic and diluted loss per share (Note 15)</i>	<i>(0.13)</i>	<i>(0.03)</i>

Statement of Comprehensive Loss

	2009	2008
	\$	\$
Net loss	(13,878,383)	(1,625,057)
Cumulative foreign currency translation adjustment at October 1, 2009 (Note 2.1)	2,102,242	-
Foreign currency translation adjustment	(201,731)	-
Comprehensive loss	(11,977,872)	(1,625,057)

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

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

	2009	2008
	\$	\$
<b>Assets</b>		
Current assets		
Cash	7,689,695	7,615,119
Restricted cash	-	1,037,846
Receivables (Note 4)	12,807,205	20,004,848
Inventories (Note 5)	392,709	669,881
Prepaid expenses	665,162	886,085
Income tax recoverable	544,177	-
Future income tax assets (Note 16)	207,698	-
	<b>22,306,646</b>	<b>30,213,779</b>
Restricted cash (Note 20)	2,022,940	3,158,986
Long-term investment (Notes 9 & 12)	3,425,000	5,815,000
Property and equipment (Note 6)	1,526,561	1,856,279
Goodwill (Notes 2.4k & 8)	15,195,645	20,407,126
Intangible assets (Note 7)	8,918,517	7,852,042
Future income tax assets (Note 16)	-	192,398
	<b>53,395,309</b>	<b>69,495,610</b>
<b>Liabilities</b>		
Current liabilities		
Bank credit facilities (Note 10)	5,006,206	11,596,044
Accounts payable and accrued liabilities (Note 11)	12,836,057	20,953,507
Income tax payable	-	114,043
Deferred revenue	71,796	484,078
Current portion of long term debt (Note 12)	1,672,602	3,322,106
	<b>19,586,661</b>	<b>36,469,778</b>
Long-term debt (Note 12)	11,689,450	12,087,493
Future income tax liabilities (Note 16)	1,661,127	1,117,599
Pension obligation (Note 13)	495,440	289,838
	<b>33,432,678</b>	<b>49,964,708</b>
<b>Shareholders' equity</b>		
Share capital (Note 14)	72,010,934	55,488,839
Contributed surplus	11,499,512	12,527,139
Accumulated other comprehensive income	1,900,511	-
Deficit	(65,448,326)	(48,485,076)
	<b>19,962,631</b>	<b>19,530,902</b>
	<b>53,395,309</b>	<b>69,495,610</b>

Commitments and contingencies (Note 21)

**Approved by the Board**

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

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

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

**ProSep Inc.**  
**Consolidated statements of contributed surplus**  
**Years ended December 31**

	2009				Total contributed surplus
	Stock-based compensation	Warrants	Conversion feature of loans	Other	
	\$	\$	\$		
Contributed surplus as beginning of year	2,548,774	8,000,821	1,977,544	-	12,527,139
Stock-based compensation	360,722	-	-	-	360,722
Induced conversion and settlement of convertible debentures	-	-	(1,977,544)	417,635	(1,559,909)
Issuance of new convertible debentures	-	-	171,560	-	171,560
Expiry of warrants	-	(7,339,993)	-	7,339,993	
Contributed surplus as at end of year	2,909,496	660,828	171,560	7,757,628	11,499,512

	2008				Total contributed surplus
	Stock-based compensation	Warrants	Conversion feature of loans	Other	
	\$	\$	\$		
Contributed surplus as beginning of year	2,066,473	7,433,980	632,273	-	10,132,726
Stock-based compensation and restricted share units	482,301	-	-	-	482,301
Value of warrants issued from convertible debenture	-	566,841	-	-	566,841
Debenture convertible feature	-	-	1,345,271	-	1,345,271
Contributed surplus as end of year	2,548,774	8,000,821	1,977,544	-	12,527,139

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

**ProSep Inc.**  
**Consolidated statements of deficit and accumulated other comprehensive income**  
**Years ended December 31**

**Deficit**

	2009	2008
	\$	\$
Deficit, beginning of the year	(48,485,076)	(46,605,116)
Transaction costs (Note 14)	(886,470)	(254,903)
Inducement for debt conversion (Note 12 (a))	(2,198,397)	-
Net loss	(13,878,383)	(1,625,057)
Deficit, end of the year	(65,448,326)	(48,485,076)

**Accumulated other comprehensive income**

	2009	2008
	\$	\$
Balance, beginning of the year	-	-
Cumulative foreign currency translation adjustment at October 1, 2009 (Note 2.1)	2,102,242	-
Foreign currency translation adjustment	(201,731)	-
Balance, end of the year	1,900,511	-

As of December 31, 2009, the sum of deficit and Accumulated other comprehensive income is \$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**

	2009	2008
	\$	\$
<b>Operating activities</b>		
Net loss	(13,878,383)	(1,625,057)
Interest received on long-term investment	390,000	-
Items not affecting cash		
Stock-based compensation	360,722	482,301
Amortization of property and equipment	909,966	801,953
Amortization of intangible assets	668,574	678,714
Accretion on long-term debt	432,738	502,966
Impairment of goodwill	6,500,000	-
Decrease (increase) in fair value of long-term investment	(400,000)	1,385,000
Interest on long term debt paid in shares	-	344,441
Loss on debt settlement (Note 12 (a))	2,071,544	-
Periodic pension cost in excess of (less than) contribution	186,607	(101,812)
Future income taxes (recovery) (Note 16)	550,158	(164,994)
Change in fair value of derivative financial instruments	-	12,450
Unrealized exchange gain	(353,347)	(1,497,177)
	<b>(2,561,421)</b>	<b>818,785</b>
Changes in operating working capital items	<b>(935,090)</b>	<b>(4,352,754)</b>
	<b>(3,496,511)</b>	<b>(3,533,969)</b>
<b>Investing activities</b>		
Restricted cash (Note 20)	<b>(985,094)</b>	-
Acquisition of property and equipment	<b>(701,041)</b>	(565,045)
Investment in technology	<b>(1,208,214)</b>	-
	<b>(2,894,349)</b>	<b>(565,045)</b>
<b>Financing activities</b>		
Restricted cash (Note 20)	<b>3,158,986</b>	(3,158,986)
Bank credit facilities (Note 10)	<b>856,980</b>	1,202,416
Increase in long term debt	<b>67,906</b>	5,372,696
Shares issued (net of expenses)	<b>4,113,530</b>	-
Repayment of long-term debt and debt issue costs	<b>(1,931,254)</b>	(1,724,866)
	<b>6,266,148</b>	<b>1,691,260</b>
<b>Increase (Decrease) in cash</b>	<b>74,576</b>	<b>(1,047,515)</b>
<b>Effect of exchange rate on cash</b>	<b>199,294</b>	<b>1,360,238</b>
<b>Cash beginning of year</b>	<b>7,615,119</b>	<b>8,662,634</b>
<b>Cash end of year</b>	<b>7,689,695</b>	<b>7,615,119</b>

*Additional information - see Note 19*

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

**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 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 has incurred a loss of \$13,878,383 for the year ended December 31, 2009, has an accumulated deficit of \$65,448,326 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, 2009. These conditions require that the Company seeks non operational sources of financing, and achieves profitable operations in the future. In July 2009, the Company proceeded with a significant restructuring of its bank indebtedness. This transaction enabled the Company to restructure debt of \$7 845,620 and closed a rights issue for \$5,000,000 (Note 12). At December 31, 2009, the Company had a cash balance of \$7,689,695 and a restricted cash balance of \$2,022,940 expiring on October 5, 2010. The Company believes that it has sufficient liquidity to meet its obligations for the next twelve months.

While management believes the use of going concern assumptions is appropriate, the 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****Foreign currency transactions and Integrated foreign operations**

For foreign currency transactions and foreign subsidiaries considered financially and operationally integrated, the temporal method of translation of foreign currencies is used. Monetary items were translated at the rate in effect at the balance sheet date, non-monetary items were translated at their historical rate. Revenues and expenses were translated at the rate in effect at the transaction date or at the average monthly exchange rates during the year as appropriate except for amortization, which was translated at historical cost. Foreign currency transaction gains and losses were included in Financial Charges.

**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 has been 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 course of the year, 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 ABCP facility, the subsequent restructuring of the indebtedness (see Note 1), the closing of a new rights issue, the transfer of the manufacturing activities for the TORR systems from Montreal to Houston, and the consequent scheduled move of the head office to smaller premises.

Consequently, upon reconsideration, 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.

Effective October 1, 2009, and as a result of the change in the status of the foreign subsidiaries, the Company translates its foreign operations using the current rate method. 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 as follows

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

## 2. Accounting policies (continued)

### 2.2 New accounting standards

Effective January 1, 2009, in accordance with transitional provisions, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, Goodwill and Intangible Assets, which superseded Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to its initial recognition. The adoption of this new standard did not have a significant impact on the financial statements.

Effective January 1, 2009, in accordance with transitional provisions, the CICA issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which requires the Company to consider its own credit risk as well as the credit risk of its counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. The standard is effective for the first quarter of 2009 and is required to be applied retrospectively without restatement of prior periods. The adoption of this standard did not have a significant impact on the valuation of financial assets or liabilities.

In 2009, in accordance with transitional provisions, the CICA amended Section 3862, Financial Instruments Disclosures, to include additional disclosure requirements about fair value measurements of financial instruments and to enhance the liquidity risk disclosure requirement. The disclosure in the consolidated financial statements complies with the amendments.

### 2.3 Future Accounting Standards

The CICA issued the following new Handbook Sections which are effective for fiscal years subsequent to December 31, 2009.

In January 2009, the CICA issued Section 1601, Consolidated Financial Statements, and Section 1602, Non-controlling Interests, which together replace Section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Financial Reporting Standard ("IFRS"), IAS 27 (Revised), Consolidated and Separate Financial Statements.

In January 2009, the CICA also issued Section 1582, Business Combinations. This Section replaces the former Section 1581, Business Combinations. The new standard requires the acquiring entity in a business combination to recognize most of the assets acquired and liabilities assumed in the transaction at fair value, including contingent assets and liabilities, as well as recognize and measure the goodwill acquired in the business combination, or a gain from a bargain purchase. Acquisition-related costs are to be expensed.

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract was amended to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require, in situations where a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance.

The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If the Abstract is adopted early, in a reporting period that is not the first reporting period in the entity's fiscal year, it must be applied retroactively from the beginning of the Company's fiscal period of adoption. The Company does not anticipate to early adopt EIC-175. Furthermore, as it will become effective when the Company will be reporting under IFRS, the Company does not anticipate that it will ever adopt this new standard for Canadian GAAP purposes.

### 2.4 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, Pure Group AS, ProSep Technologies, Inc., ProPure AS, ProSep AP Sdn Bhd, ProPure ME and TORR UK Limited.

#### b) Use of estimates

The preparation of financial statements in conformity 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 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.

**2. Accounting policies (continued)**

*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 way most suitable for each contract, which can be based on expenses incurred or on the value of tasks completed. For contracts based on value of tasks completed, cost of goods sold is also based on the degree of completion. The difference between cost of goods sold and cost incurred to date is reported as a liability on the balance sheet under accrued liabilities (note 11). 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 therefore they are recorded at their estimated fair value. Gains or losses resulting from changes in fair values are included in the financial income or expense 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.

**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 years
Demonstration units	3 years
Leasehold improvements	term of lease
Equipment	5 years
Plant equipment under capital lease	5 years
Moulds - Cartridges	3 years
Vehicles	3 to 5 years

## 2. Accounting policies (continued)

### 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, interest payable 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. Recoverability of Goodwill has been reviewed in 2009 and an impairment change of \$6,500,000 was required as described in Note 8.

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.

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 earnings or 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, 2009 and no impairment change was required.

**2. Accounting policies (continued)****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.

**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. Acquisition**

On October 25, 2007, The Company acquired 100% of the shares of Norwegian-based Pure Group AS, a provider of leading technologies for oil, gas and water purification for total consideration of \$29,149,540. The terms of the acquisition also included a conditional bonus payment of 1,000,000 of the Company's common shares subject to achieving aggregate revenues in excess of \$25,798,526 (147,000,000 NOK) from the sale of specified ProPure AS products for the period ended June 30, 2009. These results were not achieved and therefore no amount has been recorded and no shares were issued in relation to the conditional bonus payment.

**4. Receivables**

	2009	2008
	\$	\$
Trade accounts receivable	3,430,318	4,889,791
Unbilled receivables *	8,868,456	14,528,661
Sales taxes and other	508,431	586,396
	<b>12,807,205</b>	<b>20,004,848</b>

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

**5. Inventories**

	2009	2008
	\$	\$
Raw materials	48,872	352,954
Finished goods	192,685	167,629
Spare parts	151,152	149,298
	<b>392,709</b>	<b>669,881</b>

During the years ended December 31, 2009 and 2008 there was no write-down of inventories recorded and no reversal of write-down.

**6. Property and equipment**

	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>

	2008		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	633,354	354,370	278,984
Furniture and fixtures	417,825	131,989	285,836
Research and development equipment	333,858	291,779	42,079
Demonstration units	1,143,082	542,125	600,957
Leasehold improvements	260,970	65,594	195,376
Equipment	526,859	229,226	297,633
Plant equipment under capital lease	118,389	40,640	77,749
Vehicles	22,655	13,227	9,428
Moulds - Cartridges	179,618	111,381	68,237
	<b>3,636,610</b>	<b>1,780,331</b>	<b>1,856,279</b>

**7. Intangible assets**

	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>

	2008		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patent and acquired Technology	4,430,000	434,625	3,995,375
Customer relationships	2,800,000	326,666	2,473,334
Trade names	1,500,000	116,667	1,383,333
	<b>8,730,000</b>	<b>877,958</b>	<b>7,852,042</b>

\* Developed technology is stated at cost and includes the expenditures incurred at ProPure AS during 2009 and will be amortized once commercialization starts.

**8. Goodwill**

	2009	2008
	\$	\$
Balance, beginning of the year	20,407,126	20,407,126
Impairment	(6,500,000)	-
Cumulative foreign currency translation adjustment at October 1, 2009 (Note 2.1)	1,641,713	-
Foreign currency translation adjustment	(353,194)	-
<b>Balance, end of the year</b>	<b>15,195,645</b>	<b>20,407,126</b>

In July 2009, in light of the Company's market capitalization and the balance sheet restructuring initiative (refer to Note 12), 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.

**9. Long term Investment and related credit facility**

	2009	2008
	\$	\$
Class A-1 Notes:	258,500	-
Class A-2 Notes:	2,703,500	-
Class B Notes:	436,000	-
Class C Notes:	27,000	-
Asset-backed Commercial Paper	-	5,815,000
<b>Total</b>	<b>3,425,000</b>	<b>5,815,000</b>

At December 31, 2009, the Company held asset-backed commercial paper ("ABCP") 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. As expected, the restructuring plan led to the replacement of the ABCP held by the Company by new floating rate notes that have 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 regroups the so-called 100% synthetic transactions, that 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 through to the holders the cash flows generated by the underlying assets.

According to the restructuring plan, the Company has received in January 2009 long-term floating rate MAV 2 notes (the "Notes") with the following discounted nominal amounts:

	\$
Class A-1 Notes:	371,936
Class A-2 Notes:	4,291,318
Class B Notes:	778,993
Class C Notes:	168,316
Class IA, series 1 and 2 Notes:	3,365,062
<b>Total</b>	<b>8,975,625</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 had been originally rated A by DBRS. The Class A-2 Notes have however been downgraded to BBB (low) and placed under review with negative implications by DBRS on August 11, 2009. 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 2 Notes has been reduced to zero. However, they remain eligible to the sales mechanism described under Credit facility related to IA notes described below. On February 9, 2010, DBRS confirmed the BBB (low) rating and removed the Under Review with Negative Implications status citing the passage of time and the recent stability in the credit environment.

The Notes are considered as new financial instruments, have been designated as held for trading and are classified as long-term investments.

**9. Long term Investment and credit facility (continued)**

Since the restructuring in January 2009, the Company has received cash payments totalling \$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 payments received on the Notes to December 31, 2009 total \$17,292.

In connection with the restructuring of the ABCP, the Company has 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 agreement representing an amount equal to 75% the nominal amount of such Notes. This credit facility expires in March 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 in March 2011, in full payment of the loan.

**Credit Facility related to Eligible notes**

This credit agreement provides for a \$4,656,767 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 under 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 to National Bank the Eligible Notes 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 providing indirectly 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. These two credit agreements have provided the Company with \$7,180,564 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**

Although there have been some isolated transactions subsequent to January 31, 2009, there were no active market quotations available. 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, 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. 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 in considering the fair value of the investment.

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	2009		2008	
	Expected Yield	Market related Discount factors (Canada Bond rate plus)	Expected Yield	Market related Discount factors (Canada Bond rate plus)
Class A-1	283 basis points*	590 basis points	141 basis points**	575 basis points
Class A-2	283 basis points*	705 basis points	141 basis points**	575 basis points
Class B	283 basis points*	850 basis points	141 basis points**	1100 basis points
Class C	0 basis points*	2350 basis points	141 basis points**	1600 basis points
Ineligible	0 basis points	203 basis points	0 basis points**	450 basis points

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

\*\* December 31, 2008 bankers' acceptance swap rate of 1.91% minus 50 basis points

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, 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, 2009, the fair values of the embedded derivatives were established based on the following significant assumptions:

	Embedded put options	
	IA Notes	Eligible Notes
Maturity	March 2011	March 2012
Fair value of underlying Notes	nil	\$3,425,000
Discount rate	3.50%	3.50%
Estimated fair value of put options	\$2,400,000	nil

At December 31, 2008, the implicit value of the put option was considered in the estimation of the value of the ABCP that was anticipated to be converted into IA Notes.

**9. Long term Investment and credit facility (continued)**

Based on its assessment of fair values of the Notes and the embedded put option, the Company recognized an increase in fair value of its investment in ABCP and Notes of \$400,000 during the year ended December 31, 2009 (a decrease in value of \$1,385,000 for the year ended December 31, 2008). The cumulative impairment charge represents \$3,175,000 since the acquisition of the original ABCP (35.3% 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 \$88,975 change in the aggregate fair value.

**10. Bank credit facilities**

The Company has a bank credit facility with DnB NOR consisting of a senior overdraft facility of 30,000,000 NOK (\$5,417,999 at December 31, 2009) and a guarantee facility of 15,000,000 NOK (\$2,708,999 at December 31, 2009) to be used to provide customer guarantees against advances received under sales contracts. The bank credit facility outstanding is 27,719,866 NOK (\$5,006,206) at December 31, 2009 (25,048,660 NOK (\$4,396,044) at December 31, 2008) and is secured by the assets of the Company. The interest rate of 3.96% (5.48% in 2008) is the one month Norwegian Interbank Offered Rate (NIBOR) of 1.96% (3.98% in 2008), plus 2% (plus 1.5% in 2008) per annum on the overdraft facility.

In 2008 the Company had a credit facility with National Bank totalling \$7,200,000 which was replaced in the second quarter of 2009 by the two credit agreements described in Note 9 and presented as Revolving credit facilities with National Bank of Canada in Note 12.

The letters of guarantee outstanding amount to \$2,083,112 at December 31, 2009 (\$2,325,943 at December 31, 2008).

**11. Accounts payable and accrued liabilities**

	2009	2008
	\$	\$
Accounts payable	3,081,803	3,113,637
Warranty provision	484,590	487,638
Accrued liabilities and interest payable	9,178,490	17,352,232
Short term loan	91,174	-
	<b>12,836,057</b>	<b>20,953,507</b>

**12. Long-term debt and Interest payable**

	2009		2008	
	\$	\$	\$	\$
	Loan	Interest payable	Loan	Interest payable
Unsecured debenture in the nominal amount of \$4 millions USD, bearing interest at 13.25% per annum.(a) and (c)	-	-	4,898,400	55,208
Secured convertible loans in the aggregate nominal amount of \$1.5 million, bearing interest at 12% per annum compounded (monthly effective rate of 5.56%) (a) and (b)	-	-	979,540	649,540
Convertible unsecured subordinated debenture in the nominal amount of \$5.1 million, bearing interest at 13%. (a) and (e)	-	-	3,108,165	110,283
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)	3,600,526	87,306	-	-
Revolving credit facilities with National Bank of Canada bearing interest at prime rate (2.25% at December 31, 2009) minus 1% payable monthly (Note 9).	-	-	-	-
- IA Notes facility, maturing in March 2011	2,523,797	-	-	-
- Less embedded put options (Notes 9 & 22)	(2,400,000)	-	-	-
- Eligible Notes facility, first tranche, maturing in March 2012	2,524,753	-	-	-
- Eligible Notes facility, second tranche, maturing in March 2012	2,132,014	-	-	-
Obligations under capital leases (f)	104,764	-	105,488	-
Credit facility with DnB NOR: The interest rate of 5.11% (5.48% in 2008) is the three month Norwegian Interbank Offered Rate (NIBOR) +3.00% and the principal amount is payable in 10 equal instalments of 4,500,000 NOK (\$812,700 as of December 31, 2009) every 6 months. Expiration date is October 25, 2012. (d)	4,876,198	343,379	6,318,006	98,447
	<b>13,362,052</b>	<b>430,685</b>	15,409,599	913,478
Current portion of long term debt and interest payable	<b>(1,672,602)</b>	<b>(430,685)</b>	(3,322,106)	(913,478)
<b>Long-term debt and interest payable</b>	<b>11,689,450</b>	-	12,087,493	-

## 12. Long-term debt and Interest payable (continued)

(a) In connection with the rights issue described in Note 14 (a), the Company completed on July 16, 2009, a significant restructuring of its indebtedness. 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 convertible into common shares at a price of \$0.30 per share and bearing interest at 13.25% payable every six months and maturing on July 16, 2014.

These transactions have been accounted for as either inducements to convert or settlements of the previous liabilities and a loss on debt settlement totalling \$2,071,544 has been recognized in the consolidated statement of loss and inducement for debt conversion of \$2,198,397 was recorded 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 which represent the estimated borrowing rate available to the Company for similar debentures having 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).

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

b) On November 2, 2004, the Company completed a private placement of secured convertible term loans secured by the assets of the Company in the aggregate principal amount of \$3 million, convertible into 4,615,385 common shares at \$0.65. Warrants were issued to purchase 4,615,385 common shares at \$0.65.

The convertible loans bore interest at 12% per annum and were to mature on October 29, 2009. The interest payable for years One, Two and Three was payable on the term date and years Four and Five will be payable yearly. At the option of the debt holders, interest could have been paid in common shares at the authorized discounted market value which is the average of closing price of the common share on the TSX for the twenty trading days preceding the date of exercise of the conversion right.

The accretion of convertible loan was calculated using the effective interest method with monthly effective rate of 5.56%, \$275,304 has been recorded to the statement of loss for the year ended December 31, 2009 (\$242,103 for the period ended December 31, 2008).

On April 13, 2006, one of the holders of the convertible term loan exercised the right to convert the aggregate principal amount of a portion of such loan, \$1,000,000, and the accrued and unpaid interest of an aggregate amount of \$180,388, into common shares of the Company. The principal amount was converted at a price of \$0.65 per common share of the Company and the accrued and unpaid interest at a price of \$0.879, for a total of 1,743,682 common shares being issued by the Company. The transaction has been accounted for by reducing the debt, interest payable and contributed surplus, respectively, by an amount of \$700,959, \$180,388 and \$421,514 and the share capital was increased by \$1,302,861.

On July 13, 2007, one of the holders of the convertible term loan exercised the right to convert the aggregate principal amount of a portion of such loan, \$500,000, and the accrued and unpaid interest, an aggregate amount of \$180,194, into common shares of the Company. The principal amount was converted at a price of \$0.65 per common share, for a total of 769,231 common shares being issued by the Company. The aggregate amount of the accrued and unpaid interest was converted at a price of \$0.57 per common share, for a total of 1,086,922 common shares issued by the Company. The transaction has been accounted for by reducing the debt, interest payable and contributed surplus, respectively, by an amount of \$403,061, \$180,194 and \$210,758 and the share capital was increased by 1,086,922 shares.

c) On October 29, 2007, ProSep Inc. obtained a \$4,000,000 unsecured debenture. The debenture carried an interest of 13% per annum, payable monthly (effective interest rate of 13.4%). The principal amount repayable in 48 equal monthly instalments including capital and interest, commencing on the 19th month following disbursement of funds. The Company has also issued along with the debenture 2,424,242 warrants to purchase shares of the Company at a price of \$1.65 per share for a period of five years. The warrants issued as a part of this unsecured debenture are recorded in contributed surplus at their relative fair value of \$83,865.

In November 2008, the terms of the \$4,000,000 unsecured debenture were changed. The principal amount of the debenture has been changed from \$4,000,000 to \$4,000,000 USD (\$4,898,400 as at December 31, 2008). The company received \$752,000 due to the exchange rate. In consideration for the change of currency, the interest rate was changed from 13% to 13.25%. All other terms and conditions remained unchanged. In accordance with CICA section 3855 and EIC 88, this change was considered as an extinction of the original debt and the issuance of a new one. Consequently, an amount of \$93,872 of deferred financing expenses was written off to the statement of loss.

d) 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 new credit facility with DnB NOR in October 2007. This facility is secured by the assets of the Company. The new credit facility consists of a five-year senior acquisition facility in an amount of 27,000,000 NOK (\$4,876,198) at December 31, 2009, (36,000,000 NOK (\$6,318,006) at December 31, 2008). The Company has financial covenants to respect under this facility which were respected at December 31, 2009.

e) On April 24, 2008, the Company issued unsecured convertible subordinated debentures for an amount of \$5,090,000. The debentures were due on April 30, 2013 and bore interest at 13% (effective interest rate of 27.77%). The principal amount of the debentures was convertible at any time at the holder's option into common shares at a conversion price of \$0.45. Interest was payable every six months in cash, and the company could elect to pay interest in common shares using a conversion price equal to 90% of the market value (as defined in the trust indenture) of the common shares at the time of payment. Furthermore, the Company had the option of early cash redemption of the debentures between April, 2010 and February, 2013. In addition, 1,018,000 share purchase warrants were issued to the debentures holders at an exercise price of \$0.30 per share and expiring on April 24, 2013.

For accounting purposes, the debentures include both a liability component and an equity component (the holders' conversion option and the warrants). The liability component is classified for financial instrument purposes as other liabilities. The fair initial value of the liability component of \$3,552,408 has been 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 warrants and no conversion rights. The fair value of the warrants of \$192,321 was determined using the Black & Scholes option pricing model using the following assumptions: risk free interest rate 3.20%; dividend yield 0%; expected volatility 66%; 5 years expected life. The residual of the proceeds over the fair value of the liability component and the warrants was attributed to the conversion option (\$1,345,271).

**12. Long-term debt and Interest payable (continued)**

The issuance costs incurred have been accounted for as a reduction of the liability component (\$588,922) and as issuance expenses (\$254,903) for the portion attributable to the equity component. The issuance costs include 1,018,000 share purchase warrants with an exercise price of \$0.30 per share and expiring on April 24, 2013 (valued at \$192,321) and the reduction of the exercise price of 2,424,242 share purchase warrants issued on October 26, 2007 from \$1.65 to \$0.55 per share (change in fair value of \$182,199). The warrants were evaluated with the Black & Scholes model using the following assumptions: risk free interest rate 3.17%; dividend yield 0%; expected volatility 66%; 4.5 years expected life.

In October 2008, in accordance with the trust indenture, the Company has elected to pay in common shares the interest on the unsecured convertible subordinated debenture. The Company paid the interest due October 31, 2008, by issuing 1,886,885 common shares at an average price of \$0.18 (rounded) per share for a total amount of \$344,441, which was credited to share capital.

f) Long-term debt instalments and obligation under capital leases for the next five years are:

2010	1,672,602
2011	1,798,116
2012	6,290,808
2013	-
2014	3,600,526

**13. Pension Obligation**

The Company's pension plan, related to the Norwegian operations and required by local laws, gives 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 has been done on December 31, 2009.

The information relating to the pension plans are as follows:

	2009	2008
	\$	\$
<b>Change in benefit obligation</b>		
Benefit obligation, beginning of year	1,442,632	1,341,097
Service cost	329,956	358,486
Interest cost	54,541	65,887
Settlement	-	(103,292)
Payroll tax of employer contribution	(12,100)	(47,659)
Foreign exchange rate changes	6,683	(14,100)
Actuarial gain	(520,128)	(157,787)
<b>Benefit obligation, end of year</b>	<b>1,301,584</b>	<b>1,442,632</b>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	1,096,530	1,000,000
Actual return on plan assets	(175,904)	(172,787)
Employer contribution	57,792	338,169
Settlement	-	(57,152)
Foreign exchange rate changes	5,130	(11,700)
<b>Fair value of assets, end of year</b>	<b>983,548</b>	<b>1,096,530</b>
Reconciliation of the funded status of the benefits plan to amounts recorded in the financial statements.		
Accrued benefit obligation	1,301,584	1,442,632
Fair value of plan assets	983,548	1,096,530
Funded status of plan - deficit	318,036	346,102
Unamortized actuarial gain (loss)	177,404	(56,264)
Pension obligation	495,440	289,838

**13. Pension Obligation (continued)**

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

**Net periodic benefit cost**

	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)
Settlement	-	-	-
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>

  

	2008		
	Incurred	Adjustments (a)	Recognized
	\$	\$	\$
Current service cost	358,486	-	358,486
Interest cost	65,887	-	65,887
Actual return on plan assets	172,787	(224,243)	(51,456)
Settlement	(46,140)	-	(46,140)
Actuarial gain	(157,787)	104,432	(53,355)
<b>Net periodic benefit cost</b>	<b>393,233</b>	<b>(119,811)</b>	<b>273,422</b>

(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 \$57,792 in 2009 and \$338,169 in 2008.

**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 14 years.

The plan assets are segregated in the following categories:

	2009	2008
	%	%
Foreign equity	0	12.3
Bonds	55	40.9
Bonds held to maturity	0	11.3
Real estate	16	12.3
Money market	10	7.2
Norwegian equity	12	1.4
Other	7	14.6

**Significant assumptions:**

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

**Accrued benefit obligations**

Discount rate	4.4	3.8
Rate of compensation increase	4.3	4.0

**Benefit costs**

Discount rate	3.8	4.7
Expected long-term rate of return on plan assets	5.6	5.8
Rate of compensation increase	4.0	4.5

**14. Share capital**

Authorized				
Unlimited common shares without par value				
Stated				
		<b>2009</b>		<b>2008</b>
		<b>Number of shares</b>	<b>\$</b>	<b>Number of shares</b>
				<b>\$</b>
Balance, beginning of year		64,443,451	55,488,839	62,556,566
Payment of interest to debenture holders Oct 31, 2008 (Note 12 (e))		-	-	1,886,885
Induced conversion of long term debt (Note 12 (a))		37,749,998	8,583,975	-
Conversion of accrued interest (Note 12 (a))		5,131,693	667,120	-
Conversion of unsecured debentures due 2013 (Note 12 (a))		17,469,230	2,271,000	-
Issued pursuant to the exercise of rights (a)		38,461,538	5,000,000	-
Balance, end of year		<b>163,255,910</b>	<b>72,010,934</b>	64,443,451
				55,488,839

(a) Pursuant to a short form prospectus dated July 14, 2009 and in conjunction with the debt restructuring described in Note 12 (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 (share issue expenses).

*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.

There were no share purchase options granted during the years ended December 31, 2009 and 2008.

Changes in the number of options are as follows:

	<b>December 31, 2009</b>		December 31, 2008	
	<b>Number of options</b>	<b>Weighted average exercise price</b>	Number of options	Weighted average exercise price
		<b>\$</b>		<b>\$</b>
Balance, beginning of year	449,000	0.32	3,745,250	0.89
Expired	-	-	(1,469,250)	1.03
Forfeited	(29,000)	0.43	(366,000)	0.82
Cancelled	-	-	(1,461,000)	0.94
Balance, end of year	<b>420,000</b>	<b>0.31</b>	449,000	0.32
Exercisable	<b>315,000</b>	<b>0.31</b>	226,500	0.32

The table below presents additional information regarding the Company's stock option program as at December 31, 2009:

<b>Range of exercise price</b>	<b>Number of options</b>	<b>Weighted-average remaining life (years)</b>	<b>Number of options exercisable</b>
\$0.31	420,000	2.97	315,000

The amount expensed and recorded in contributed surplus for option costs granted to employees is \$ 23,385 for the year ended December 31, 2009 (\$313,034 for the year ended December 31, 2008).

**14. Share capital (continued)***Warrants*

Changes in the number of warrants are as follows:

	December 31, 2009		December 31, 2008	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
		\$		\$
Balance, beginning of period	27,635,027	0.61	25,599,027	0.64
Expired	(23,174,785)	0.64	-	-
Granted (Note 12e)	-	-	2,036,000	0.30
Balance, end of period	4,460,242	0.44	27,635,027	0.61 *
Warrants exercisable	4,460,242	0.44	27,635,027	0.61 *

Range of exercise price	Number of warrants	Weighted-average remaining life (years)
\$0.30 - \$0.55	4,460,242	3.04

\* The weighted average exercise price has changed during the year ended December 31, 2008 (Note 12 (e)).

*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, 2009, the Company granted 2,415,000 restricted share units at a weighted average value of \$0.20 (rounded) per share for a total of \$483,925 (1,450,000 were issued for the year ended December 31, 2008 at \$0.35 (rounded) per share for a total value of \$514,500). The expense recorded in the consolidated statements of loss and credited to contributed surplus was \$337,337 for the year ended December 31, 2009 (\$169,267 for the year ended December 31, 2008).

	2009	2008
	Number of restricted share units	Number of restricted share units
Balance, beginning of period	1,851,500	455,000
Granted	2,415,000	1,450,000
Forfeited	(104,722)	(53,500)
Balance, end of period	4,161,778	1,851,500

**15. Basic and diluted loss per share**

Basic and diluted loss per share has been calculated using the weighted-average number of common shares outstanding during the period: 106,085,384 shares for the year ended December 31, 2009 (62,877,078 shares for the year ended December 31, 2008).

As a result of the loss 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 units as well as the convertible feature of the loan have not been included in the calculation of diluted loss per share because the effect would have been anti-dilutive. For the year ended December 31, 2008, 27,635,027 potentially dilutive warrants, 449,000 potentially dilutive options and 1,851,500 potentially dilutive restricted share units have not been included in the calculation for the same reason. The debenture and secured loans convertible features have not been taken into consideration because they would have had the same anti-dilutive effect (Note 12).

**16. Income taxes****Future Income Tax**

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

	<u>2009</u>	<u>2008</u>
	\$	\$
Provisions & reserves	239,143	249,802
Deferred revenues	-	44,833
Tax losses carried forward	8,554,303	8,263,204
Capital loss	478,922	525,994
Intangible assets	108,426	120,738
Foreign exchange difference	-	20,998
Research and development expenses	597,307	597,307
Property and equipment	393,619	548,792
Pension obligation	384,722	73,561
Share issuance costs	-	30,508
Financing fees	317,626	157,519
Sub-Total	<u>11,074,068</u>	<u>10,633,256</u>
Property and equipment	(105,988)	(92,011)
Intangible assets	(2,462,733)	(2,305,970)
Sub-Total	<u>(2,568,721)</u>	<u>(2,397,981)</u>
Valuation allowance	<u>(9,958,777)</u>	<u>(9,160,476)</u>
Net future tax liabilities	<u>(1,453,429)</u>	<u>(925,201)</u>
Future tax assets	207,698	192,398
Future tax liabilities	<u>(1,661,127)</u>	<u>(1,117,599)</u>
	<u>(1,453,429)</u>	<u>(925,201)</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.

**Tax Expense**

The reconciliation of the tax expense is as follows:

	<u>2009</u>	<u>2008</u>
	\$	\$
Loss before income taxes	(13,404,291)	(448,220)
Expected income tax recovery based on statutory rate (December 31, 2009 statutory tax rate is 30.9%, December 31, 2008 it was 30.09%)	(4,141,926)	(138,500)
Change in statutory rate	108,147	(15,502)
Unrecorded tax benefits	806,343	955,598
Impairment of goodwill	2,008,500	-
Expiry of non capital losses	277,268	275,324
Other	120,313	(260,218)
Effect due to refinancing	620,207	-
Non deductible portion of the devaluation of investments	-	225,896
Effect of foreign tax rate	(293,321)	2,637,214
Effect caused by foreign exchange on foreign subsidiaries	820,926	(2,741,126)
Non deductible stock-based payments	111,463	149,031
Non deductible financing fees	36,172	89,120
Tax provision	<u>474,092</u>	<u>1,176,837</u>
Current tax provision (recovery)	(76,066)	1,341,831
Future tax provision (recovery)	550,158	(164,994)
	<u>474,092</u>	<u>1,176,837</u>

**16. Income taxes (continued)***Tax losses carried forward*

At December 31, 2009, the Company had the following non-capital losses carried forward and unclaimed deductions available to reduce taxable income in the future:

	2009		
	\$ Canada	\$ Norway	\$ Malaysia
Canadian Scientific Research & Experimental Development and expenses without limitation	1,890,856	-	-
Non capital losses carried forward, expiring in			
2010	1,912,304	-	-
2014	2,698,776	-	-
2015	-	-	-
2026	8,112,742	-	-
2027	3,138,918	-	-
2028	2,423,245	-	-
2029	1,560,714	-	-
	<b>19,846,699</b>	<b>-</b>	<b>-</b>
Non capital losses carried forward without limitation	-	10,418,372	1,094,997
<b>Total</b>	<b>21,737,555</b>	<b>10,418,372</b>	<b>1,094,997</b>

**17. Cost of goods sold**

	2009	2008
	\$	\$
Products & services sold	28,058,017	38,042,471
Warranty provision	39,649	(2,308,235)
	<b>28,097,666</b>	<b>35,734,236</b>

**18. Other supplemental information**

	2009	2008
	\$	\$
Research and Development		
Research and development expenses	130,400	1,300,306
Research and development tax credits	-	(144,694)
	<b>130,400</b>	<b>1,155,612</b>

**18. Other supplemental information (continued)**

	2009	2008
Financial (income) charges, net		
Other financial liabilities	\$	\$
Interest on long-term debt	1,334,716	1,801,690
Accretion on long-term debt	432,738	502,966
Interest charges	455,597	670,789
Sub-total	2,223,051	2,975,445
Held for trading		
Change in fair value of derivative financial instrument	-	12,450
Interest revenue on held for trading financial assets	(110,076)	(207,664)
Sub-total	(110,076)	(195,214)
Loss (gain) on foreign exchange	1,681,611	(2,177,776)
	3,794,586	602,455

	2009	2008
Amortization	\$	\$
Property and equipment	909,966	801,953
Intangible assets	668,574	678,714
	1,578,540	1,480,667

**19. Supplemental cash flow information**

	2009	2008
	\$	\$
Interest paid	1,562,306	2,011,483
Income taxes paid	405,205	1,218,290

**20. Restricted cash**

	2009	2008
	\$	\$
Restricted cash, short term	-	1,037,846
Restricted cash, long term	2,022,940	3,158,986
	2,022,940	4,196,832

In November 2009, \$1,931,764 USD (\$2,021,731) was restricted cash for the issuance of a letter of guarantee maturing on October 5, 2010 with National Bank of Canada. As of December 31 2009, this restricted cash amounted to \$1,932,919 USD (\$2,022,940) due to interest earned on the initial amount.

In November 2008, 17,999,900 NOK (\$3,158,986) was required under the credit facility with DnB NOR (Note 12d). On April 29, 2009, the Company agreed to a new covenant structure on this facility which enabled the release of this amount. On October 25, 2007, \$1,037,846 was deposited following the acquisition of Pure Group AS. During the second quarter of 2009, most of this amount was released to the seller.

**21. Commitments and contingencies**

The Company has entered into lease agreements, over various term commitments up to a maximum of 10 years, for the leasing of commercial spaces and office equipment. The annual commitments for the next 5 years and thereafter are as follows:

	\$
2010	1,030,952
2011	882,200
2012	837,087
2013	840,095
2014	777,630
Thereafter	3,269,932

During the year 2009, the Company has entered into three lease agreements for new offices in two of its business units and its corporate office.

**21. Commitments and contingencies (continued)**

In addition to the letters of guarantee disclosed in Note 10, the Company has an amount of \$3,643,958 (\$1,878,727 in 2008) of letters of guarantee outstanding with Export Development Canada.

The Company is a defendant in a legal action against Westend Enviro Consultants ("Westend") for a total amount of \$280,000, the outcome of which is not determinable at year end. In management's opinion, the resolution of such actions will not have a major impact on the financial condition of the Company.

**22. Financial instruments**

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

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.

	December 31, 2009		December 31, 2008	
	\$ Book value	\$ Fair value	\$ Book value	\$ Fair value
Financial assets:				
Held for trading:				
Cash	7,689,695	7,689,695	7,615,119	7,615,119
Derivative financial instrument	2,400,000	2,400,000	-	-
Sub-Total classified as held for trading	10,089,695	10,089,695	7,615,119	7,615,119
Restricted cash	2,022,940	2,022,940	4,196,832	4,196,832
Long-term investment	3,425,000	3,425,000	5,425,000	5,425,000
Sub-Total designated as held for trading	5,447,940	5,447,940	9,621,832	9,621,832
Total	15,537,635	15,537,635	17,236,951	17,236,951
Loans and receivables:				
Trade accounts receivable	3,430,318	3,430,318	4,889,791	4,889,791
Financial liabilities:				
Other financial liabilities:				
Bank credit facilities	5,006,206	5,006,206	11,596,044	11,596,044
Accounts payable and accrued liabilities	12,836,057	12,836,057	20,953,507	20,953,507
Long-term debt, including current portion	15,762,052	15,862,445	15,409,599	16,493,634
	33,604,315	33,704,708	47,959,150	49,043,185

*Fair value*

The carrying values of restricted cash, receivables, investments, 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	7,689,695	-	-
Restricted Cash	2,022,940	-	-
Long Term Investments	-	-	3,425,000
Embedded Put Options	-	2,400,000	-

**22. Financial instruments (continued)**

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

	2009
	<b>Long term Investments</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	(389,034)
Closing balance	<u>3,425,000</u>

*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 forecasts and actual cash flows for all of its business units and taking the necessary actions to maintain enough liquidity for operations and for growth objectives.

The table below presents the contractual maturities of financial liabilities at December 31, 2009:

	Less than six months	Between six and twelve months	Between one and five years
	\$	\$	\$
Bank credit facilities	99,123	5,105,329	-
Accounts payable and accrued liabilities	12,836,057	-	-
Long term debt (including current portion)	1,267,686	1,246,921	16,320,312
Total	<u>14,202,866</u>	<u>6,352,250</u>	<u>16,320,312</u>

*Credit risk*

Financial instruments which potentially subject the Company to a concentration of credit risk principally consist of cash and cash equivalents, trade accounts receivable and unbilled receivables. The maximum exposure of the Company is limited to the carrying amounts. The Company has its cash and cash equivalents 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 (Note 22) and consequently the Company is exposed to a concentration of credit risk. Amounts receivable from two customers represent 61% of trade accounts receivable at December 31, 2009 (three customers represent 64% at December 31, 2008). In addition, five customers represent 85.3% of unbilled receivables at December 31, 2009 (three customers represent 75% at December 31, 2008).

At December 31, 2009, \$1,310,427 of trade accounts receivables have been outstanding for more than 90 days. Of this amount, \$979,252 has been received in January and February 2010.

*Currency risk*

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

	2009				
	USD Functional currency unit (US operations)				
	USD	EURO	GBP	SGD	NOK
Cash	-	-	-	-	-
Trade accounts and unbilled receivables	-	-	-	-	-
Intercompany receivables	-	-	-	-	-
Restricted cash short term	-	-	-	-	-
Bank credit facilities	-	-	-	-	-
Accounts payable and accrued liabilities	-	-	-	-	(354,150)
Intercompany payables	-	-	-	-	-
Total in CAD	-	-	-	-	<u>(354,150)</u>

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

## 22. Financial instruments (continued)

	2009				
	NOK Functional currency unit (European and Middle-East & Product Development operations)				
	USD	EURO	GBP	SGD	NOK
Cash	221,174	-	-	-	-
Trade accounts and unbilled receivables	233,429	42,402	-	-	-
Intercompany receivables	-	-	-	-	-
Restricted cash short term	-	-	-	-	-
Bank credit facilities	-	-	-	-	-
Accounts payable and accrued liabilities	(34,662)	(18,407)	-	-	-
Intercompany payables	-	-	-	-	-
<b>Total in CAD</b>	<b>419,940</b>	<b>23,995</b>	-	-	-

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

	MYR Functional currency unit (Asia Pacific Operations)				
	USD	EURO	GBP	SGD	NOK
	Cash	5,350	-	-	-
Trade accounts and unbilled receivables	-	141,095	-	-	-
Intercompany receivables	-	-	-	-	-
Restricted cash short term	-	-	-	-	-
Bank credit facilities	-	-	-	-	-
Accounts payable and accrued liabilities	(76,655)	(102,615)	(8,716)	(127,116)	-
Intercompany payables	-	-	-	-	-
<b>Total in CAD</b>	<b>(71,305)</b>	<b>38,480</b>	<b>(8,716)</b>	<b>(127,116)</b>	-

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

	CAD Functional currency unit (Corporate office)				
	USD	EURO	GBP	SGD	NOK
	Cash	180,787	-	-	-
Trade accounts and unbilled receivables	-	-	-	-	-
Intercompany receivables	2,010,423	-	-	-	784
Restricted cash long-term	2,022,935	-	-	-	-
Bank credit facilities	-	-	-	-	-
Accounts payable and accrued liabilities	(141,084)	-	-	-	(2,874)
Intercompany payables	(243,271)	-	-	-	(374,276)
<b>Total in CAD</b>	<b>3,829,790</b>	-	-	-	<b>(376,366)</b>

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, 2009, a 1% increase in exchange rates of the respective foreign currencies on that date would have resulted in a loss of \$33,412 before income taxes.

**22. Financial instruments (continued)**

	2008				
	NOK	USD	MYR	GBP	EUR
Cash	10,370,336	3,298,125	583,892	-	108,000
Trade accounts receivables	2,370,048	2,985,702	3,343,989	-	66,422
Unbilled receivables	7,955,745	10,505,870	752,881	-	-
Restricted cash long term	17,999,900	-	-	-	-
Bank credit facilities	25,048,660	-	-	-	-
Accounts payable and accrued liabilities	7,168,000	12,378,810	2,507,641	443,983	8,321
Long-term debt	36,000,000	79,207	-	-	-

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

*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, 2009 there was no foreign exchange forward contract outstanding. There was also no foreign exchange forward contract at December 31, 2008.

*Interest rate risk*

In addition to the interest rate risk on the Long-term investment described in Note 9, 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 in exchanging variable rates for fixed rates. A change of 1% in the interest rates would have an impact of \$170,630 per year on the basis of the outstanding debt and bank credit facilities on the balance sheet at December 31, 2009.

**23. Capital Management**

The Company is not a capital intensive corporation, but is working capital intensive. During the past years the Company has accumulated a large deficit. The objective of the Company 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, 2009, the Company entered into significant transactions that have affected components of its capital, namely the refinancing on a long term basis of the former ABCP credit facility (see Note 9), the restructuring of the debentures issued by the parent company (see Note 12) and the rights offering (see Note 14)

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

	2009	2008
	\$	\$
Bank credit facilities	<b>5,006,206</b>	11,596,044
Long term debt, including current portion and interest payable	<b>13,792,737</b>	16,323,077
	<b>18,798,943</b>	27,919,121
Less cash	<b>7,689,695</b>	7,615,119
<b>Net debt</b>	<b>11,109,248</b>	20,304,002
<b>Shareholders' equity</b>	<b>19,962,631</b>	19,530,902
<b>Total Capital</b>	<b>31,071,879</b>	39,834,904
Net debt as a percentage of total Capital	<b>36%</b>	51%

**ProSep Inc.**

**Notes to the consolidated financial statements**

**24. 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, ProPure & Middle-East and ProSep 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.

*Revenue and expenses by business units*

	<b>2009</b>						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Revenue	26,723,377	3,706,574	9,828,746	1,160,041	-	-	41,418,738
Revenue inter segment *	74,683	166,223	174,010	-	-	(414,916)	-
Total revenue	26,798,060	3,872,797	10,002,756	1,160,041	-	(414,916)	41,418,738
Cost of goods sold	18,696,982	1,423,698	7,849,845	542,057	-	(414,916)	28,097,666
Gross margin	8,101,078	2,449,099	2,152,911	617,984	-	-	13,321,072
Operating expenses	5,815,266	2,927,952	1,014,435	130,400	3,292,640	-	13,180,693
EBITDA**	2,285,812	(478,853)	1,138,476	487,584	(3,292,640)	-	140,379

*Revenue and expenses by business units*

	<b>2008</b>						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Revenue	43,046,128	5,926,010	2,066,588	565,653	-	-	51,604,379
Revenue inter segment *	125,017	130,148	1,011,854	-	-	(1,267,019)	-
Total revenue	43,171,145	6,056,158	3,078,442	565,653	-	(1,267,019)	51,604,379
Cost of goods sold	33,994,365	436,840	2,547,276	22,774	-	(1,267,019)	35,734,236
Gross margin	9,176,780	5,619,318	531,166	542,879	-	-	15,870,143
Operating expenses	3,792,685	3,141,527	669,072	1,319,713	3,927,244	-	12,850,241
EBITDA**	5,384,095	2,477,791	(137,906)	(776,834)	(3,927,244)	-	3,019,902

\* 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.

ProSep Inc.

Notes to the consolidated financial statements

24. Segmented information (continued)

Revenue originated from:

	2009						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
United States	26,798,060	-	-	-	-	(74,683)	26,723,377
Norway	-	3,522,544	-	1,160,041	-	(166,223)	4,516,362
Canada	-	350,253	-	-	-	-	350,253
Malaysia	-	-	10,002,756	-	-	(174,010)	9,828,746
	<b>26,798,060</b>	<b>3,872,797</b>	<b>10,002,756</b>	<b>1,160,041</b>	<b>-</b>	<b>(414,916)</b>	<b>41,418,738</b>

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.

	2008						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
United States	43,171,145	-	-	-	-	(125,017)	43,046,128
Norway	-	4,769,534	-	565,653	-	(111,148)	5,224,039
Canada	-	1,286,624	-	-	-	(19,000)	1,267,624
Malaysia	-	-	3,078,442	-	-	(1,011,854)	2,066,588
	<b>43,171,145</b>	<b>6,056,158</b>	<b>3,078,442</b>	<b>565,653</b>	<b>-</b>	<b>(1,267,019)</b>	<b>51,604,379</b>

Three clients of US operations represented 72% of the Company's consolidated revenue for the year ended December 31, 2008.

Assets

	2009						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Total assets	<b>27,998,154</b>	<b>8,049,673</b>	<b>9,026,821</b>	<b>-</b>	<b>8,320,661</b>	<b>-</b>	<b>53,395,309</b>

  

	2008						
	US Operations	European & Middle-East Operations	Asia Pacific Operations	Product Development activities	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Total assets	36,767,783	12,025,983	6,995,633	-	13,706,211	-	69,495,610

**ProSep Inc.**

**Notes to the consolidated financial statements**

**24. Segmented information (continued)**

*Geographical information*

	2009	2008
	\$	\$
Sales to customers situated in:		
North America (USA, Canada)	13,205,477	20,000,058
South America (Venezuela, Columbia, Argentina)	7,863,942	11,874,322
Middle-East (Kuwait)	4,619,710	8,278,178
South-East Asia (Malaysia)	6,316,278	-
Europe (Norway, Spain)	2,672,437	4,098,502
Other countries	6,740,894	7,353,319
	<b>41,418,738</b>	<b>51,604,379</b>

*Assets*

	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
Other 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>
	2008				
	United States	Norway	Malaysia	Canada	Consolidated Operations
	\$	\$	\$	\$	\$
Property and equipment	702,566	599,311	36,710	517,692	1,856,279
Goodwill	10,161,126	7,559,000	2,687,000	-	20,407,126
Other intangibles	3,377,733	2,012,000	2,250,000	212,309	7,852,042
	<b>14,241,425</b>	<b>10,170,311</b>	<b>4,973,710</b>	<b>730,001</b>	<b>30,115,447</b>

**25. Comparative figures**

Comparative figures for the consolidated financial statements as at December 31, 2008 have been reclassified to conform with the December 31, 2009 presentation.