

Consolidated Financial Statements of

**CRITICAL OUTCOME  
TECHNOLOGIES INC.**

(a development stage company)

Years ended April 30, 2008, and 2007 and cumulative  
period from April 30, 1999 (inception) to April 30, 2008



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## AUDITORS' REPORT

To the Shareholders of Critical Outcome Technologies Inc.

We have audited the consolidated balance sheets of Critical Outcome Technologies Inc. (a development stage company) as at April 30, 2008 and 2007 and the consolidated statements of comprehensive loss, deficit, and cash flows for the each of the years then ended and the cumulative period from April 30, 1999 (inception) to April 30, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 30, 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

London, Canada

July 9, 2008, except for note 20 which is as of July 16, 2008.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)  
Consolidated Balance Sheets

April 30, 2008 and 2007

|   | 2008                | 2007                |
|---|---------------------|---------------------|
| <b>Assets</b>                           |                     |                     |
| Current assets:                         |                     |                     |
| Cash and cash equivalents               | \$ 3,113,220        | \$ 2,417,801        |
| Short-term investments (note 4)         | 3,100,489           | -                   |
| Miscellaneous receivables               | 135,357             | 76,655              |
| Prepaid expenses and deposits           | 31,462              | 28,095              |
|   | <u>6,380,528</u>    | <u>2,522,551</u>    |
| Equipment (note 5)                      | 131,151             | 52,560              |
| Molecules (note 6)                      | 2,949,129           | -                   |
| Patents (note 7)                        | 253,310             | 134,298             |
| Trademark (note 8)                      | -                   | 870                 |
| Investment in DDP Therapeutics (note 3) | -                   | 1                   |
|   | <u>\$ 9,714,118</u> | <u>\$ 2,710,280</u> |

## Liabilities and Shareholders' Equity

|  |                     |                     |
|--|---------------------|---------------------|
| Current liabilities:   |                     |                     |
| Accounts payable and accrued liabilities                     | \$ 317,022          | \$ 179,091          |
| Due to shareholders (note 9)                                 | 432,340             | 118,631             |
| Notes payable (note 10)                                      | 20,000              | 20,000              |
| Current portion of obligations under capital lease (note 11) | 20,024              | 20,244              |
|  | <u>789,386</u>      | <u>337,966</u>      |
| Obligations under capital lease (note 11)                    | 1,263               | 21,287              |
| Shareholders' equity:  |                     |                     |
| Share capital and warrants (note 12)                         | 12,179,189          | 4,037,165           |
| Contributed surplus  | 1,008,259           | 675,469             |
| Deficit  | (4,263,979)         | (2,361,607)         |
|  | <u>8,923,469</u>    | <u>2,351,027</u>    |
| Commitments (note 17)  |                     |                     |
| Subsequent events (note 20)                                  |                     |                     |
|  | <u>\$ 9,714,118</u> | <u>\$ 2,710,280</u> |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

  
\_\_\_\_\_  
Dr. Wayne Danter

Director

  
\_\_\_\_\_  
Dr. Kathleen Ferguson

Director

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Consolidated Statements of Comprehensive Loss and Deficit

|  | Years ended April 30 |                | Cumulative<br>period<br>April 30, 1999<br>(inception) to<br>April 30, 2008 |
|--|----------------------|----------------|--|
|  | 2008                 | 2007           |  |
| Revenue:   |                      |                |  |
| Contract services  | \$ 30,822            | \$ -           | \$ 63,322  |
| Screening services   | -                    | 2,500          | 2,500  |
|  | 30,822               | 2,500          | 65,822   |
| Expenses:  |                      |                |  |
| Salaries and benefits  | 662,670              | 423,014        | 1,259,602  |
| Stock-based compensation   | 362,763              | 424,469        | 1,038,232  |
| Professional fees  | 351,835              | 168,038        | 685,192  |
| Amortization of molecules  | 162,040              | -              | 162,040  |
| Research and product development                                   | 148,981              | 263,400        | 586,169  |
| Marketing  | 131,633              | 108,199        | 288,491  |
| General and administration   | 131,234              | 83,457         | 280,363  |
| Corporate governance   | 94,440               | 14,749         | 109,189  |
| Amortization of equipment  | 70,883               | 27,747         | 147,580  |
| Interest and bank charges  | 32,825               | 10,106         | 58,190   |
| Amortization of patents  | 4,270                | -              | 4,270  |
| Reorganization costs   | 4,051                | 23,964         | 110,595  |
| Loss on disposal of equipment                                      | 1,977                | -              | 1,977  |
| Amortization of trademark  | 870                  | 870            | 4,350  |
|  | 2,160,472            | 1,548,013      | 4,736,240  |
| Loss before other income   | (2,129,650)          | (1,545,513)    | (4,670,418)  |
| Other income:  |                      |                |  |
| Investment tax credit refunds                                      | 50,112               | 75,050         | 187,727  |
| Interest   | 177,166              | 40,480         | 218,712  |
|  | 227,278              | 115,530        | 406,439  |
| Loss and comprehensive loss  | (1,902,372)          | (1,429,983)    | (4,263,979)  |
| Deficit accumulated during development<br>stage, beginning of year | (2,361,607)          | (931,624)      | -  |
| Deficit accumulated during development<br>stage, end of year       | \$ (4,263,979)       | \$ (2,361,607) | (4,263,979)  |
| Basic and diluted loss per common share                            | \$ (0.05)            | \$ (0.05)      |  |
| Weighted average number of common<br>shares outstanding            | 41,321,501           | 29,866,634     |  |

See accompanying notes to consolidated financial statements.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Consolidated Statements of Cash Flows

|   | Years ended April 30 |                | Cumulative<br>period<br>April 30, 1999<br>(inception) to<br>April 30, 2008 |
|---|----------------------|----------------|--|
|   | 2008                 | 2007           |  |
| Cash provided by (used in):                                   |                      |                |  |
| Operating activities:   |                      |                |  |
| Loss  | \$ (1,902,372)       | \$ (1,429,983) | \$ (4,263,979)   |
| Items not involving cash:                                     |                      |                |  |
| Stock-based compensation                                      | 362,763              | 424,469        | 1,038,232  |
| Amortization  | 238,063              | 49,450         | 318,240  |
| Loss on disposal of equipment                                 | 1,977                | -              | 1,977  |
| Change in non-cash operating working capital<br>(note 16)     | 75,862               | (131,993)      | 101,053  |
|   | (1,223,707)          | (1,088,057)    | (2,804,477)  |
| Financing activities:   |                      |                |  |
| Issuance of common shares and warrants<br>Due to shareholders | 6,108,035            | 3,460,873      | 9,875,456  |
| Notes payable and other advances                              | (56,291)             | (8,563)        | 62,339   |
| Decrease in obligations under capital lease                   | -                    | (25,000)       | 20,000   |
| Research advances   | (20,244)             | (8,122)        | (29,908)   |
|   | -                    | -              | 269,745  |
|   | 6,031,500            | 3,419,188      | 10,197,632   |
| Investing activities:   |                      |                |  |
| Increase in short-term investments                            | (3,100,489)          | -              | (3,100,489)  |
| Purchase of equipment   | (151,450)            | (18,223)       | (180,362)  |
| Purchase of molecules   | (737,153)            | -              | (737,153)  |
| Additions to patents and trademarks                           | (123,282)            | (65,571)       | (261,931)  |
|   | (4,112,374)          | (83,794)       | (4,279,935)  |
| Increase in cash  | 695,419              | 2,247,337      | 3,113,220  |
| Cash and cash equivalents, beginning of year                  | 2,417,801            | 170,464        | -  |
| Cash and cash equivalents, end of year                        | \$ 3,113,220         | \$ 2,417,801   | \$ 3,113,220   |
| Represented by:   |                      |                |  |
| Cash  | \$ 544,095           | \$ 317,801     | \$ 544,095   |
| Cash equivalents  | 2,569,125            | 2,100,000      | 2,569,125  |
|   | \$ 3,113,220         | \$ 2,417,801   | \$ 3,113,220   |
| Supplemental cash flow information:                           |                      |                |  |
| Interest paid   | \$ 32,009            | \$ 2,351       | \$ 34,935  |
| Non-cash transactions:  |                      |                |  |
| Acquisition of equipment under capital lease                  | -                    | 11,081         | 62,274   |

See accompanying notes to consolidated financial statements.

# **CRITICAL OUTCOME TECHNOLOGIES INC.**

(a development stage company)

Notes to Consolidated Financial Statements

Years ended April 30, 2008 and 2007

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## **Description of business:**

Critical Outcome Technologies Inc. ("COTI") is a biotechnology company focused on applying its proprietary computer-based technology, CHEMSAS®, to identify, profile and optimize commercially viable drug candidates at the earliest stage of preclinical drug development and thereby dramatically reduce the timeline and cost of getting new drug therapies to market.

In developing its technology, COTI has focused on novel, proprietary, small molecules used to treat cancer and HIV. This focus has been on cancers with high morbidity and mortality such as acute leukemia in adults, hormone resistant breast cancer, hormone resistant prostate cancer, small cell lung cancer and melanoma, which currently have either poor or no effective therapies.

Using CHEMSAS®, the Company is developing a pipeline of highly optimized libraries of 6-10 small molecules for specific therapy targets and plans to sell/license these libraries to interested pharmaceutical partners for human trials and further drug development. Currently, the libraries in various stages of development in the pipeline are targeted at small cell lung cancer, colorectal cancer, HIV integrase inhibitors, chronic and acute leukemia and multiple sclerosis. The Company may take particularly promising individual molecules from its libraries forward for development in the pre-clinical phase of drug development and then through a Phase 1 clinical trial. These compounds would then be available for sale, licensing or co-development with a pharmaceutical partner.

The Company is also following a collaboration strategy to use its technology for pharmaceutical partners who have their own therapy targets which can benefit from the Company's drug discovery technology.

## **Amalgamation:**

On October 13, 2006, Critical Outcome Technologies Inc. (Private COTI) amalgamated with Aviator Petroleum Corporation (Aviator), a public company listed on the TSX Venture Exchange (the TSXV) to form a new company with the name Critical Outcome Technologies Inc. (Public COTI) under the provisions of the Business Corporations Act (Ontario).

The amalgamation between Aviator and Private COTI was an arm's length transaction requiring shareholder approval and a majority of minority shareholder approval pursuant to applicable corporate laws. The amalgamation constituted the qualifying transaction of Aviator pursuant to the policies of the TSXV and is the means by which Private COTI became a public issuer.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## Amalgamation (continued):

Under the amalgamation agreement, the Aviator common shares were exchanged for 5,635,000 common shares of Public COTI. In addition, the Aviator agent's options outstanding were exchanged for agent's options of Public COTI with the same terms entitling the holder to acquire up to 275,000 Public COTI common shares. The Private COTI common shares were exchanged for 28,967,332 Public COTI common shares with a deemed value of \$0.34521 per share. In addition, each outstanding \$0.40 warrant, \$0.70 warrant, \$0.30 agent's warrant and \$0.40 agent's warrant was exchanged on a one for one basis for replacement securities of Public COTI with the same terms. The transaction resulted in the shareholders of Private COTI retaining an 83.7% interest in the amalgamated company, with shareholders of Aviator retaining a 16.3% interest. The COTI common shares commenced trading on October 30, 2006 with 34,602,332 shares issued and outstanding on that date (see note 12).

Since the qualifying transaction and amalgamation resulted in Private COTI shareholders acquiring control of the amalgamated company, Private COTI was deemed to be the acquirer for financial reporting purposes. The share exchange was therefore considered to be a reverse takeover. As Aviator was deemed a non-operating public enterprise the transaction was accounted for as a capital transaction wherein the net monetary assets of Aviator were recorded at their fair market values, net of transaction costs to the extent of cash on hand in Aviator.

The net monetary assets of Aviator upon amalgamation were as follows:

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|   |            |
|---|------------|
| Monetary assets                             | \$ 353,249 |
| Less monetary liabilities                   | 18,706     |
| <hr/>                                       |            |
| Net monetary assets                         | 334,543    |
| Less transactions costs                     | 328,298    |
| <hr/>                                       |            |
| Amount allocated to share capital (note 12) | \$ 6,245   |

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# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 1. Significant accounting policies:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Significant accounting policies adopted by the Company are as follows:

### (a) Basis of presentation:

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company is a development stage company and is subject to risks common to rapidly growing technology based companies, including a limited operating history, dependence on key personnel, potential product development failure, the need to raise capital for successful development, marketing and operations in meeting the Company's liabilities and commitments as they become due. The consolidated financial statements do not include adjustments that would be required if the going concern assumption was not appropriate and consequently that the assets are not realized and the liabilities settled in the normal course of operations.

The Company has incurred a loss of \$1,902,372 ( 2007 - \$1,429,983) and negative cash flow from operations of \$1,223,707 (2007 - \$1,088,057) for the year ended April 30, 2008. As at April 30, 2008, the Company has an accumulated deficit of \$4,263,979 (2007 - \$2,361,607) which results in a shareholders' equity of \$8,923,469 (2007 - \$2,351,027). As of April 30, 2008 the Company has working capital of \$5,591,142.

### (b) Basis of consolidation:

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, 6441513 Canada Inc., operating as DDP Therapeutics (2007 – 10% ownership). Results of operations of the subsidiary are included from the date of acquisition (note 3). All significant inter-company balances and transactions have been eliminated upon consolidation.

### (c) Cash and cash equivalents:

Cash and short-term investments, for purposes of reporting cash flows, include amounts held in banks and highly liquid investments with maturities at point of purchase of three months or less. The Company places its cash and cash investments with institutions and investments having high credit ratings.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 1. Significant accounting policies (continued):

### (d) Foreign currency translation:

Currency transactions and balances are translated into the Canadian dollar reporting currency using the temporal method. The Company's foreign currency monetary items include cash, accounts receivable and accounts payable which are translated at the rate prevailing at the balance sheet date. Revenues and expenses are translated at the average rates in effect during the applicable accounting periods. Gains and losses on foreign currency translation are reflected in the consolidated statements of comprehensive loss and deficit.

### (e) Equipment:

Equipment is recorded at amortized cost. Amortization is recorded on a straight-line basis over the estimated useful lives of the assets whether purchased directly by the Company or acquired under a capital lease as follows:

| Asset                  | Rate                    |
|------------------------|-------------------------|
| Furniture and fixtures | 5 years                 |
| Computer hardware      | 2 - 3 years             |
| Computer software      | Term of license         |
| Leasehold improvements | Remaining term of lease |

### (f) Intangible assets:

Intangible assets acquired individually or as part of a group of assets are initially recognized and measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination, is allocated to the individual assets based on their relative fair value. Intangible assets with finite lives, including molecules, patents, and trademarks are amortized on a straight-line basis over their estimated useful lives as follows:

| Intangible asset | Useful life              |
|------------------|--------------------------|
| Molecules        | 8 years                  |
| Patents          | Remaining life of patent |
| Trademarks       | 5 years                  |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 1. Significant accounting policies (continued):

### (f) Intangible assets (continued):

Intangible assets with indefinite useful lives are not amortized and are tested for impairment annually or more frequently if events and changes in circumstances indicate that an asset might be impaired.

### (i) Patents:

The direct costs of evaluating and investigating patents are accumulated by specific molecule or group of molecules and these capitalized costs are amortized over the life of the patent beginning in the month subsequent to the month the patent is granted on a straight-line basis over the remaining life of the patent. Additional patent costs incurred to validate the patent in specific jurisdictions after patent grant are capitalized and amortized over the remaining patent life as incurred.

Annual patent maintenance costs are expensed as incurred.

The accumulated cost of a product investigated for patenting which is not subsequently patented is expensed in the month when the decision is made to not pursue the patent.

### (ii) Trademark:

The costs of evaluating and investigating trademark registration are accumulated by specific process and where trademark registration is obtained such costs are capitalized and amortized over the lesser of the marketing life of the process or five years beginning in the year after the trademark is received. Where trademark registration is not ultimately obtained accumulated costs are expensed.

### (g) Impairment of long-lived assets:

Long-lived assets, including equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Recoverability is assessed based on the carrying amount of the long-lived asset and its net recoverable value, which is generally determined based on undiscounted cash flows expected to result from the use and eventual disposal of the long-lived asset. If the carrying value of the long-lived asset is not recoverable, an impairment loss is recognized to write down the long-lived asset to its fair value.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 1. Significant accounting policies (continued):

### (h) Short-term investments:

Short-term investments are recorded at cost. Gains and losses on disposal of investments are recognized when realized.

### (i) Research and product development:

Research expenditures are expensed as incurred. Development expenditures are deferred when they meet the criteria for capitalization in accordance with Canadian GAAP, and the future benefits could be regarded as being reasonably certain. At April 30, 2008 and 2007 no development costs were deferred

### (j) Revenue recognition:

The Company recognizes technical consulting and molecule screening service revenue upon completion of the contracted service or in accordance with completed milestones as earned under contract.

### (k) Investment tax credits:

Investment tax credits ("ITCs") are accrued when qualifying expenditures are made and there is reasonable assurance that the credits will be realized. ITCs relating to research and development expenses are recorded as other income and those relating to capital expenditures are recorded as a reduction of the cost of the asset acquired.

### (l) Share capital:

#### (i) Non-monetary consideration:

Shares issued as purchase consideration in non-monetary transactions are recorded at fair value determined by management based upon the fair value of the shares as disclosed by the trading price of those shares on the TSX Ventures Exchange on the date of an agreement to issue shares as determined by the Board of Directors.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 1. Significant accounting policies (continued):

(l) Share capital (continued):

(ii) Stock-based compensation:

The Company measures the cost for stock options granted to consultants, employees and directors based on an estimate of the fair value as at the date of the grant. The Company uses a Black-Scholes option pricing model to estimate the fair value. The fair value of stock options which vest immediately are recorded as stock-based compensation expense at the date of the grant with a corresponding increase to contributed surplus. Stock options that vest over time are expensed over the vesting period using the straight-line method. The effect of a change in the estimated number of options expected to vest is a change in an estimate and the cumulative effect of the change on current and prior periods is recognized in the period of the change reflecting the overstatement of prior period compensation recorded. On exercise of a stock option, the consideration received and the estimated fair value previously recorded in contributed surplus is recorded as share capital.

(iii) Share issuance costs:

Costs directly identifiable with the raising of share capital financing are charged against share capital. Share issuance costs incurred in advance of share subscriptions are recorded as non-current deferred assets.

(m) Income taxes:

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and the respective tax bases of assets and liabilities, measured using substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect on future income tax assets and liabilities of a change in income tax rates are recognized as income or loss in the year that the income tax rate change occurs.

The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 1. Significant accounting policies (continued):

### (n) Use of estimates:

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying value of equipment, molecules, patents and trademarks, valuation of future income taxes and accounting for share capital, warrants and options. Actual results could differ from those estimates.

### (o) Basic and diluted loss per share:

Basic and diluted losses per share are determined using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed in a manner consistent with basic earnings per share, except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of options and warrants, if dilutive. The number of additional shares is calculated by assuming the number of outstanding stock options and warrants are exercised and the proceeds from such exercises were used to acquire shares of common stock at the average market price during the year.

## 2. Changes in accounting policies:

Effective May 1, 2007, the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). These accounting policy changes were adopted on a prospective basis with no restatement of prior period financial statements:

### (a) Section 1530, "*Comprehensive Income*":

This accounting standard specifies how comprehensive income is to be reported and presented. Comprehensive income is the change in the Company's shareholder equity that results from transactions and other events from other than the Company's shareholders and includes items that would not normally be included in net earnings, such as unrealized gains or losses on available-for-sale investments. This standard requires certain gains and losses that would otherwise be recorded as part of net earnings be presented in other comprehensive income until such items are realized.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 2. Changes in accounting policies (continued):

### (a) Section 1530, "*Comprehensive Income*" (continued):

This standard also requires the presentation of comprehensive income, and its components in a separate financial statement that is displayed with the same prominence as the other financial statements. Accumulated other comprehensive income is presented as a new category in shareholders' equity.

The Company does not have any available-for-sale investments, derivative instruments or self-sustaining foreign operations and, accordingly, the Company has no comprehensive income or loss to report.

### (b) Section 3251, "*Equity*":

Section 3251 establishes standards for the presentation of equity and changes in equity, including changes arising from those items recorded in comprehensive income. Were the Company to have had any comprehensive income or loss it would have added a consolidated statement of comprehensive income or loss to these consolidated financial statements and made the corresponding changes to shareholders' equity.

### (c) Section 3855, "*Financial Instruments – Recognition and Measurement*":

This standard sets out criteria for the recognition and measurement of financial instruments. The standard requires all financial instruments within its scope, including derivatives, to be included on a Company's balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized cost. Changes in fair value are to be recognized in the statements of comprehensive income and deficit or accumulated other comprehensive income, depending on the classification of the related instruments. All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the asset or liability. As such, any of the Company's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if the requirements had always been in effect. Changes to the fair value of assets and liabilities prior to adoption are recognized by adjusting opening deficit or opening "other accumulated comprehensive income".

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 2. Changes in accounting policies (continued):

### (c) Section 3855, "*Financial Instruments – Recognition and Measurement*" (continued):

All financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification as follows: (1) held-for-trading financial instruments are measured at fair value and changes in fair value are recognized in net earnings in the period in which they arise; (2) held-to-maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost and amortization of premiums or discounts and losses due to impairment are included in current period net earnings; (3) available-for-sale financial assets are measured at fair value and changes in fair value are included in "other comprehensive income" until the gain or loss is recognized in income; (4) all derivative financial instruments are measured at fair value, even when they are part of a hedging relationship and changes in fair value are included in net earnings in the period in which they arise, except for hedge transactions which qualify for hedge accounting treatment in which case gains and losses are recognized as other comprehensive income.

In accordance with this new standard, the Company has classified its cash, and cash equivalents as held-for-trading and short-term investments as held to maturity. Miscellaneous receivables are classified as loans and receivables. Accounts payable and accrued liabilities, due to shareholders and notes payable were classified as other financial liabilities. The Company currently does not have embedded derivatives or hedge transactions.

### (d) Section 3861 "*Financial Instruments - Disclosure and Presentation*":

Establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives, including disclosures of associated risks relating to financial instruments.

The adoption of these standards had no significant impact on the consolidated financial statements for the year ended April 30, 2008.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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### 3. Acquisition of DDP Therapeutics:

In the year ended April 30, 2007, the Company had a 10% ownership interest and certain officer shareholders of COTI had a 50% ownership interest in a company, 6441513 Canada Inc, operating as DDP Therapeutics (DDP), formed in early 2006 to develop a library of small cell lung cancer molecules discovered by the Company using CHEMSAS®. Under an agreement created April 7, 2006, the Company transferred the library of small cell lung cancer molecules to DDP for \$1. COTI was entitled, under the agreement, to receive a payment in the amount of 10% of the aggregate net proceeds raised by DDP in connection with a financing to support (a) the validation of the transferred molecules for purposes of an investigational new drug filing and (b) entering into a strategic agreement with a pharmaceutical company.

On November 27, 2007, the Company completed an acquisition from Whippoorwill Holdings Limited, 2080084 Ontario Inc. and Dr. Wayne Danter (collectively the Sellers) of all the outstanding common shares in the capital of DDP, not already owned by the Company. The Company also purchased two 5% promissory notes owing by DDP to two of the Sellers on the terms announced by the Company on September 17, 2007. Ownership of DDP prior to completion of the Share Purchase consisted of; COTI 10%, Dr. Wayne Danter, President of COTI, 10%, Whippoorwill Holdings Limited, a wholly owned company of Mr. John Drake, the CEO of COTI 40% and 2080084 Ontario Inc., an unrelated party, 40%.

The purchase cost recorded by COTI was \$3,172,967 and has been allocated to 90% of the fair value of the assets and liabilities of DDP using an agreed value for the 10 small cell lung cancer molecules (Molecules) owned by DDP of \$5,500,000. An amount of \$637,105, being a portion of the proceeds from a private placement (see note 11(d)) was used to acquire the promissory note of 2080084 Ontario Inc., pay the accrued interest on the promissory notes and make a partial payment for the common shares of DDP of \$194,963. The Company also issued a promissory note in the amount of \$370,000 payable to Whippoorwill Holdings Limited in exchange for the assignment of the promissory note held by Whippoorwill Holdings Limited from DDP. This promissory note matures for payment on July 31, 2008 and bears interest at the rate of 5% per annum (note 9).

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

### 3. Acquisition of DDP Therapeutics (continued):

One-half of the balance of the purchase price for the DDP common shares was satisfied by the issuance of 1,431,441 common shares of COTI to the Sellers at \$1.40, the same issue price per share paid on the private placement, and 1,431,441 common shares of COTI, representing the other one-half of the balance of the purchase price, have been conditionally allotted and reserved for issuance to the Sellers upon the Molecules achieving certain development milestones related to investigational new drug (IND) filings in the United States and/or the issuance of patents in Europe or the United States.

Should the milestones not be reached by the eighth anniversary of the Closing, the Company has the option to either (i) issue the remaining Share Consideration to the Sellers or (ii) pay the Sellers the amount, if any, by which the fair value of the Molecules exceeds the amount invested in the Molecules by COTI, including the amount of the investment of Share Consideration issued to the Sellers up to that point. If the fair value of the Molecules at that time is less than the amount invested in the Molecules by the Company, no amount shall be payable to the Sellers.

The acquisition of DDP has been accounted for as a purchase of assets because DDP does not meet the definition of a business under EIC 124 of the CICA Handbook. Total consideration, as determined by the issuance of common shares at the same share price of \$1.40 paid on the private placement (note 12(ii)) plus cash paid, plus the assumption of certain liabilities and payment of transaction costs, was \$3,172,967. The consideration paid was allocated to the assets acquired and liabilities assumed based on the estimated fair values on the date of acquisition as set out below:

---

|  |                 |
|--|-----------------|
| Assets acquired:                         |                 |
| Cash                                     | \$ 15,178       |
| Other receivables                        | 93,516          |
| Intangible assets - molecules            | 3,111,169       |
|  | <hr/> 3,219,863 |
| Less liabilities assumed:                |                 |
| Accounts payable and accrued liabilities | 46,896          |
|  | <hr/>           |
| Net assets acquired                      | \$ 3,172,967    |
|  | <hr/>           |
| Consideration paid:                      |                 |
| Cash                                     | \$ 637,105      |
| Common shares issued                     | 2,004,017       |
| Debt assumed                             | 370,000         |
| Acquisition costs                        | 161,845         |
|  | <hr/>           |
|  | \$ 3,172,967    |

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# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

### 3. Acquisition of DDP Therapeutics (continued):

In accounting for the acquisition, a net future tax liability of \$655,234 arises relating to the temporary differences associated with non-capital tax loss carry forward balances and scientific research and expenditure development pools of DDP as well as the valuation of the purchased molecules. The future tax liability has not been recorded due to the reduction in the valuation allowance against the Company's existing unrecognized future tax assets (note 14).

In an asset purchase transaction, the future milestone events represent contingent transactions which consideration, if any, will be accounted for at the time that the contingent event occurs and is settled. The amount of consideration given up at the time such transaction occurs would be added to molecules up to their fair value with a corresponding increase in share capital if share consideration issued, or a reduction in cash if a cash payment.

### 4. Short-term investments:

The Company has excess cash invested in short-term securities having maturities greater than three months but less than a year, and rated A high or greater by Standard and Poor's and the Dominion Bond Rating Service. Maturities range from May 29, 2008 to February 6, 2009. The cost of these investments at April 30, 2008 was \$3,100,489 (market \$3,124,849).

### 5. Equipment:

April 30, 2008

|                        | Cost              | Accumulated<br>amortization | Net book<br>value |
|------------------------|-------------------|-----------------------------|-------------------|
| Furniture and fixtures | \$ 79,051         | \$ 10,016                   | \$ 69,035         |
| Computer hardware      | 69,694            | 56,955                      | 12,739            |
| Computer software      | 101,973           | 64,912                      | 37,061            |
| Leasehold improvements | 21,084            | 8,768                       | 12,316            |
|                        | <u>\$ 271,802</u> | <u>\$ 140,651</u>           | <u>\$ 131,151</u> |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 5. Equipment (continued):

April 30, 2007

|                        | Cost       | Accumulated<br>amortization | Net book<br>value |
|------------------------|------------|-----------------------------|-------------------|
| Furniture and fixtures | \$ 5,856   | \$ 3,489                    | \$ 2,367          |
| Computer hardware      | 61,487     | 39,612                      | 21,875            |
| Computer software      | 61,913     | 33,595                      | 28,318            |
| Leasehold improvements | -          | -                           | -                 |
|                        | \$ 129,256 | \$ 76,696                   | \$ 52,560         |

Included in equipment are assets under capital lease with a cost of \$57,601 (2007 - \$62,274) and accumulated amortization of \$53,574 (2007 - \$45,803).

## 6. Molecules:

When the Company acquired DDP Therapeutics on November 27, 2007 (note 3), it acquired a small cell lung cancer library. Under the terms of the purchase agreement there are two milestones which could result in additional consideration being paid for these molecules up to the eighth anniversary of the agreement. Should these milestones not be achieved the Company must either abandon its efforts to develop and commercialize the molecules or it must issue payment of common shares or a cash payment as determined under the purchase agreement on the eighth anniversary. The Company has determined it is not possible to establish the likelihood of these milestones being achieved and accordingly, is amortizing the molecule costs over the eight years to the anniversary date on November 27, 2015.

|           | 2008         |                             | 2007              |                   |
|-----------|--------------|-----------------------------|-------------------|-------------------|
|           | Cost         | Accumulated<br>amortization | Net book<br>value | Net book<br>value |
| Molecules | \$ 3,111,169 | \$ 162,040                  | \$ 2,949,129      | \$ -              |

## 7. Patents:

The Company is pursuing or has been granted composition of matter patents on certain molecules for therapeutic indication and manufacturing process as set out below. Patents granted have unamortized lives of 173 to 182 months.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 7. Patents (continued):

April 30, 2008

|                 | Cost              | Accumulated<br>amortization | Net book<br>value |
|-----------------|-------------------|-----------------------------|-------------------|
| Patents pending | \$ 119,084        | \$ -                        | \$ 119,084        |
| Patents granted | 138,496           | 4,270                       | 134,226           |
|                 | <u>\$ 257,580</u> | <u>\$ 4,270</u>             | <u>\$ 253,310</u> |

April 30, 2007

|                 | Cost              | Accumulated<br>amortization | Net book<br>value |
|-----------------|-------------------|-----------------------------|-------------------|
| Patents pending | \$ 58,339         | \$ -                        | \$ 58,339         |
| Patents granted | 75,959            | -                           | 75,959            |
|                 | <u>\$ 134,298</u> | <u>\$ -</u>                 | <u>\$ 134,298</u> |

## 8. Trademark:

Trademark registration was obtained for exclusive use of the name, CHEMSAS®, which describes the Company's proprietary molecular profiling technology. Costs incurred were amortized over five years. The accumulated costs are as follows:

April 30, 2008

|   | Cost     | Accumulated<br>amortization | Net book<br>value |
|---|----------|-----------------------------|-------------------|
| CHEMSAS® - molecular profiling technology | \$ 4,350 | \$ 4,350                    | \$ -              |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 8. Trademark (continued):

April 30, 2007

|   | Cost     | Accumulated<br>amortization | Net book<br>value |
|---|----------|-----------------------------|-------------------|
| CHEMSAS® - molecular profiling technology | \$ 4,350 | \$ 3,480                    | \$ 870            |

## 9. Due to shareholders:

The amounts advanced by shareholders are unsecured. Advances made to the Company prior to March 1, 2005 are non-interest bearing and advances made subsequent to this date are supported by promissory notes bearing interest at 5-7%. Under the terms of the acquisition of DDP on November 27, 2007 (note 3), the Company acquired a promissory note of \$370,000 owing to one of the Sellers of DDP who is a shareholder, director and officer of the Company. A portion of this note was paid by the Company on payment of closing legal costs of the Seller.

|   | 2008       | 2007       |
|---|------------|------------|
| Non-interest bearing advances due on demand | \$ 30,030  | \$ 38,098  |
| 5% interest bearing note due July 31, 2008  | 353,247    | -          |
| 7% interest bearing notes due on demand     | 49,063     | 80,533     |
|   | \$ 432,340 | \$ 118,631 |

Interest expense on the interest bearing notes for the years ended April 30, 2008 was \$13,175, (April 30, 2007 - \$5,572).

## 10. Notes payable:

|  | 2008      | 2007      |
|--|-----------|-----------|
| Unsecured notes payable bearing interest at bank prime rate plus 3%, due on demand with 30 days notice | \$ 20,000 | \$ 20,000 |

Interest expense for the years ended April 30, 2008 was \$1,794 (April 30, 2007 - \$1,796).

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 11. Obligations under capital lease:

|   | 2008     | 2007      |
|---|----------|-----------|
| 2008  | \$ -     | \$ 22,352 |
| 2009  | 20,813   | 20,813    |
| 2010  | 1,290    | 1,290     |
| Total minimum lease payments                | 22,103   | 44,455    |
| Less amount representing interest           | 816      | 2,924     |
|   | 21,287   | 41,531    |
| Current portion of capital lease obligation | 20,024   | 20,244    |
|   | \$ 1,263 | \$ 21,287 |

The Company has entered into various capital leases which expire prior to September, 2009 for certain computer equipment. The interest rates implicit in the leases range from 5.56% to 10.37%.

## 12. Share capital and warrants:

| Expiry date                 | April 30, 2008 |              | April 30, 2007 |              |
|-----------------------------|----------------|--------------|----------------|--------------|
|                             | Issued         | Amount       | Issued         | Amount       |
| Authorized:                 |                |              |                |              |
| Unlimited common shares     |                |              |                |              |
| Unlimited preference shares |                |              |                |              |
| Issued:                     |                |              |                |              |
| Common shares               | 45,655,409     | \$12,002,272 | 37,507,052     | \$ 3,598,977 |
| Share purchase warrants:    |                |              |                |              |
| \$0.40 warrants             | April 18/08    | -            | 533,332        | 13,830       |
| \$0.40 agent warrants       | Oct 12/08      | 73,805       | 378,930        | 52,921       |
| \$0.60 warrants             | July 15/08     | 1,000,000    | 1,000,000      | 151,990      |
| \$0.70 warrants             | April 12/08    |              |                |              |
|                             | to July 17/09  | 98,224       | 3,545,950      | 219,447      |
|                             |                | 1,172,029    | 5,458,212      | 438,188      |
| Share capital and warrants  |                | \$12,179,189 |                | \$ 4,037,165 |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 12. Share capital and warrants (continued):

The details of shares and warrants issued, exercised, expired or cancelled are summarized in the following table:

|   | Shares       | Amount        |
|---|--------------|---------------|
| Shares issued for cash, April 30, 1999 and balance          |              |               |
| April 30, 2005  | 200          | \$ 2          |
| Shares issued for molecular mining technology               | 110          | 1             |
| Shares issued to repay research advances                    | 150          | 269,745       |
| Shares issued for additional financing                      | 56           | 100,000       |
| Shares issued for stock dividend                            | 8,764        | -             |
| Shares issued on exercise of warrants                       | 720          | 40            |
| Shares exchanged on share conversion                        | (10,000)     | -             |
| Shares exchanged on share conversion                        | 10,000,000   | -             |
| Shares issued on exercise of stock option                   | 439,001      | 4             |
| Shares exchanged on amalgamation                            | (10,439,001) | -             |
| Shares issued on amalgamation                               | 21,640,000   | -             |
| Shares issued on private placement                          | 733,332      | 182,000       |
| Balance April 30, 2006                                      | 22,373,332   | 551,792       |
| Shares issued on private placement                          | 6,594,000    | 1,858,010     |
| Shares exchanged on amalgamation                            | 5,635,000    | 6,245         |
| Shares issued on private placement                          | 2,000,000    | 832,243       |
| Shares issued on \$0.10 agent stock options                 | 263,500      | 22,988        |
| Shares issued on \$0.40 warrants                            | 240,000      | 101,352       |
| Shares issued on \$0.30 warrants                            | 40,000       | 13,743        |
| Shares issued on \$0.70 warrants                            | 80,750       | 64,826        |
| Shares issued on \$0.40 agent warrants                      | 280,470      | 147,778       |
| Balance April 30, 2007                                      | 37,507,052   | 3,598,977     |
| Shares issued on private placement                          | 2,857,143    | 3,665,882     |
| Shares issued on purchase of DDP Therapeutics               | 1,431,441    | 2,004,017     |
| Shares issued on \$0.40 warrants                            | 533,332      | 225,310       |
| Shares issued on \$0.70 warrants                            | 2,931,316    | 2,246,460     |
| Shares issued on \$0.40 agent warrants                      | 305,125      | 163,707       |
| Shares issued on stock option plan exercises                | 110,000      | 99,989        |
| Shares cancelled on \$0.10 agent stock options (note 12(h)) | (20,000)     | (2,070)       |
| Balance April 30, 2008                                      | 45,655,409   | \$ 12,002,272 |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 12. Share capital and warrants (continued):

- (a) On October 11, 2006, the Company completed a private placement of 6,594,000 units for gross proceeds of \$2,637,600 and issued 6,594,000 common shares and 3,297,000 \$0.70 warrants. Each unit consisted of one common share and one-half a common share purchase warrant at an issue price of \$0.40. Each whole common share purchase warrant was exercisable into one additional common share at a price of \$0.70 until April 13, 2008. Costs associated with this placement were \$458,723 for net proceeds of \$2,178,877. In addition, agents were issued 659,400 warrants (agent's warrants) equaling 10% of the number of units sold. Each agent's warrant has the right to purchase one unit at \$0.40 until October 13, 2008.

The Company allocated a portion of the gross proceeds to each warrant class based on their pro-rata share of the calculated fair value of the total unit fair value at issuance. An allocation of \$179,547 was made to the \$0.70 warrants using the Black-Scholes option pricing model assuming a risk free interest rate of 4.56%, an expected volatility of 64.1%, an expected life of 18 months and no expected dividends. Agent's warrants were allocated \$141,320 using assumptions of: a weighted average expected life of 30 months; a weighted average volatility of 70.8%; and a weighted average risk free interest rate of 4.5%.

- (b) On October 13, 2006, Critical Outcome Technologies Inc. (Private COTI) amalgamated with Aviator Petroleum Corp. (Aviator), a public company listed on the TSXV, to form a new company with the name Critical Outcome Technologies Inc. (Public COTI).

Under the amalgamation agreement, Aviator common shares were exchanged for 5,635,000 common shares of Public COTI. In addition, 275,000 Aviator agent's stock options outstanding were exchanged for agent's stock options of Public COTI with the same terms entitling holders to acquire up to 275,000 Public COTI common shares at \$0.10 per share. The Private COTI common shares were exchanged for 28,967,332 Public COTI common shares. Each outstanding \$0.40 warrant, \$0.70 warrant, \$0.30 agent's warrant and \$0.40 agent's warrant of Private COTI was exchanged on a one for one basis for replacement securities of Public COTI with the same terms.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 12. Share capital and warrants (continued):

- (c) On January 16, 2007, the Company completed a private placement of 2,000,000 units at an issue price of \$0.50 per unit for gross proceeds of \$1,000,000. Each unit consisted of one common share and one-half a common share purchase warrant with each whole warrant exercisable into one additional common share at a price of \$0.60 per share until July 16, 2008. Costs of the private placement were \$15,767. Pursuant to TSXV regulations, the 2,000,000 shares issued under the unit offering were subject to a four month hold period ending on May 15, 2007.

The \$0.60 warrants were allocated \$151,990 of the gross proceeds based on their pro-rata share of the calculated fair value of the total unit fair value at issuance using a Black-Scholes pricing model and assuming: a risk free interest rate of 4.28%; an expected volatility of 64.7%; an expected life of 18 months and no expected dividend yield.

- (d) In December 2006 and January 2007, a total of 263,500 agent's stock options (note 12(b)) were exercised for 263,500 common shares with gross proceeds to the Company of \$26,350 and costs incurred to issue the shares of \$3,362.
- (e) During the year ended April 30, 2007, warrants were exercised and common shares issued as set out in the tables above. The fair value of the embedded warrants contained in each agent's warrant were calculated as set out in note 12(a) and (c). Gross proceeds of \$276,713 upon warrant exercise were credited to common share capital and the respective warrant account was relieved of the warrant value of \$59,169 attributed to the exercised warrants at the date of issuance and transferred to share capital. The costs incurred to issue these shares and any associated warrants were \$8,183.
- (f) During the year ended April 30, 2008, 3,769,773 warrants were exercised and common shares issued as set out in the table above. Gross proceeds of \$2,387,305 upon warrant exercise were credited to common share capital and the respective warrant account was relieved of the warrant value of \$261,271 attributed to the exercised warrants at the date of issuance and transferred to share capital. The costs incurred to issue these shares and any associated warrants were \$13,099. A total of 516,410 \$0.70 warrants expired on April 12, 2008.
- (g) On October 5, 2007, 110,000 stock options issued under the Company's stock option plan were exercised for gross proceeds of \$70,400 with costs of \$382 (note 13(e)). Share capital was increased by the net proceeds of \$70,018 and \$29,971 from a reduction in contributed surplus relating to previously recognized stock-based compensation expense for these options.
- (h) On October 11, 2007, 20,000 common shares previously issued under exercise of \$0.10 agent stock options for gross proceeds of \$2,000, plus costs of \$70 were cancelled by the Company.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 12. Share capital and warrants (continued):

- (i) On November 29, 2007, the Company completed a brokered private placement through its agent, Northern Securities Inc. of 2,857,143 common shares offered to accredited investors in Ontario at \$1.40 per common share for gross proceeds of \$4,000,000. Total costs of the placement were \$334,118 including the agent's fee of \$280,000. The common shares issued under the offering were subject to a four month hold from the date of closing the private placement until the close of business on March 29, 2008.

## 13. Stock-based compensation:

The Company maintains a stock option plan for directors, officers, employees and consultants who contribute to the long-term goals of the Company. Under the plan, the maximum number of shares available for purchase pursuant to options granted shall not exceed 10% of the outstanding issued shares. The awarding of options, their exercise price and vesting period is determined by the Compensation Committee of the Board. Changes in the number of options outstanding, with their weighted average exercise prices are summarized below:

|                      |                   | 2008                            |                   | 2007                            |
|----------------------|-------------------|---------------------------------|-------------------|---------------------------------|
|                      | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Opening balance      | 1,385,000         | \$ 0.72                         | -                 | \$ -                            |
| Granted              | 330,000           | 1.41                            | 1,385,000         | 0.72                            |
| Exercised            | (110,000)         | 0.64                            | -                 | -                               |
| Cancelled or expired | (140,000)         | 1.14                            | -                 | -                               |
| Ending balance       | 1,465,000         | \$ 0.84                         | 1,385,000         | \$ 0.72                         |

- (a) On January 11, 2007, the Company granted 1,185,000 stock options to certain directors and employees with an exercise price of \$0.64 and on January 12, 2007, issued a further 50,000 stock options with an exercise price of \$0.70. On March 26, 2007, an additional 150,000 options were granted to a new director. The options have a five year maturity from the date of the grant. Certain of these options vested immediately and the balance vest one-fifth or one-sixth every six months from the date of the grant.
- (b) On May 1, 2007 the Board of Directors approved a grant of 130,000 stock options to a director at an exercise price of \$1.00 which vested immediately.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 13. Stock-based compensation (continued):

- (c) On May 11, 2007, 100,000 options were granted to the Chief Operating Officer of the Company pursuant to his employment contract. The exercise price was \$1.34 per share with vesting to occur over 3.25 years based upon contract milestones. The first 25,000 options vested on October 1, 2007. On December 15, 2007 the 75,000 unvested options expired under the terms of the plan. On March 15, 2008 the 25,000 vested options expired.
- (d) On September 28, 2007, 40,000 unvested options expired under the terms of the plan.
- (e) On October 5, 2007, 110,000 options were exercised at a price of \$0.64 per common share.
- (f) On October 9, 2007 the Board of Directors approved a grant of 25,000 stock options vesting immediately to each of the four non-employee members of the Scientific Advisory Committee (SAC) at an exercise price of \$2.00.

For the year ending April 30, 2008, the Company incurred total stock-based compensation of \$421,247 offset by a recovery of \$58,485 for costs previously expensed related to expired options.

The stock option compensation expense relating to the grants recorded during the year ended April 30, 2008 and the assumption estimates are as follows:

---

|                                       | Director   | Officer   | SAC        |
|---------------------------------------|------------|-----------|------------|
| Risk free interest rate               | 4.45 %     | 4.54 %    | 4.00 %     |
| Expected dividend yield               | -          | -         | -          |
| Expected share volatility             | 145%       | 145%      | 120%       |
| Expected average option life in years | 2.57       | 3.25      | 5.00       |
| Estimated stock option compensation   | \$ 111,540 | \$ 97,400 | \$ 176,700 |

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# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 13. Stock-based compensation (continued):

Details of the outstanding stock options at April 30, 2008 are summarized below:

| Weighted average exercise price       | Options granted and outstanding at April 30, 2008 | Vested           | Unvested       | Weighted average remaining contractual life in years | Total stock-based compensation value | Weighted average option value |
|---------------------------------------|---|------------------|----------------|--|--------------------------------------|-------------------------------|
| \$0.64                                | 1,035,000   | 809,996          | 225,004        | 3.70   | \$ 336,180                           | \$0.296                       |
| 0.70                                  | 50,000  | 24,999           | 25,001         | 3.71   | 15,908                               | 0.318                         |
| 1.00                                  | 130,000   | 130,000          | -              | 4.00   | 111,540                              | 0.858                         |
| 1.35                                  | 150,000   | 150,000          | -              | 3.90   | 176,400                              | 1.176                         |
| 2.00                                  | 100,000   | 100,000          | -              | 4.44   | 176,700                              | 1.767                         |
| <b>\$0.84</b>                         | <b>1,465,000</b>                                  | <b>1,214,995</b> | <b>250,005</b> | <b>3.80</b>  | <b>\$ 816,728</b>                    | <b>\$0.537</b>                |
| Total expensed to April 30, 2008      |   |                  |                |  | \$ 787,232                           |                               |
| Available for grant at April 30, 2008 |   |                  | 3,100,541      |  |                                      |                               |

Details of the outstanding stock options at April 30, 2007 are summarized below:

| Exercise price | Options granted and outstanding at April 30, 2007 | Vested         | Unvested       | Weighted average remaining contractual life in years | Total stock-based compensation value | Weighted average option value |
|----------------|---|----------------|----------------|--|--------------------------------------|-------------------------------|
| \$0.64         | 1,185,000   | 754,998        | 430,002        | 4.7  | \$ 350,260                           | 0.296                         |
| 0.70           | 50,000  | 8,333          | 41,667         | 4.7  | 15,908                               | 0.318                         |
| 1.35           | 150,000   | 150,000        | -              | 4.9  | 176,400                              | 1.176                         |
|                | <b>1,385,000</b>                                  | <b>913,331</b> | <b>471,669</b> |  | <b>\$ 542,568</b>                    | <b>0.392</b>                  |

Stock-based compensation expected to vest in future periods is summarized below:

|      |           |               |
|------|-----------|---------------|
| 2009 | \$        | 26,996        |
| 2010 |           | 2,500         |
|      | <b>\$</b> | <b>29,496</b> |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 14. Income taxes and investment tax credits:

The following table reconciles income taxes, calculated at combined Canadian federal and provincial tax rates, with the income tax expense in the consolidated financial statements:

|   | 2008           | 2007           |
|---|----------------|----------------|
| Loss before income taxes                | \$ (1,902,000) | \$ (1,430,000) |
| Statutory rate                          | 35.25%         | 36.12%         |
| Expected income tax recovery            | (670,000)      | (517,000)      |
| Amounts not deductible for tax          | 131,000        | 150,000        |
| Share issuance costs deductible for tax | (71,000)       | (254,000)      |
| Tax impact of amalgamation              | -              | (41,000)       |
| Expiration of non-capital losses        | 5,000          | 18,000         |
| Change in future income tax rates       | 91,000         | 55,000         |
| Change in valuation allowance           | (224,000)      | 626,000        |
| Tax impact of acquisition               | 656,000        | -              |
| Other                                   | 82,000         | (37,000)       |
| Income tax expense                      | \$ -           | \$ -           |

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at April 30, 2008 are presented below:

|   | 2008       | 2007       |
|---|------------|------------|
| Losses carried forward                          | \$ 847,000 | \$ 423,000 |
| Research expenditures deferred for tax purposes | 400,000    | 173,000    |
| Equipment                                       | 4,000      | 3,000      |
| Intangible assets                               | -          | 34,000     |
| Financing expenses                              | 225,000    | 229,000    |
| Future tax assets                               | 1,476,000  | 862,000    |
| Less future tax liabilities relating to:        |            |            |
| Intangible assets                               | (838,000)  | -          |
| Net future tax assets                           | 638,000    | 862,000    |
| Less valuation allowance                        | (638,000)  | (862,000)  |
|   | \$ -       | \$ -       |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 14. Income taxes and investment tax credits (continued):

The valuation allowance for future tax assets as at April 30, 2008 is \$638,000 (April 30, 2007 - \$862,000). In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences may become deductible. Management considers the periods in which those temporary differences become deductible and the scheduled reversal of future tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the future tax assets are deductible, management currently believes it is more likely than not that the Company will not realize the benefits of the deductible difference and therefore these benefits have not been recognized in the consolidated financial statements.

The Company has federal non-capital losses of approximately \$2,900,000, provincial non-capital losses of approximately \$2,942,000, federal research and development expenditures of \$1,216,000 and \$1,504,000 of provincial research and development expenditures, which may be applied to reduce taxable income of future years expiring as follows:

|  | Federal    | Provincial |
|--|------------|------------|
| 2009   | \$ 127,000 | \$ 127,000 |
| 2013   | 36,000     | 78,000     |
| 2014   | 186,000    | 186,000    |
| 2025   | 178,000    | 178,000    |
| 2026   | 463,000    | 463,000    |
| 2027   | 580,000    | 580,000    |
| 2028   | 1,330,000  | 1,330,000  |
| Research and development expenditures, no expiry | 1,216,000  | 1,504,000  |

Certain expenses incurred by the Company during the year ended April 30, 2008 may qualify as research and development as described by provisions in the Canadian Income Tax Act. At April 30, 2008, the Company had not received \$70,294 of refundable tax credits owing to its subsidiary, DDP Therapeutics. The Company has also filed for approximately \$45,000 of refundable Ontario tax credits which have not been recorded as the Company does not have reasonable assurance regarding collectibility.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 15. Financial instruments:

The Company's financial assets and liabilities consist of cash and cash equivalents, short-term investments, miscellaneous receivables, accounts payable and accrued liabilities, due to shareholders and notes payable.

Fair value estimates are made as of a specific point in time, using available information about the financial instrument. The Company has determined that the carrying value of its financial assets and liabilities approximates their fair value because of the relatively short periods to maturity of these instruments, their capacity for prompt liquidation or their interest rates approximate market rates.

(a) Price risk:

Price risk results from three sources; currency rate changes, fluctuation in market interest rates and changes in market prices for the underlying financial instrument. It is management's opinion that the Company is not exposed to significant price risk arising from its financial instruments.

(b) Credit risk:

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. The Company regularly monitors credit risk exposure and takes steps to mitigate the likelihood that these exposures will result in an actual loss. The Company does not have any financial instruments such as asset-backed commercial paper that potentially subject it to significant credit risk.

(c) Liquidity risk:

Liquidity risk, also referred to as funding risk, relates to potential difficulty in raising funds to meet commitments associated with financial instruments. Based upon the high credit ratings associated with its financial assets and the Company's spending plans, the Company has determined that it is not subject to significant liquidity risk during the next fiscal year.

(d) Foreign currency risk:

The Company has contracts denominated in United States dollars and is exposed to risk with respect to fluctuations in exchange rates between Canadian and United States dollars. The Company does not use derivative instruments to reduce its exposure to foreign currency risk. As a result, variations in foreign exchange rates could cause fluctuations in the Company's operating results.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 16. Change in non-cash operating working capital:

|  | 2008        | 2007         |
|--|-------------|--------------|
| Miscellaneous receivables                | \$ (58,702) | \$ (67,813)  |
| Prepaid expenses and deposits            | (3,367)     | (72,005)     |
| Accounts payable and accrued liabilities | 137,931     | 7,825        |
|  | \$ 75,862   | \$ (131,993) |

## 17. Commitments:

Effective June 1, 2007, the Company entered into a two year lease agreement for 1,600 square feet of office space consisting of its existing offices and an additional 800 square feet of adjoining space. The monthly lease payment for June and July, 2007 under this lease was negotiated at the prior lease's monthly rate of \$1,558. Effective August 1, 2007, the lease rate for the combined space is \$3,115. The remaining minimum fiscal year lease payments are; \$37,380 in 2009 and \$3,115 in 2010.

At April 30, 2008, the Company was assessed additional property taxes of approximately \$20,000 for prior years which it intends to contest. The future impact of this assessment would be an increase in rent expense for 2009 and 2010 of approximately \$9,000 and \$800 respectively.

## 18. Segmented information:

Management has determined that the Company operates in one reportable segment based on the economic characteristics of its research and its services. All of the Company's operations are located in Canada.

## 19. Related party transactions:

During the year ended April 30, 2008, the Company entered into transactions with its directors, shareholders and officers under normal terms and conditions. These transactions have been recorded at the exchange amount, being the amounts agreed to by the parties, as follows:

|                           | 2008   | 2007     |
|---------------------------|--------|----------|
| Contract services revenue | \$ -   | \$ 2,500 |
| Directors meeting fees    | 35,000 | -        |
| Professional fees         | 11,425 | 45,000   |

Other related party transactions are disclosed in notes 3, 9, 10, 11, 12 and 13.

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

## 20. Subsequent events:

(a) Amalgamation with DDP Therapeutics:

On May 1, 2008, the Company amalgamated with its wholly owned subsidiary, DDP Therapeutics (note 3) to remove the legal and administrative separation of the entities. All non-capital tax loss carry forwards and SR&ED pool balances of DDP are available to the Company following the amalgamation.

(b) Stock option grant:

On June 10, 2008, the Board of Directors approved a grant of 335,678 stock options to the directors. The options vested immediately with an exercise price of \$0.75 and have a five year life. On July 16, 2008, the Board granted 100,000 stock options to an employee of the Company with an exercise price of \$1.20 and a five year life. These options vest one-sixth immediately and one-sixth every six months until fully vested on January 16, 2011. The stock-based compensation value of this grant and the assumption estimates are as follows:

|  | Directors  | Employee   |
|--|------------|------------|
| Risk free interest rate                  | 3.38%      | 4.01%      |
| Expected dividend yield                  | -          | -          |
| Expected share volatility                | 115%       | 115%       |
| Expected average option life in years    | 5          | 5          |
| Estimated total stock-based compensation | \$ 205,771 | \$ 103,000 |

(c) Warrants:

Subsequent to year end, the Company realized gross proceeds of \$626,950 from the exercise of common share warrants and issued the required \$0.70 warrants related to exercise of \$0.40 agent warrants. Details of the exercises are summarized below:

|                       | Gross proceeds | Shares issued | Warrants issued |
|-----------------------|----------------|---------------|-----------------|
| \$0.40 agent warrants | \$ 2,450       | 6,125         | 3,063           |
| \$0.60 warrants       | 600,000        | 1,000,000     | -               |
| \$0.70 warrants       | 24,500         | 35,000        | -               |
|                       | \$ 626,950     | 1,041,125     | 3,063           |

# CRITICAL OUTCOME TECHNOLOGIES INC.

(a development stage company)

Notes to Consolidated Financial Statements (continued)

Years ended April 30, 2008 and 2007

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## 21. Future changes in accounting policies:

### (a) Capital disclosures:

In December 2006, the CICA issued new handbook section, 1535 - *Capital Disclosures*, which requires an entity to disclose its objectives, policies and processes for managing capital. This new standard is effective for the company beginning May 1, 2008.

### (b) Financial instruments:

In December 2006, the CICA issued two new handbook sections 3862 - *Financial Instruments - Disclosures*, and 3863 - *Financial Instruments - Presentation*. These new standards are effective for the Company beginning May 1, 2008.

The Company is currently reviewing the impact of these new standards on the presentation of the 2009 consolidated financial statements.

## 22. Comparative figures:

Certain of the 2007 comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.