

ProSep Inc.
(Formerly TORR Canada Inc.)
Consolidated Financial Statements
December 31, 2008, December 31, 2007 and June 30, 2007



Raymond Chabot Grant Thornton

Auditors' Report

To the Shareholders of
ProSep Inc. (formerly TORR Canada Inc.)

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We have audited the consolidated balance sheets of ProSep Inc. (formerly TORR Canada Inc.) as at December 31, 2008 and 2007 and the consolidated statements of loss and comprehensive loss, deficit, contributed surplus and cash flows for the year ended December 31, 2008 and for the six-month period ended December 31, 2007. 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, 2008 and 2007 and the results of its operations and its cash flows for the year ended December 31, 2008 and for the six-month period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at June 30, 2007 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated August 7, 2007.

Raymond Chabot Grant Thornton LLP¹

Montréal, March 3, 2009

¹ Chartered accountant auditor permit no. 22865

ProSep Inc.

(Formerly TORR Canada Inc.)

Consolidated statements of loss and comprehensive loss

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

	Year ended December 31, 2008	(Note 1) Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Revenue	51,604,379	5,785,229	26,055,117
Cost of goods sold (Note 16)	35,734,236	5,156,933	28,494,797
Gross margin	15,870,143	628,296	(2,439,680)
Expenses			
Sales and marketing	1,854,230	628,622	1,525,820
Research and development (Note 17)	1,155,612	279,315	474,198
General and administrative	9,840,399	4,321,438	3,222,026
	12,850,241	5,229,375	5,222,044
	3,019,902	(4,601,079)	(7,661,724)
Decrease in fair value of investment in ABCP	1,385,000	1,800,000	-
Financial charges (income), net (Note 17)	602,455	749,561	(134,727)
Write-off of intangible assets, property and equipment	-	321,260	-
Amortization (Note 17)	1,480,667	592,272	408,548
Loss before income taxes	(448,220)	(8,064,172)	(7,935,545)
Current tax provision (Note 15)	1,341,831	22,683	-
Future tax recovery (Note 15)	(164,994)	(11,544)	-
	1,176,837	11,139	-
Net loss and comprehensive loss	(1,625,057)	(8,075,311)	(7,935,545)
Weighted average number of shares (basic and diluted)	62,877,078	53,036,426	46,477,317
Basic and diluted loss per share (Note 14)	(0.03)	(0.15)	(0.17)

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

ProSep Inc.
(Formerly TORR Canada Inc.)
Consolidated balance sheets
As at December 31, 2008, December 31, 2007 and June 30, 2007

	December 31, 2008	(Note 1) December 31, 2007	June 30, 2007
	\$	\$	\$
Assets			
Current assets			
Cash and cash equivalents (Note 18)	7,615,119	8,662,634	16,507,702
Restricted cash (Note 19)	1,037,846	1,055,846	-
Receivables (Note 4)	20,004,848	11,299,053	4,420,479
Deferred contract costs	-	66,048	76,411
Inventories (Note 5)	669,881	615,430	383,627
Prepaid expenses	886,085	418,222	159,450
Investment	-	-	2,491,971
Derivative financial instruments	-	12,450	103,550
	30,213,779	22,129,683	24,143,190
Restricted cash (Note 19)	3,158,986	-	-
Long term investment (Note 8)	5,815,000	7,200,000	-
Property and equipment (Note 6)	1,856,279	2,093,671	887,318
Goodwill (Note 3)	20,407,126	20,407,126	-
Intangible assets (Note 7)	7,852,042	8,530,759	594,420
Future tax assets (Note 15)	192,398	72,596	-
Deferred financing costs	-	-	68,657
Deferred acquisition costs	-	-	562,809
	69,495,610	60,433,835	26,256,394
Liabilities			
Current liabilities			
Bank credit facilities (Note 9)	11,596,044	10,602,541	-
Accounts payable and accrued liabilities (Note 10)	20,953,507	15,765,232	6,621,331
Income tax payable	114,043	-	-
Deferred revenue	484,078	349,515	383,908
Current portion of long term debt (Note 11)	3,322,106	1,660,518	2,275
	36,469,778	28,377,806	7,007,514
Interest payable (Note 11)	-	651,493	713,262
Long-term debt (Note 11)	12,087,493	11,178,087	1,616,327
Future tax liabilities (Note 15)	1,117,599	1,162,791	-
Pension obligation (Note 12)	289,838	391,650	-
	49,964,708	41,761,827	9,337,103
Shareholders' equity			
Share capital (Note 13)	55,488,839	55,144,398	46,382,045
Contributed surplus	12,527,139	10,132,726	9,198,470
Deficit	(48,485,076)	(46,605,116)	(38,661,224)
	19,530,902	18,672,008	16,919,291
	69,495,610	60,433,835	26,256,394

Commitments and contingencies (Note 20)

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

Approved by the Board

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

" **G rard Caron** " G rard Caron, Director

ProSep Inc.

(Formerly TORR Canada Inc.)

Consolidated statements of deficits

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

	Year ended December 31, 2008	(Note 1) Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Deficit, beginning of the period	(46,605,116)	(38,661,224)	(30,725,679)
Adjustment related to the adoption of section 3855 of CICA handbook	-	131,419	-
Balance as restated, beginning of the period	(46,605,116)	(38,529,805)	(30,725,679)
Transaction costs attributable to convertible debenture (Note 11d)	(254,903)	-	-
Net loss and comprehensive loss	(1,625,057)	(8,075,311)	(7,935,545)
Deficit, end of the period	(48,485,076)	(46,605,116)	(38,661,224)

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

ProSep Inc.
(Formerly TORR Canada Inc.)
Consolidated statements of contributed surplus
Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

	Stock-based compensation	Warrants	Conversion feature of loans	Total contributed surplus
	\$	\$	\$	\$
Contributed surplus as at June 30, 2006	779,310	6,507,096	843,031	8,129,437
Stock-based compensation	816,125	-	-	816,125
Accretion of warrants on convertible loans	-	252,908	-	252,908
Contributed surplus as at June 30, 2007	1,595,435	6,760,004	843,031	9,198,470
Adjustment relating to adoption of section 3855 of CICA handbook	-	590,111	-	590,111
Balance as restated as at June 30, 2007	1,595,435	7,350,115	843,031	9,788,581
Stock-based compensation	480,335	-	-	480,335
Options exercised	(9,297)	-	-	(9,297)
Fair value of warrants awarded following issue of unsecured debenture (Note 11)	-	83,865	-	83,865
Reversal of a portion of conversion feature of loans (Note 11)	-	-	(210,758)	(210,758)
Contributed surplus as at December 31, 2007	2,066,473	7,433,980	632,273	10,132,726
Stock-based compensation	482,301	-	-	482,301
Value of warrants issued or repriced following issue of convertible debenture (Note 11 d)	-	566,841	-	566,841
Debenture conversion feature (Note 11 d)	-	-	1,345,271	1,345,271
Contributed surplus as at December 31, 2008	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.
(Formerly TORR Canada Inc.)
Consolidated statements of cash flows
Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

	Year ended December 31, 2008	Note 1 Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Operating activities			
Net loss and comprehensive loss	(1,625,057)	(8,075,311)	(7,935,545)
Items not affecting cash			
Stock-based compensation	482,301	480,335	816,125
Amortization of property and equipment	801,953	235,650	300,573
Write-off of intangible assets, property and equipment	-	321,260	-
Amortization of intangible assets	678,714	356,622	107,975
Amortization of financing related costs	-	-	282,332
Accreted interest	502,966	643,843	465,102
Accrued interest on long term investment	-	-	(252,134)
Decrease in fair value of investment in ABCP	1,385,000	1,800,000	-
Interest on long term debt paid in shares (Note 13)	344,441	-	-
Periodic pension cost in excess of contributions	(101,812)	136,700	-
Future income taxes (Note 15)	(164,994)	(11,544)	-
Change in fair value of derivative financial instruments	12,450	91,100	(103,550)
Unrealized exchange loss (gain)	(1,497,177)	49,179	-
	818,785	(3,972,166)	(6,319,122)
Changes in non-cash operating working capital items	(4,352,754)	1,203,261	448,853
	(3,533,969)	(2,768,905)	(5,870,269)
Investing activities			
Business acquisition (Note 3)	-	(20,117,116)	-
Restricted cash (Note 19)	-	(1,037,846)	-
Disposal of investments	-	2,455,881	-
Acquisition of investments	-	(8,963,910)	-
Acquisition of property and equipment	(565,045)	(58,471)	(753,204)
Deferred acquisition costs	-	-	(562,809)
	(565,045)	(27,721,462)	(1,316,013)
Financing activities			
Restricted cash	(3,158,986)	-	-
Increase in long term debt (Note 11 b and d)	5,372,696	12,018,136	-
Bank credit facilities (Note 9)	1,202,416	10,602,541	-
Reimbursement of long-term debt	(1,724,866)	(6,552)	(2,274)
Issuance of share capital (Note 13)	-	16,250	254,517
	1,691,260	22,630,375	252,243
Effect of exchange rate on cash and cash equivalents	1,360,238	14,923	-
Decrease in cash and cash equivalents	(1,047,515)	(7,845,068)	(6,934,040)
Cash and cash equivalents, beginning of year/period	8,662,634	16,507,702	23,441,742
Cash and cash equivalents, end of year/period	7,615,119	8,662,634	16,507,702

Additional information - see Note 18

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

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

1. Incorporation, description of business and going concern

ProSep Inc. ("The Company") is incorporated under the *Canada Business Corporations Act*. Its shares are widely held and 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.

Effective July 1st, 2007, the company changed its fiscal year end from June 30 to December 31.

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.

So far, the Company has incurred significant losses and has relied on non-operational sources of financing to fund operations. Accordingly, there exists doubt that the Company would be able to continue as a going concern as at December 31, 2008. However, the Company is currently working to improve its working capital level in the future by converting the short term loan with National Bank on long-term debt as follows: \$2,531,250 converted into a 2-year credit facility extendable for additional one-year periods up to a maximum of five one-year renewals and \$4,668,750 converted into a 3-year credit facility extendable for additional one-year periods up to a maximum of four one-year renewals. Moreover, during the year the net cash generated from operations before changes in working capital was \$818,785 compared to a negative \$3,972,166 for the six-month period ended December 31, 2007. The ability of the Company to continue as a going concern depends on realizing the above and achieving profitability.

At December 31, 2008, the Company was in breach of one of its financial covenants under the credit facility with DnB NOR. However, the Company has since obtained a long-term waiver for this breach (Note 11 c).

While management believes the use of going concern assumptions is appropriate, there is no assurance that the above will be successful. 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 Changes in accounting policies

In the first quarter of fiscal 2008, the Company adopted four new Handbook sections issued by the Canadian Institute of Chartered Accountants (CICA). The adoption of these standards did not have any material effect on the Company's results, financial position or cash flows.

a) Financial Instruments - Disclosures

Section 3862, Financial Instruments - Disclosures. This Section describes the required disclosures related to the significance of financial instruments on the entity's financial position and performance and the nature and extent of risks arising for financial instruments to which the entity is exposed and how the entity manages those risks.

The adoption of this Section requires that the Company present sensitivity analyses regarding currency risk, foreign exchange risk, interest rate risk and market risk. Comparative information about the nature and extent of risks arising from financial instruments is not required in the year the Section 3862 is adopted.

b) Financial Instruments - Presentation

Section 3863 Financial Instruments - Presentation. This Section establishes standards for presentation of financial instruments and non-financial derivatives.

c) Capital Disclosures

Section 1535 Capital Disclosures. This Section establishes standards for disclosing information about an entity's capital and how it is managed to enable users of financial statements to evaluate the entity's objectives, policies and procedures for managing capital. This Section requires the disclosures of summary quantitative data concerning the components it manages as capital, whether during the period it complied with any externally imposed capital requirements to which it is subject and when the entity has not complied with such requirements, the consequences of such non-compliance.

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

2. Accounting policies (continued)

The adoption of this Section requires that information on capital management is now included in the notes to the consolidated financial statements. This information is included in Note 21, Capital Management.

d) Inventories

On January 1, 2008 the Company adopted Section 3031 Inventories. This section provides guidance on the determination of cost of inventories and its subsequent recognition as an expense, including any write-downs or reversal of write-downs. The section requires inventories to be measured at the lower of cost and net realizable value.

2.2 Future Accounting Standards

The CICA issued the following new Handbook Sections which are effective for fiscal years subsequent to December 31, 2008.

Section 3064, Goodwill and Intangible Assets, which replaces Section 3062.

This Section clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset. Accordingly, start-up costs must be expensed as incurred. This Section applies to the Company for the year beginning on January 1, 2009. The Company is currently evaluating the impact of the adoption of this new Section on the consolidated financial statements.

The CICA has decided to converge Canadian generally accepted accounting principles (Canadian GAAP) with International Financial Reporting Standards (IFRS). Starting on January 1, 2011 accounting and financial statements will have to comply with IFRS. The Company is currently assessing the impact on the transition to IFRS on the Company's financial statements.

2.3 Significant accounting policies

a) Principles of consolidation

The consolidated financial statements include the accounts of ProSep Inc. and its wholly owned subsidiaries TORR Acquisition Norway AS, TORR Finance Group LLC, Pure Group AS, ProSep Technologies, Inc., Pro Pure AS, ProSep AP Sdn Bhd, TORR UK Limited and ProPure ME. Intercompany transactions and balances are eliminated on consolidation.

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 of a convertible instrument, 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 cost, future tax as well as fair value estimates of stock options, restricted share units and decrease in value of long-term investment. All the estimates are based on management best knowledge of current events and actions that the Company might consider to do in the future. Actual results could differ from these estimates.

c) Revenue recognition

The Company's revenues are derived from various sources: (i) Manufacturing contracts, (ii) field trials and other related services, (iii) TORR system sales.

The Company offers complete and integrated solutions to meet its customers' 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 collectibility is reasonably assured. For product sales, the recognition criteria are generally met when title and risk of loss have been transferred from the Company to the buyer, which may be upon shipment or delivery to the customer site, based on contract terms or legal requirements in foreign countries. Instances in which the agreement with the customer contains a customer acceptance clause, revenue is deferred until customer acceptance is obtained. Service revenue is recognized when the services are rendered.

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

2. Accounting policies (continued)

c) Revenue recognition (continued)

i) 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 liability on the balance sheet under accrued liabilities (note 10). If the degree of completion of a project cannot be established reliably, only revenue corresponding to expenses incurred will be recognized. Any loss on projects is fully recognized when it is ascertained that the project will incur a loss.

ii) Field trials and other related services

Field trials are services rendered by technicians and/or engineers operating a demonstration of the Company's various 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 related equipment is recognized on the basis of services rendered.

iii) TORR system sales

On January 1, 2007, the Company, on a retroactive basis, decided to recognize revenue from the design, manufacturing and delivery of TORR™ systems under completion accounting using the completed contract method. The Company changed to this method during the year to more appropriately reflect the production type nature of the arrangements to deliver TORR™ systems. Under the completed contract method, revenue billed and related contract expenses are deferred until the production of a unit is completed, delivery to the customer occurs and there is reasonable assurance of collection. Any loss on projects is fully recognized when it is ascertained that the project will incur a loss.

iv) Warranty provision

A warranty provision is accounted for in cost of goods sold when the product is delivered and in accordance with the terms of the contract. When relevant, the 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.

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 that the Company will receive a grant. Grants are presented as a deduction of the expense to which the grant relates. Investment grants are presented as a reduction of the relevant asset cost and amortized systematically over the assets service life.

f) Research and development expenses

Research costs are expensed as incurred. Development costs are expensed when they do not meet the criteria for deferral as prescribed by Canadian GAAP. To date, no development costs have been deferred.

g) Research and development ("R&D") investment tax credits

The R&D investment tax credits are recorded as earned to the extent they are realizable and recorded in reduction of related costs. They must be examined and approved by the tax authorities and it is possible that the amounts granted will differ from the amounts recorded.

h) Cash and cash equivalents

Cash and cash equivalents, including liquid investments with an original maturity date of less than three months, are stated at cost, which approximates fair value.

i) Deferred contract costs

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

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

2. Accounting policies (continued)

j) 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.

k) 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	5 to 10 years
Equipment	5 years
Plant equipment under capital lease	5 years
Moulds - Cartridges	3 years
Vehicles	3 to 5 years

l) 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 other comprehensive loss 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 cash equivalents, restricted cash and long-term investments and derivative financial instruments are classified 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 recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measurement of trade 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.

m) Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net identifiable assets and liabilities related to the acquired business. Goodwill is not subject to amortization, and is tested for impairment annually or more frequently if events or changes in circumstances indicate the asset might be impaired, in which case the carrying amount of the asset is written down to the fair value.

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

2. Accounting policies (continued)

n) Intangible assets

Intangible assets are assessed as to whether the asset has a specific or indefinite service life. Intangible assets with a specific service life are amortized over the financial service life and are tested for impairment if there are indications of loss of value. Intangible assets with indefinite service life are not amortized but are tested for loss of value at least once a year.

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

Customer relationships	10 years
Trade name	15 years
Technology	13 to 15 years
Patents	13 years

o) Impairment of long-lived assets

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 as at December 31, 2008 and no impairment was required.

p) Post-employment benefit plans

The Company accrues its obligations under employee defined benefit plans, 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 (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 (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.

q) Stock-based compensation

The Company accounts for stock-based compensation using the fair value method of accounting for both non-employee and employee grants. 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 over the vesting period of the options and restricted share units. 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.

r) 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 diluted loss per share. This method assumes that the proceeds would be used to purchase common shares at the average market price during the year.

s) Income taxes

The Company recognizes a current tax liability or asset for current taxes payable or receivable. 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.

ProSep Inc.

(Formerly TORR Canada Inc.)

Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

2. Accounting policies (continued)

t) Foreign currency translation

Monetary assets and liabilities are translated at the rate in effect at balance sheet date. Non-monetary assets and liabilities are translated at the historical exchange rate. Items denominated in currency other than the Canadian dollar in the statements of loss are translated at average month rates except for amortization, which is translated at historical rates. All exchange gains and losses are included in net loss.

All subsidiaries are considered integrated foreign subsidiaries and, accordingly, monetary assets and liabilities are translated at the rates prevailing at the balance sheet date, whereas items appearing in the statements of loss are translated at exchange rates in effect at the transaction dates. Gains or losses resulting from translation are recognized in net loss.

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 which comprised of the following components:

- i) A cash outlay of \$10,499,310 of which \$1,037,846 was deposited in a separate escrowed bank account to be held for any eventual indemnity and adjustment to the purchase price owed to the Company under the share purchase agreement.
- ii) Acquisition costs of \$2,580,301
- iii) 5,143,222 common shares of which 1,457,229 are in escrow and accounted for at \$0.70 representing the average trading price 5 days before and 5 days after the announcement date of July 30, 2007 for a total amount of \$3,600,255.
- iv) 9,600,749 common shares of ProSep Inc. under a lock-up agreement accounted for at \$0.45 (rounded) per share after a discount of 35.4% (rounded) to take into consideration the effect of the lock-up agreement for a total amount of \$4,342,538. Since that date, 7,371,984 common shares have been released, leaving a balance of 2,228,763 common shares under the lock-up agreement.
- v) Repayment of preferred shares in the acquired company which was financed through a new credit facility for \$8,127,136 (45,000,000 NOK). Refer to Note 11 c.

The excess consideration over fair value recorded as goodwill is \$20,407,126, which is not deductible for tax purpose. The consolidated financial statements include the result of operations for Pure Group AS since October 25, 2007. The purchase price allocation for this acquisition was as follows:

	<u>\$</u>
Tangible assets acquired	
Accounts Receivable	9,935,435
Unbilled receivable	614,805
Inventory	251,666
Prepaid expenses	359,816
Property and equipment	1,392,253
Future tax asset	150,261
Total tangible assets	12,704,236
Liabilities assumed	
Accounts payable and accrued liabilities	10,569,977
Pension obligation	255,497
Future tax liability	1,252,000
Other	484,348
Total liabilities	12,561,822
Net tangible assets acquired	142,414
Intangible assets	
Technology	4,100,000
Customer relationships	2,800,000
Trade name	1,500,000
Backlog	200,000
Goodwill	20,407,126
	29,149,540

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3. Acquisition (continued)

The technology, customer relationships, trade name and backlog are amortized over their useful lives.

The terms of the acquisition also include 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 ending June 30, 2009. If these results are achieved the goodwill will be adjusted by the amount of the bonus payment. No amount has been recorded in relation to the conditional bonus payment.

4. Receivables

	December 31,	December 31,	June 30,
	2008	2007	2007
	\$	\$	\$
Trade accounts receivable	4,889,791	4,645,219	4,144,232
Unbilled receivables *	14,528,661	5,788,413	-
Sales taxes and other	586,396	865,421	276,247
	20,004,848	11,299,053	4,420,479

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

5. Inventories

	December 31,	December 31,	June 30,
	2008	2007	2007
	\$	\$	\$
Raw materials	352,954	237,378	56,402
Finished goods	167,629	251,500	327,225
Spare parts	149,298	126,552	-
	669,881	615,430	383,627

During the year ended December 31, 2008 there was no write-down on inventories recorded and no reversal of write-down (nil for the six-month period ended December 31, 2007 and for the year ended June 30, 2007).

6. Property and equipment

	December 31, 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
	3,636,610	1,780,331	1,856,279

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6. Property and equipment (continued)

	December 31, 2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	452,505	185,811	266,694
Furniture and fixtures	261,245	45,033	216,212
Research and development equipment	309,795	273,632	36,163
Demonstration units	1,139,692	292,803	846,889
Leasehold improvements	111,970	13,843	98,127
Equipment	497,161	104,705	392,456
Plant equipment under capital lease	118,389	13,042	105,347
Vehicles	22,655	2,259	20,396
Moulds - Cartridges	165,618	54,231	111,387
	3,079,030	985,359	2,093,671

	June 30, 2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	253,901	137,348	116,553
Furniture and fixtures	87,236	29,915	57,321
Research and development equipment	309,601	268,334	41,267
Demonstration units	482,794	273,914	208,880
Leasehold improvements	63,915	7,253	56,662
Equipment	316,212	58,372	257,840
Plant equipment under capital lease	15,950	6,148	9,802
Moulds - Cartridges	165,618	26,625	138,993
	1,695,227	807,909	887,318

7. Intangible assets

	December 31, 2008		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patent and Technology	4,430,000	434,625	3,995,375
Customer relationships	2,800,000	326,666	2,473,334
Trade name	1,500,000	116,667	1,383,333
Backlog	200,000	200,000	-
	8,930,000	1,077,958	7,852,042

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7. Intangible assets (continued)

	December 31, 2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patent and Technology	4,430,000	135,908	4,294,092
Customer relationships	2,800,000	46,666	2,753,334
Trade name	1,500,000	16,667	1,483,333
Backlog	200,000	200,000	-
	<u>8,930,000</u>	<u>399,241</u>	<u>8,530,759</u>

	June 30, 2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Patent and Technology	1,413,740	819,320	594,420
	<u>1,413,740</u>	<u>819,320</u>	<u>594,420</u>

8. Long term Investment

The investment is comprised of third party asset backed commercial paper ("ABCP") acquired on July 12, 2007, rated R1 (High) by Dominion Bond Rating Services "DBRS" at the time of purchase, the highest credit rating issued for commercial paper, with a par value of \$9,000,000. This investment was classified as held for trading with a fair value of \$8,963,910. During the month of August 2007, the ABCP market experienced liquidity problems. As a result, in some cases, as commercial paper matured certain Canadian Third Party programs were unable to raise funds from new issuances and therefore were not able to refund maturing commercial paper. The maturity date on the \$9,000,000 of outstanding ABCP was August 14, 2007, and the amount due was not repaid.

On August 16, 2007 announcement was made by a group representing banks, asset providers and major investors that they had agreed in principle to a long-term proposal and interim agreement to convert the ABCP into long-term variable rate notes maturing no earlier than the scheduled maturity of the underlying assets. On September 6, 2007, a Pan-Canadian restructuring committee consisting of major investors was formed. The Committee was created to propose a solution to the liquidity problem affecting the ABCP and has retained legal and financial advisors to oversee the proposed restructuring process.

On December 23, 2007 the Pan Canadian restructuring committee announced an agreement in principle to restructure the ABCP issued by 20 trusts, including the trust of which the Company holds ABCP. Under the proposal, holders of ABCP were to exchange their paper for floating rate notes that have maturities based on the maturities of the underlying ABCP. The notes are to be designed so that all available cash flow in the trusts will be paid to note holders.

On March 17, 2008, the Ontario Superior Court of Justice granted an application by the Committee under the Companies' Creditors Arrangement Act (CCAA) establishing a procedure for noteholder approval of the restructuring plan. The vote took place on April 25, 2008 and noteholders approved the restructuring plan subject to approval by the Court.

On October 20, 2008, the Pan Canadian restructuring committee announced that it was continuing to lead the restructuring efforts on behalf of investors but has postponed by one month the closing date that was originally targeted to occur by the end of October 2008. This delay owed mostly to the complexity of the transaction documents, the large number of parties involved and recent market volatility. Replacement loan offerings can only be finalized after the ABCP restructuring implementation agreements have been put into final form and approved by the Ontario Superior Court, one of the key steps which will precede the closing of the ABCP restructuring.

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8. Long term Investment (continued)

The ABCB restructuring efforts of the Pan Canadian committee led to a final agreement on December 24, 2008, the closing of which occurred on January 21, 2009. As expected, the restructuring plan contemplated the replacement of the ABCP by new floating rate notes that have maturities based on the maturities of the underlying ABCP. The key elements of the plan are as follows:

Creation of three new trusts named "Master Asset Vehicles" ("MAV"):

- MAV 1 and MAV 2 are composed of 100% synthetic transactions, that is a combination of assets provided as collateral and credit default swaps and hybrid transactions, that is a combination of synthetic assets and traditional assets. They include also the ineligible (subprime) assets of these transactions ;

- MAV 3 is composed of transactions comprised solely of traditional assets or ineligible assets.

Creation of five categories of notes for MAV 1 and MAV 2 (A-1, A-2, B, C and IA) and two categories for MAV 3 (TA and IA). The TA and 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 with the following face values which represents the "ABCP" value as of August 14, 2007:

	\$
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

The MAV 2 A-1, A-2, B and C Notes legally mature in 2056. However, the expected maturity date is in 2016.

In addition to the replacement notes, the Company has received in January 2009 upon the restructuring cash amounting to \$298,526 representing accrued interest for the period from August 2007 to August 2008, net of the estimated restructuring costs incurred by the Pan Canadian committee.

The ABCP held by the Company has not traded in an active market since mid-August 2007 and as of December 31, 2008, there were no quotations from an active market available.

The fair value of the ABCP as of December 31, 2008, was determined based on management's judgment using available information and assumptions market participants would use in pricing such ABCP as at the balance sheet date. The Company reviewed information provided by the Pan-Canadian restructuring committee and DBRS including current and anticipated credit ratings, composition and valuation estimates of the underlying assets, the estimate of the extent of leverage in the trusts, the progress in the approval process of the restructuring plan and general economic conditions in considering the fair value of the investment. Given the final agreement reached in December 2008 and notes received in January 2009, the Company has estimated the fair value using a valuation approach based on a 100% likelihood of a successful restructuring.

The Company estimated the fair value of these investments using the discounted cash flow evaluation technique based on observable market assumptions to the extent possible. The main assumptions are comprised of the accrued interest received in January 2009 for the period from August 2007 to August 2008, the anticipated coupons moving forward, the anticipated maturity for the variable rate notes to be obtained in exchange for the ABCP and an appropriate discount rate based on the prevailing value of the notes, whenever applicable, considering risks of future losses. The estimated discount rate was determined based on observable market assumptions for similar securities. For the ABCP backed by ineligible assets, the fair value was established based on the terms of the proposed agreement with National Bank of Canada ("National Bank") as is further described below. The Company used the forecasted rates available in the proposed restructuring plan prepared by the Pan-Canadian committee and the following discount factors:

Replacement notes	Expected Yield	Market related Discount factors
Class A1 and A2	141 basis points*	Canada Bond rate plus 575 basis points
Class B	141 basis points*	Canada Bond rate plus 1100 basis points
Class C	141 basis points*	Canada Bond rate plus 1600 basis points
Ineligible	0 basis points*	Canada Bond rate plus 450 basis points

* December 31, 2008 BA swap rate of 1.91% minus 50 basis points

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8. Long term investment (continued)

The risk premiums added to the basic Canadian government bond rates reflect the liquidity, credit and other risks. Regarding the ineligible securities, the nominal amount used in the yield and discount calculation was reduced by 25% to take into consideration the agreement proposed by the National Bank which was conditional upon the implementation of the ABCP restructuring plan prepared by the Pan-Canadian committee. For these ineligible assets, a \$2,531,250 revolving credit facility agreement was proposed representing an amount equal to 75% of the face value of the replacement notes received in lieu of the ineligible assets. This credit facility is valid for two years and maturity is extendable for additional one-year periods, up to a maximum of five one-year renewals. The proposed agreement also grants to the Company the right to sell to National Bank the Ineligible notes at an exercise price of 75% of the notional amount exercisable at the end of two years. The proceeds from the exercise of the option would have to be used to settle the credit facility. Consequently, by accepting this agreement, the Company will incur a maximum loss of 25% on the ineligible securities.

National Bank has also offered, for the eligible assets (namely the MAV 2 Class A-1, A-2, B and C notes), a revolving credit facility totalling \$4,668,750 or 83% of the total face value of the replacement notes with a face value of \$5,625,000. This credit facility is valid for 3 years and extendable for additional one-year periods, up to a maximum of four one-year renewals. The proposed agreement also grants to the Company the right to sell to National Bank a portion of the eligible notes representing 45% of the notional amount of the eligible note. The proceeds from the exercise of the option would have to be used to settle the credit facility.

These credit agreements will provide the Company with \$7,200,000 in long term financing facility in replacement of the current term loan secured with the ABCP and maturing on April 30, 2009. The bank's recourse with respect to this new credit facility will be limited to the replacement notes.

Based on this assessment of fair values, the Company recognized an impairment charge of \$1,385,000 during the year ended December 31, 2008 while \$1,800,000 was recorded during the six-month period ended December 31, 2007 for a total impairment charge of \$3,185,000 since the acquisition, representing a cumulative impairment of 35% of the original cost.

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 next quarters. Following the analysis, the Company identified that the discount rate related to Classes A-1 and A-2 of MAV 2, generate the vast majority of the volatility in the valuation model of the ABCP's fair value. For example, a 50 basis point increase in the discount rate for A-1 and A-2 notes results in a \$136,000 decrease on the investments' value.

The Company has provided a first ranking hypothecation of the ABCP to secure a term loan with recourse (Note 9). This recourse is in third ranking hypothecation.

As the ABCP has since been replaced by long term notes, the Company has classified its ABCP as long-term investments.

9. Bank credit facilities

On October 17, 2007 the Company secured a \$7,200,000 demand loan facility with National Bank to finance working capital needs. On March 25, 2008, the Company renewed its agreement with National Bank and converted the credit facility payable on demand to a term loan with a new maturity date of April 30, 2009. The amount of this term loan of \$7,200,000 is presented as a bank credit facility as at December 31, 2008 (same as at December 31, 2007) and is secured by the long-term investment in ABCP (Note 8), in addition to third ranking universal hypothecation. The interest rate of 2.00% comprises the Canadian prime rate currently at 3.50% minus 1.5% per annum payable on a monthly basis. As at December 31, 2007, the interest rate was 4.50%.

The company has a bank credit facility with DnB NOR which consists of a senior overdraft facility of 30,000,000 NOK (\$5,265,005 at December 31, 2008) and a guarantee facility of 15,000,000 NOK (\$2,632,503 at December 31, 2008) to be used to provide customer guarantees against advances received under sales contracts. The bank credit facility outstanding is 25,048,660 NOK (\$4,396,044) at December 31, 2008 (18,716,072 NOK \$3,402,541 at December 31, 2007) and is secured by the assets of the Company. The interest rate of 5.48% is Norwegian Interbank Offered Rate (NIBOR) 3 month, equal to 3.98% plus 1.5% per annum.

The letters of guarantee outstanding amount to \$2,123,508 as at December 31, 2008 (\$1,502,417 as at December 31, 2007). There is no letter of credit outstanding as at December 31, 2008 (nil as at December 31, 2007).

10. Accounts payable and accrued liabilities

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Accounts payable	3,113,637	1,873,812	992,058
Warranty provision	487,638	2,740,714	2,561,841
Accrued liabilities and interest payable *	17,352,232	11,150,706	3,067,432
	20,953,507	15,765,232	6,621,331

*Accrued liabilities include cost derived from the percentage of completion of manufacturing contracts.

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11. Long-term debt and interest payable

	December 31, 2008		December 31, 2007	
	\$ Loan	\$ Interest payable	\$ Loan	\$ Interest payable
Secured convertible loans in the aggregate principal amount of \$1,5 million, convertible into common shares, bearing interest at 12% per annum compounded and maturing on October 29, 2009. (a)	979,540	649,540	737,437	693,682
Unsecured debenture in the principal amount of \$4 millions, bearing interest at 13% per annum, payable monthly. In 2008, this debenture has been converted into USD. (b)	-	-	3,811,317	-
Unsecured debenture in the principal amount of \$4 millions USD (\$4,898,400 as at December 31, 2008), bearing interest at 13,25% per annum, payable monthly. The principal amount and interest are payable in 48 equal monthly instalments of \$107,807 USD (\$132,020 as at December 31, 2008) starting on April 1, 2009 and expiring on March 1, 2013.(b)	4,898,400	55,208	-	-
Credit facility with DnB NOR. The interest rate of 5.48% as at December 31, 2008 is the three-month Norwegian Interbank Offered Rate (NIBOR) + 1.5% and the principal amount is payable in 10 equal instalments of 4 500 000 NOK (\$789,751 as at December 31, 2008) every 6 months. Expiration date is October 25, 2012. (c)	6,318,006	98,447	8,180,926	-
Convertible unsecured subordinated debenture (d)	3,108,165	110,283		
Obligations under capital leases	105,488	-	108,925	-
	15,409,599	913,478	12,838,605	693,682
Current portion of long term debt and interest payable	(3,322,106)	(913,478)	(1,660,518)	(42,189)
Long-term debt and interest payable	12,087,493	-	11,178,087	651,493

	June 30, 2007	
	Loan	Interest payable
Secured convertible loans in the aggregate principal amount of \$1,5 million, convertible into common shares, bearing interest at 12% per annum compounded and maturing on October 29, 2009. (a)	1,606,353	713,262
Obligations under capital leases	12,249	-
	1,618,602	713,262
Current portion of long term debt and interest payable	(2,275)	-
Long-term debt and interest payable	1,616,327	713,262

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11. Long-term debt and Interest payable (continued)

a) 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. Subsequent to the adoption of section 3855 of the CICA handbook, the Company reviewed the initial allocation between debt and equity to include the fair value of warrants as an equity component. This change resulted in a reduction of the carrying value of long-term debt by \$790,187 as at June 30, 2007.

The fair value of the warrants and convertible feature of the loans have been calculated as \$1,264,546 and \$1,264,546 respectively using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	3.17%
Expected life	52 months
Volatility	90%
Dividend rate	0%

The convertible loans bear interest at 12% per annum and mature on October 29, 2009. The interest payable for years One, Two and Three will be payable on the term date and years Four and Five will be payable yearly. At the option of the debt holders, interest may be 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 is calculated using the effective interest method with monthly effective rate of 5.56%, \$242,103 has been recorded to the statement of loss for the year ended December 31, 2008 (\$234,887 for the six-month period ended December 31, 2007).

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.

b) On October 29, 2007, ProSep Inc. obtained a \$4,000,000 unsecured debenture. The debenture carries an interest of 13% per annum, payable monthly (effective interest rate of 13.4% in 2007). The principal amount is repayable in 48 equal monthly instalments including capital and interest, commencing on the 19th month following disbursement of funds. The Company may repay the amounts owing to the lender as of the 25th month following disbursement of funds, up to a maximum of \$1,000,000 per 12-month period and with a premium of 5% of the repaid amount. 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. The fair value was calculated using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	4.20%
Expected life	36 months
Volatility	50%
Dividend rate	0%

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.

c) 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 (Note 3), the Company 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 36,000,000 NOK (\$6,318,006) at December 31, 2008, (45,000,000 NOK (\$8,180,926) at December 31, 2007).

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11. Long-term debt and Interest payable (continued)

At December 31, 2008, the Company was in breach of one of its financial covenants under the credit facility with DnB NOR. The Company has since obtained a long-term waiver for such breach. In exchange of the waiver, the Company must maintain an amount of \$3,158,986 (18 000 000 NOK) in a separate escrowed bank account to be held until the new covenant structure of the credit facility is determined (Note 19).

d) On April 24, 2008, the Company issued unsecured convertible subordinated debentures for an amount of \$5,090,000. The debentures are due on April 30, 2013 and bear interest at 13% (effective interest rate of 27.77%). The principal amount of the debentures is convertible at any time at the holder's option into common shares at a conversion price of \$0.45. Interest is payable every six months in cash, and the company may 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 has the option of early cash redemption of the debentures between April, 2010 and February, 2013. The Company may elect to pay the redemption in common shares using a conversion price equal to 90% of the market value of the common shares at the time of redemption. The market value is defined in the trust indenture. 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 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).

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.

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

2009	3,842,567
2010	2,709,664
2011	2,858,601
2012	3,023,490
2013	5,477,473

12. Pension Obligation

The Company's plan gives the right to defined future benefits. These are mainly dependent on 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 as at December 31 of each year. The last actuarial evaluation of the plan has been done on December 31, 2008 and the next evaluation will be on December 31, 2009.

For the year ended June 30, 2007, there was no pension plan in the Company.

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Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

12. Pension Obligation (continued)

The information relating to the pension plans are as follows:

	December 31, 2008	December 31, 2007
	\$	\$
Change in benefit obligation		
Benefit obligation at beginning of the period	1,341,097	-
Acquisition (Note 3)	-	1,221,797
Service cost	358,486	133,900
Interest cost	65,887	20,600
Settlement	(103,292)	-
Payroll tax of employer contribution	(47,659)	-
Foreign exchange rate changes	(14,100)	34,400
Actuarial gain	(157,787)	(69,600)
Benefit obligation at the end of the period	1,442,632	1,341,097

Change in plan assets

Fair value of plan assets at beginning of the period	1,000,000	-
Acquisition (Note 3)		966,300
Actual return on plan assets	(172,787)	8,100
Employer contribution	338,169	-
Settlement	(57,152)	-
Foreign exchange rate changes	(11,700)	25,600
Fair value of assets at the end of the period	1,096,530	1,000,000

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

Accrued benefit obligation	1,442,632	1,341,097
Fair value of plan assets	1,096,530	1,000,000
Funded status of plan - deficit	346,102	341,097
Unamortized actuarial loss (gain)	56,264	(50,553)
Pension obligation	289,838	391,650

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

Net periodic benefit cost

	Year ended December 31, 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 loss	(157,787)	104,432	(53,355)
Net periodic benefit cost	393,233	(119,811)	273,422

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12. Pension Obligation (continued)

	Six-month period ended December 31, 2007		
	Incurred	Adjustments (a)	Recognized
Current service cost	133,900	-	133,900
Interest cost	20,600	-	20,600
Actual return on plan assets	(8,100)	(9,700)	(17,800)
Actuarial loss	(69,600)	69,600	-
Net periodic benefit cost	76,800	59,900	136,700

(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 \$385,828 in 2008 and nil in 2007.

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:

	December 31, 2008	December 31, 2007
	%	%
Foreign equity	12.3	25.0
Bonds	40.9	25.0
Bonds held to maturity	11.3	22.0
Real estate	12.3	12.0
Money market	7.2	6.0
Norwegian equity	1.4	3.0
Other	14.6	7.0

Significant assumptions:

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

Accrued benefits obligations

	%	%
Discount rate	3.8	4.7
Rate of compensation increase	4.0	4.5

Benefits costs

Discount rate	4.7	4.7
Expected long-term rate of return on plan assets	5.8	5.7
Rate of compensation increase	4.5	4.5

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13. Share capital

Authorized

Unlimited common shares without par value

Stated

	Number of shares	Amount
		\$
Balance, June 30, 2006	46,192,340	46,127,528
Warrants exercised	500,000	250,000
Options exercised	8,333	4,517
Balance, June 30, 2007	46,700,673	46,382,045
Conversion of convertible term loan	1,086,922	794,013
Options exercised	25,000	25,547
Issue of shares for the Pure Group acquisition (Note 3)	14,743,971	7,942,793
Balance, December 31, 07	62,556,566	55,144,398
Issue of shares in payment of interests (Note 11 d)	1,886,885	344,441
Balance, December 31, 2008	64,443,451	55,488,839

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 and is 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 year ended December 31, 2008. The weighted average fair value of share purchase options awarded during the six-month period ended December 31, 2007 was estimated at \$0.25 per option (\$0.63 per option during the year ended June 30, 2007), using the Black-Scholes option pricing model and the following assumptions:

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
Risk-free interest rate	-	3.84% to 4.05%	4.01% to 4.13%
Expected life of options	-	5 years	5 years
Volatility	-	50%	91% to 95%
Dividend rate	-	0%	0%

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13. Share capital (continued)

Changes in the number of options are as follows:

	Year ended December 31, 2008		Six-month period ended December 31, 2007	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
		\$		\$
Balance, beginning of period	3,745,250	0.89	3,131,917	1.01
Granted	-	-	719,000	0.35
Expired	(1,469,250)	1.03	(57,417)	1.00
Exercised	-	-	(25,000)	0.65
Forfeited	(366,000)	0.82	(23,250)	0.74
Cancelled	(1,461,000)	0.94	-	-
Balance, end of period	449,000	0.32	3,745,250	0.89

	Year ended June 30, 2007	
	Number of options	Weighted average exercise price
		\$
Balance, beginning of year	2,442,000	1.09
Granted	1,005,000	0.86
Expired	(126,083)	1.25
Exercised	(8,333)	0.54
Forfeited	(180,667)	1.03
Balance, end of year	3,131,917	1.01

The table below presents additional information regarding the Company's stock option program as at December 31, 2008:

Range of exercise price	Number of options	Weighted- average remaining life (years)	Number of options exercisable
\$0.31 - \$0.50	445,000	3.97	222,500
\$0.57 - \$ 1.00	2,000	1.5	2,000
\$1.16 - \$ 1.45	2,000	1.72	2,000
	449,000		226,500

And as at December 31, 2007

Range of exercise price	Number of options	Weighted- average remaining life (years)	Number of options exercisable
\$0.31 - \$0.50	879,000	4.15	339,750
\$0.57 - \$ 1.00	1,886,750	3.03	1,318,750
\$1.16 - \$ 1.45	969,500	2.46	823,500
\$1.85	10,000	3.36	5,000
	3,745,250		2,487,000

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Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

13. Share capital (continued)

Options issued and outstanding as at the periods end are as follows:

December 31, 2008				December 31, 2007	
Granting period ended	Exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	\$		\$		\$
June 30, 03	1.35	-	-	80,000	1.35
June 30, 04	from 0.95 to 1.45	-	-	255,000	1.16
June 30, 05	from 0.50 to 1.00	2,000	1.00	874,000	0.91
June 30, 06	from 0.56 to 1.85	2,000	1.30	831,000	1.24
June 30, 07	from 0.85 to 0.92	-	-	986,250	0.86
Dec 31, 07	from 0.31 to 0.42	445,000	0.31	719,000	0.35
		449,000	0.32	3,745,250	0.89

June 30, 2007			
Granting period	Exercise price	Number of options	Weighted average exercise price
	\$		\$
2003	1.35	80,000	1.35
2004	from 0.95 to 1.45	255,000	1.16
2005	from 0.50 to 1.00	921,667	0.91
2006	from 0.56 to 1.85	874,500	1.22
2007	from 0.85 to 0.92	1,000,750	0.86
		3,131,917	1.01

The fair value of the options granted for the year ended December 31, 2008 is nil (it amounted to \$177,175 for the six-month period ended December 31, 2007 and \$636,485 for the year ended on June 30, 2007). The amount expensed and recorded in contributed surplus for option costs granted to employees and board members is \$313,034 for the year ended December 31, 2008 (\$480,335 for the six-month ended December 31, 2007 and \$816,125 at June 30, 2007).

Warrants

Changes in the number of warrants are as follows:

	Year ended		Six-month period ended	
	December 31, 2008		December 31, 2007	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
		\$		\$
Balance, beginning of period	25,599,027	0.64*	23,174,785	0.64
Granted (Note 10 d)	2,036,000	0.30	2,424,242	1.65
Balance, end of period	27,635,027	0.61	25,599,027	0.73
Warrants exercisable	27,635,027		25,599,027	

* The weighted average exercise price has changed during the year ended December 31, 2008 (Note 11 d).

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13. Share capital (continued)

	Year ended June 30, 2007	
	Number of warrants	Weighted average exercise price
		\$
Balance, beginning of year	23,174,785	0.64
Granted	500,000	0.5
Exercised	(500,000)	0.5
Balance, end of year	23,174,785	0.64
Warrants exercisable	23,174,785	

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 shares will be issued from the treasury of the Company. The number of shares reserved at any time must not exceed 5% of the aggregate number of shares.

During the year ended December 31, 2008, the Company granted 1,450,000 restricted share units at a weighted average value of \$0.35 (rounded) per share for a total of \$514,500 (455,000 were issued for the six-month period ended December 31, 2007 at \$0.31 per share for a total value of \$141,050, nil for the year ended June 30, 2007). The expense recorded in the consolidated statements of loss and credited to contributed surplus was \$169,267 for the year ended December 31, 2008 (nil for the six-month period ended December 31, 2007 and for the year ended June 30, 2007).

	Year ended December 31, 2008	Six-month ended December 31, 2007
	Number of restricted share units	Number of restricted share units
Balance, beginning of period	455,000	-
Granted	1,450,000	455,000
Forfeited	(53,500)	-
Balance, end of period	1,851,500	455,000

There were no restricted share units outstanding as at June 30, 2007.

14. Basic and diluted loss per share

Basic loss per share has been calculated using the weighted-average number of common shares outstanding during the period, 62,877,078 as at December 31, 2008 (53,036,426 as at December 31, 2007 and 46,477,317 during the year ended on June 30, 2007).

As a result of the loss for the year ended December 31, 2008, potentially 27,635,027 dilutive warrants, 449,000 dilutive options and 1,851,500 dilutive restricted units have not been included in the calculation of diluted loss per share because the effect would have been anti-dilutive. For the six-month period ended December 31, 2007 and the year ended June 30, 2007 they have not been included for the same reason.

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

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Provisions & reserves	249,802	755,089	785,000
Deferred revenues	44,833	92,977	123,000
Tax losses carry forward	8,263,204	7,107,604	5,332,000
Capital loss	525,994	281,250	-
Intangible	120,738	-	-
Foreign exchange difference	20,998	-	-
Research and development expenses	597,307	573,890	481,000
Property and equipment	548,792	391,495	280,000
Pension obligation	73,561	107,898	-
Share issuance cost	30,508	-	-
Financing Fees	157,519	253,402	402,000
Sub-Total	10,633,256	9,563,605	7,403,000
Property and equipment	(92,011)	-	-
Intangible assets	(2,305,970)	(2,386,188)	-
Sub-total	(2,397,981)	(2,386,188)	-
Valuation allowance	(9,160,476)	(8,267,612)	(7,403,000)
Net future tax liabilities	(925,201)	(1,090,195)	-
Future tax assets	192,398	72,596	-
Future tax liabilities	(1,117,599)	(1,162,791)	-
	(925,201)	(1,090,195)	-

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

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15. Income taxes (continued)

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Loss before income taxes	(448,220)	(8,064,172)	(7,935,545)
Expected income tax recovery based on statutory rate (December 31, 2008 statutory tax rate is 30.9%, December 31, 2007 and June 30, 2007 32.02%)	(138,500)	(2,582,148)	(2,540,000)
Change in statutory rate	(15,502)	1,027,027	-
Unrecorded tax benefits	955,598	448,452	1,583,000
Expiry of non capital losses	275,324	564,831	382,000
Other	(260,218)	46,933	165,000
Non deductible portion of the devaluation on investments	225,896	288,180	-
Effect of foreign tax rate	2,637,214	(25,660)	-
Effect caused by foreign exchange on foreign affiliates	(2,741,126)	(22,143)	-
Non deductible stock-based payments	149,031	153,803	261,000
Non deductible financing fees	89,120	111,864	149,000
Tax provision	<u>1,176,837</u>	<u>11,139</u>	<u>-</u>
Current tax provision	1,341,831	22,683	-
Future tax recovery	<u>(164,994)</u>	<u>(11,544)</u>	<u>-</u>
	<u>1,176,837</u>	<u>11,139</u>	<u>-</u>

Tax losses carry forward

As December 31, 2008, the Company had the following non-capital losses carried forward and unclaimed deductions available to reduce taxable income in the future:

	December 31, 2008	December 31, 2007
	\$	\$
Canadian SR&ED expenses without limitation	1,890,856	1,814,053
Non capital losses carried forward, expiring		
	Canada	
2008	-	1,023,509
2009	1,375,030	1,375,030
2010	-	-
2013	1,912,304	1,912,304
2014	2,698,776	2,698,776
2015	-	-
2026	8,112,742	8,112,742
2027	3,138,918	3,245,658
2028	2,575,415	-
	<u>19,813,185</u>	<u>18,368,019</u>
Non capital losses carried forward without limitation of time		
	Norway	
	<u>9,532,130</u>	<u>7,654,748</u>
	Malaysia	
	<u>1,329,642</u>	<u>153,450</u>

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15. Income taxes (continued)

	December 31, 2008	December 31, 2007
	\$	\$
Non capital losses carried forward, expiring		
		United States
2025	-	42,624
2027	-	99,022
	-	141,646

16. Cost of goods sold

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Products & services sold	38,042,471	5,132,807	26,181,687
Warranty provision	(2,308,235)	24,126	2,313,110
	35,734,236	5,156,933	28,494,797

The Company reversed a provision of \$2,561,841 previously recorded covering a guarantee bond in a contract with one of the ProPure & Middle East clients. Such reversal is related to a contractual obligation that ended during the year ended December 31, 2008.

17. Other supplemental information

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Research and Development			
Research and development expenses	1,300,306	279,315	759,240
Research and development tax credits	(144,694)	-	(105,524)
Government grants	-	-	(179,518)
	1,155,612	279,315	474,198
Financial (income) charges, net			
Other financial liabilities			
Interest on long-term debt	1,801,690	305,009	465,102
Accretion on long-term debt	502,966	200,872	-
Interest charges	670,789	56,502	-
Amortization of deferred financing costs	-	17,099	29,424
Financial expense related to the convertible loan	-	234,887	252,908
Sub-total	2,975,445	814,369	747,434
Held for trading			
Change in fair value of derivative financial instrument	12,450	(12,450)	(103,550)
Interest revenue on held for trading financial assets	(207,664)	(262,491)	(849,423)
Sub-total	(195,214)	(274,941)	(952,973)
Loss (gain) on foreign exchange	(2,177,776)	210,133	70,812
	602,455	749,561	(134,727)

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17. Other supplemental information (continued)

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Amortization			
Property and equipment	801,953	235,650	300,573
Intangible assets	678,714	356,622	107,975
	1,480,667	592,272	408,548

18. Supplemental cash flow information

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Cash and cash equivalents			
Cash	7,615,119	8,603,128	2,026,479
Short-term investments	-	59,506	14,481,223
	7,615,119	8,662,634	16,507,702

Short-term investments as at December 31, 2007 and June 30, 2007 consist of money market investments.

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Interest paid	2,011,483	115,996	-
Income taxes paid	1,218,290	75,833	-

19. Restricted cash

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Restricted cash short term	1,037,846	1,055,846	-
Restricted cash long term	3,158,986	-	-
	4,196,832	1,055,846	-

In November 2008, 17,999,900 NOK (\$3,158,986) was required under the credit facility with DnB NOR (note 10 c). On October 25, 2007, \$1,037,846 was deposited following the acquisition of Pure Group AS (note 3 i).

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20. 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:

	\$
2009	1,035,243
2010	1,189,560
2011	1,064,912
2012	952,701
2013	954,458
Thereafter	4,499,054

During the year 2008, the Company has entered into a lease agreement for a new shop in one of its business unit. These new premises will allow the entity to better perform their assembly of equipment.

The Company is a defendant in a claim by Westend Enviro Consultants ("Westend") filed on March 31, 2006, claiming damages for breach of contract and fraudulent misrepresentation for a total amount of \$280,000. The Company filed a Statement of Defence on June 9, 2006 denying any liability. It is premature to assess the likelihood of successfully defending this claim. No amount has been accrued.

21. Financial instruments

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

	December 31, 2008		December 31, 2007	
	\$ Book value	\$ Fair value	\$ Book value	\$ Fair value
Financial assets:				
Held for trading:				
Cash and cash equivalents	7,615,119	7,615,119	8,662,634	8,662,634
Restricted cash	4,196,832	4,196,832	1,055,846	1,055,846
Derivative financial instrument	-	-	12,450	12,450
Long-term investment	5,425,000	5,425,000	7,200,000	7,200,000
	17,236,951	17,236,951	16,930,930	16,930,930
Loans and receivables:				
Trade accounts receivable	5,258,772	5,258,772	4,645,219	4,645,219
Financial liabilities:				
Other financial liabilities:				
Bank credit facilities	11,596,044	11,596,044	10,602,541	10,602,541
Accounts payable and accrued liabilities	20,953,507	20,953,507	15,765,232	15,765,232
Long-term debt, including current portion	15,409,599	16,493,634	12,838,605	12,838,605
Interest payable	-	-	651,493	651,493
	47,959,150	49,043,185	39,857,871	39,857,871

Fair value

The carrying values of cash and cash equivalents, 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 investment has been estimated by management (Note 8).

The fair value of convertible loans, unsecured debentures and credit facility with DnB NOR were determined by discounting the cash flows using current interest rates for financial instruments with similar characteristics and maturities. Their fair values at December 31, 2008 approximate \$16,493,634.

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Liquidity risk is the risk that the Company will not have sufficient funds to meet its liabilities such as the settlement of financial debt and lease obligations and payment to its suppliers as they become due. The Company manages its 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 its growth objectives.

The table below presents the contractual maturities of financial liabilities as at December 31, 2008:

	Carrying amount	Less than six months	Between six and twelve months	Between one and five years
	\$	\$	\$	\$
Bank credit facilities	11,596,044	7,200,000	4,396,044	-
Accounts payable and accrued liabilities	20,953,507	19,816,329	1,137,178	
Long term debt (including current portion)	15,409,599	1,041,077	2,281,028	12,087,494
Total	47,959,150	28,057,406	7,814,250	12,087,494

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 Company has its cash and cash equivalents placed with high quality financial institutions. As part of its cash management process, the Company performs periodic evaluation 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 perform ongoing evaluation of their relative credit standing. Since a significant portion of the Company's sales were to a limited number of customers (Note 22) and as a consequence the Company is exposed to a concentration of credit risk. Amounts receivable from three customers represent 64% of trade accounts receivable as at December 31, 2008 (three customers represent 75% as at December 31, 2007). In addition, three customers represent 75% of unbilled receivable as at December 31, 2008 (four customers represent 99% as at December 31, 2007).

As at December 31, 2008, \$81,206 of the trade accounts receivable are outstanding for more than 90 days. From this amount, \$59,263 have been received in January 2009.

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 foreign currencies are as follows:

	December 31, 2008				
	NOK	USD	MYR	GBP	EUR
Cash and cash equivalents	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	-	-	-

ProSep Inc.

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Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

21. Financial instruments (continued)

Currency risk (continued)

	December 31, 2007				
	NOK	USD	MYR	GBP	EUR
Cash and cash equivalents	3,615,700	1,686,877	232,764	-	-
Trade accounts receivables	3,391,667	4,470,872	392,531	53,372	-
Unbilled receivables	3,638,420	5,120,848	344,589	-	-
Bank credit facilities	18,716,072	-	-	-	-
Accounts payable and accrued liabilities	17,029,212	7,478,308	372,210	-	-
Long-term debt	45,000,000	99,501	-	-	-

	June 30, 2007	
	USD	GBP
Cash and cash equivalents	1,316,067	-
Trade accounts receivable	3,293,352	-
Accounts payable and accrued liabilities	585,304	25,187

A strengthening of \$0.01 in the period-end value of the Canadian dollar compared to other currencies would have had the following impact on loss before income taxes:

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Increase (decrease) in loss before income taxes			
NOK, Norway Krone	(51,296)	(126,178)	-
USD, United States Dollar	52,520	36,322	42,368
MYR, Malaysia Ringgit	7,632	1,751	-
GBP, United Kingdom Pound	(7,867)	1,036	(532)
EUR, European Euro	2,804	-	-

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 uses 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 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.

The Company periodically contracts financial instruments with major financial institutions to manage foreign exchange risk related to future cash flows.

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Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

21. Financial instruments (continued)

Exchange rate risk and derivative financial instruments (continued)

As at December 31, 2008 there was no foreign exchange forward contract outstanding but as at December 31, 2007 the Company had the following foreign exchange forward contract outstanding:

On November 29, 2007 for a contractual amount of EUR 3,240,000 at a rate of 1.4762 US / EUR (US\$ 4,782,888) whereby the Company was committed to the sale of this currency. The foreign exchange forward contract expired in 2008, consequently, the fair value is nil as at December 31, 2008 (\$12,450 as at December 31, 2007) and the change in its fair value has been recorded in the statement of loss and comprehensive loss. The fair value has been obtained from the financial institution from whom the foreign exchange forward contract has been purchased from.

Interest rate risk

The company is exposed to interest rate fluctuation on a portion of its long-term debt and on bank credit facilities. A change of 1% in the interest rates would have an impact of \$179,140 per year, on the basis of the outstanding debt and bank credit facilities on the balance sheet as of December 31, 2008.

22. 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.

The Company defines capital as being equity plus debt, plus bank indebtedness, less cash and cash equivalents.

	December 31, 2008	December 31, 2007	June 30, 2007
	\$	\$	\$
Shareholders' equity	19,530,902	18,672,008	16,919,291
Bank credit facilities	11,596,044	10,602,541	-
Long term debt, including current portion and interest payable	15,409,599	13,490,098	2,331,864
	46,536,545	42,764,647	19,251,155
Less cash and cash equivalents	7,615,119	8,662,634	16,507,702
Capital	38,921,426	34,102,013	2,743,453

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Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

23. Segmented information

Operating segment

The Company designs, develops and manufactures process solutions to treat produced water, oil and gas for the upstream Oil and Gas industry. At the beginning of 2008, the Company has determined five reportable segments. Segments were 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.

The Company has restated the financial information for the six-month period ended December 31, 2007. No restatement was done for the year ended June 30, 2007 as these segments did not exist in the Company.

Revenue and expenses by business units

For the year ended December 31, 2008

	US Operations	ProPure & Middle-East	Pure Group Asia Pacific	Product Development	Corporate Office	Consolidation & Intercompany eliminations	Consolidated operations
	\$	\$	\$	\$	\$	\$	\$
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

For the six-month period ended December 31, 2007

	US Operations	ProPure & Middle-East	Pure Group Asia Pacific	Product Development	Corporate Office	Consolidation & Intercompany eliminations	Consolidated operations
	\$	\$	\$	\$	\$	\$	\$
Revenue	4,866,576	639,917	321,499	74,728	-	(117,491)	5,785,229
Cost of goods sold	4,143,223	783,092	324,715	23,394	-	(117,491)	5,156,933
Gross margin	723,353	(143,175)	(3,216)	51,334	-	-	628,296
Operating expenses	539,457	2,136,741	145,303	43,897	2,363,977	-	5,229,375
EBITDA*	183,896	(2,279,916)	(148,519)	7,437	(2,363,977)	-	(4,601,079)

For the year ended June 30, 2007

	ProSep Inc.
	\$
Revenue	26,055,117
Cost of goods sold	28,494,797
Gross margin	(2,439,680)
Operating expenses	5,222,044
EBITDA*	(7,661,724)

* 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.

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Notes to the consolidated financial statements**Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007****23. Segmented information (continued)***Revenue originated from:***For the year ended December 31, 2008**

	US Operations	ProPure & Middle-East	Pure Group Asia Pacific	Product Development	Corporate Office	Intercompany transactions	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
	43,171,145	6,056,158	3,078,442	565,653	-	(1,267,019)	51,604,379

Three clients of US Operations represented 72% of the consolidated revenue for the year ended December 31, 2008.

For the six-month ended December 31, 2007

	US Operations	ProPure & Middle-East	Pure Group Asia Pacific	Product Development	Corporate Office	Intercompany transactions	Consolidated operations
	\$	\$	\$	\$	\$	\$	\$
United States	4,866,576	-	-	-	-	-	4,866,576
Norway	-	372,215	-	74,728	-	-	446,943
Canada	-	267,702	-	-	-	-	267,702
Malaysia	-	-	321,499	-	-	(117,491)	204,008
	4,866,576	639,917	321,499	-	-	(117,491)	5,785,229

Three clients of US Operations represented 63% of the Company's revenue for the six-month period ended December 31, 2007.

For the year ended June 30, 2007, total revenue of \$26,055,117 originated from Canada and one client represented 98% of the Company's sales.

Assets**As at December 31, 2008**

	US Operations	ProPure & Middle-East	Pure Group Asia Pacific	Product Development	Corporate Office & Holding companies	Intercompany transactions	Consolidated operations
	\$	\$	\$	\$	\$	\$	\$
Total assets	21,145,815	4,305,381	768,682	-	43,275,732	-	69,495,610

As at December 31, 2007

Total assets	9,517,258	3,364,536	207,134	-	47,344,907	-	60,433,835
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ProSep Inc.

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Notes to the consolidated financial statements

Year ended December 31, 2008, six-month period ended December 31, 2007 and year ended June 30, 2007

23. Segmented information (continued)

Geographical information

	Year ended December 31, 2008	Six-month period ended December 31, 2007	Year ended June 30, 2007
	\$	\$	\$
Sales to customers situated in:			
United States	18,812,354	917,484	-
Argentina	11,874,322	1,974,879	-
Kuwait	8,278,178	-	-
Algeria	3,246,039	681,509	-
Norway	2,690,278	-	-
South Korea	-	-	25,526,482
Other countries	6,703,208	2,211,357	528,635
	51,604,379	5,785,229	26,055,117

Assets

As at December 31, 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
	14,241,425	10,170,311	4,973,710	730,001	30,115,447

As at December 31, 2007

	United States	Norway	Malaysia	Canada	Consolidated operations
	\$	\$	\$	\$	\$
Property and equipment	479,680	819,690	42,573	751,728	2,093,671

As at June 30, 2007, Property and equipment amounted to \$887,318 situated in Canada.

24. Comparative figures

Comparative figures for the consolidated financial statements as at and for the six-month period ended December 31, 2007 and as at and for the year ended June 30, 2007 have been reclassified to conform with the December 31, 2008 presentation. In particular, the Company has revised the presentation of bank credit facilities for an amount of \$3,402,541, which were presented with cash and cash equivalents as at December 31, 2007.