LED MD

LED MEDICAL DIAGNOSTICS INC.

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

(EXPRESSED IN U.S. DOLLARS)

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Independent Auditor's Report

To the Shareholders of
LED Medical Diagnostics Inc.

We have audited the accompanying consolidated financial statements of LED Medical Diagnostics Inc. (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, and the consolidated statements of operations and comprehensive loss, consolidated statements of changes in shareholders' equity (deficiency) and consolidated statements of cash flow for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of LED Medical Diagnostics Inc.as at December 31, 2013 and December 31, 2012, and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company incurred an operating loss of $3,640,885 and negative cash flow from operations of $3,060,948 for the year ended December 31, 2013. As at December 31, 2013, the Company had an accumulated deficit of $32,556,072. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Deloitte LLP

Chartered Accountants
April 15, 2014
Vancouver, British Columbia

LED MEDICAL DIAGNOSTICS INC.

Consolidated Statements of Financial Position

(Expressed in U.S. Dollars)

	Notes		**December 31, 2013**		December 31, 2012
Assets					
Current assets					
Cash		**$**	**4,358,986**	$	969,584
Restricted cash	4		**-**		5,026
Trade and other receivables	5		**503,736**		1,514,577
Inventory			**412,307**		296,467
Inventory held by distributor	6		**165,832**		518,400
Prepaid expenses and deposits			**297,164**		69,300
Total current assets			**5,738,025**		3,373,354
Non-current assets					
Property and equipment	7		**23,150**		28,015
Patents and intellectual property	8		**62,362**		88,167
		$	**5,823,537**	$	3,489,536
Liabilities and Shareholders' Equity (Deficiency)					
Current liabilities					
Trade payables and accrued liabilities	9	**$**	**793,046**	$	1,689,009
Advances from distributor	6		**495,494**		1,778,112
Current portion of finance lease obligation	10		**3,690**		2,982
Total current liabilities			**1,292,230**		3,470,103
Non-current liabilities					
Long-term portion of finance lease obligation	10		**3,190**		6,879
Warrants	12		**3,672,958**		140,467
Total liabilities			**4,968,378**		3,617,449
Shareholders' Equity (Deficiency)					
Share capital	13		**27,242,071**		24,658,241
Stock-based payment reserve	14		**970,004**		62,495
Warrants reserve			**4,724,698**		277,748
Accumulated other comprehensive income			**474,458**		474,458
Deficit			**(32,556,072)**		(25,600,855)
			855,159		(127,913)
		$	**5,823,537**	$	3,489,536

Nature and Continuance of Operations (Note 1)

Commitments (Note 10)

Subsequent Events (Note 21)

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

Approved on behalf of the Board:

signed "Dr. David Gane" Chief Executive Officer

Dr. David Gane

signed "Rodger Tourigny" Director

Rodger Tourigny

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LED MEDICAL DIAGNOSTICS INC.

Consolidated Statements of Operations and Comprehensive Loss
(Expressed in U.S. Dollars)
For the years ended December 31, 2013 and 2012

	Notes	**December 31, 2013**	December 31, 2012
Revenues		**$ 2,519,574**	$ 6,312,754
Cost of goods sold		**1,348,223**	2,745,477
		1,171,351	3,567,277
Expenses			
Sales and marketing		**1,252,688**	2,564,798
Research and development		**442,880**	523,492
Administration		**1,596,014**	1,207,122
Stock-based compensation	14	**907,509**	-
Deferred share unit compensation	15	**230,613**	-
Other operating expenses		**382,532**	59,776
		4,812,236	4,355,188
Operating loss		**(3,640,885)**	(787,911)
Other expenses			
Mark to market adjustments on Canadian dollar denominated warrants		**(3,277,328)**	(3,843)
Foreign exchange loss		**(24,958)**	(64,511)
Other income		**-**	2,172
		(3,302,286)	(66,182)
Net loss before income taxes		**(6,943,171)**	(854,093)
Income taxes	16	**12,046**	12,840
Net loss and comprehensive loss for the year		**$ (6,955,217)**	$ (866,933)
Loss per share – basic and diluted		**$ (0.13)**	$ (0.02)
Weighted average number of shares outstanding – basic and diluted		**53,130,759**	36,462,905

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

LED MEDICAL DIAGNOSTICS INC.

Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

(Expressed in U.S. Dollars)

For the years ended December 31, 2013 and 2012

	Number of Shares	Share Capital	Stock-based Payments Reserves	Warrants Reserve	Deficit	Other Comprehensive Income	Total Shareholders' Equity (Deficiency)
Balance, January 1, 2012	**36,335,508**	**$ 23,713,352**	**$ 62,495**	**$ 277,748**	**$ (24,733,922)**	**$ 474,458**	**$ (205,869)**
Shares issued for cash	4,650,000	1,170,223	-	-	-	-	1,170,223
Share issuance costs	-	(88,710)	-	-	-	-	(88,710)
Reclassification of warrants	-	(136,624)	-	-	-	-	(136,624)
Net loss and comprehensive loss for the year	-	-	-	-	(866,933)	-	(866,933)
Balance, December 31, 2012	**40,985,508**	**$ 24,658,241**	**$ 62,495**	**$ 277,748**	**$ (25,600,855)**	**$ 474,458**	**$ (127,913)**
Shares issued for cash	32,000,000	7,157,095	-	-	-	-	7,157,095
Share issuance costs	-	(705,495)	-	-	-	-	(705,495)
Subscriber warrants issued pursuant to private placement	-	(4,102,819)	-	4,102,819	-	-	-
Issuance of shares on exercise of warrants	10,500	4,436	-	-	-	-	4,436
Finders warrants issued pursuant to private placement	-	-	-	344,131	-	-	344,131
Stock-based compensation	-	-	907,509	-	-	-	907,509
Deferred share unit compensation	-	230,613	-	-	-	-	230,613
Net loss comprehensive loss for the year	-	-	-	-	(6,955,217)	-	(6,955,217)
Balance, December 31, 2013	**72,996,008**	**$ 27,242,071**	**$ 970,004**	**$ 4,724,698**	**$ (32,556,072)**	**$ 474,458**	**$ 855,159**

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

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Consolidated Statements of Cash Flow

(Expressed in U.S. Dollars)

For the years ended December 31, 2013 and 2012

	December 31, 2013	December 31, 2012
Cash flows from operating activities		
Net loss for the year	**$ (6,955,217)**	$ (866,933)
Adjustments to net loss for items not involving cash:		
Depreciation of equipment	**12,596**	33,971
Amortization of intellectual property	**25,805**	25,805
Finder's warrants issuance costs	**344,131**	-
Loss on disposal of assets	**-**	702
Accrued interest on shareholder loans	**-**	2,614
Mark to market adjustments on Canadian dollar denominated warrants	**3,277,328**	3,843
Deferred share unit compensation	**230,613**	-
Stock-based compensation	**907,509**	-
Unrealized foreign exchange loss	**255,163**	-
	(1,902,072)	(799,998)
Changes in working capital assets and liabilities:		
Trade and other receivables	**1,010,841**	(1,215,855)
Inventory	**(115,840)**	474,150
Inventory held by distributor	**352,568**	(51,047)
Prepaid expenses and deposits	**(227,864)**	(703)
Trade payables and accrued liabilities	**(895,963)**	290,024
Advances from distributor	**(1,282,618)**	320,750
Changes in working capital assets and liabilities	**(1,158,876)**	(182,681)
Cash flows used in operating activities	**(3,060,948)**	(982,679)
Cash flows from investing activities		
Purchase of equipment	**(7,731)**	(16,758)
Restricted cash	**5,026**	19,556
Cash flows (used in) provided by investing activities	**(2,705)**	2,798
Cash flows from financing activities		
Issuance of common shares, net of issuance costs	**6,451,600**	1,081,513
Proceeds from exercise of warrants	**4,436**	-
Repayment of finance lease obligation	**(2,981)**	(2,410)
Repayment of shareholder loans	**-**	(105,410)
Cash flows provided by financing activities	**6,453,055**	973,693
Increase (decrease) in cash	**3,389,402**	(6,188)
Cash, beginning of year	**969,584**	975,772
Cash, end of year	**$ 4,358,986**	$ 969,584

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

1. NATURE AND CONTINUANCE OF OPERATIONS

LED Medical Diagnostics Inc. ("LED" or the "Company") was incorporated under the British Columbia Business Corporations Act on July 17, 2002 as 651192 B.C. Ltd. and changed its name to LED Medical Diagnostics Inc. on August 20, 2003. The Company's head office, principal address and records office are located at 235 – 5589 Byrne Road, Burnaby, British Columbia, Canada, V5J 3J1. The registered and records office is located at 2500 – 700 West Georgia Street, Vancouver, B.C. V7Y 1B3.

The Company has developed, and markets, a medical device under the trade name VELscope®. The device is used in the dental industry to help identify oral soft tissue abnormalities including those which may be cancerous or precancerous and also to help define appropriate margins for surgical excision.

These consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The continuing operations of the Company are dependent upon its ability to generate profitable operations in the future, and to continue to secure additional financing from lenders and shareholders. There can be no assurance that the Company will be successful in its efforts to raise additional financing or if financing is available, that it will be on terms that are acceptable to the Company.

The Company incurred an operating loss of $3,640,885 and has negative cash flow from operations of $3,060,948 for the year. As at December 31, 2013 the Company had an accumulated deficit of $32,556,072. The Company's ability to continue as a going concern is dependent on its available cash, its ability to find new sources of cash and its ability to continue to raise funds to support corporate operations. Consequently, material uncertainties exist which cast significant doubt upon the Company's ability to continue as a going concern. As at December 31, 2013 and as at the date of approval of these consolidated financial statements, the outcome of these activities is unknown and subject to considerable uncertainty. These consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties or if such adjustments would be material.

2. STATEMENT OF COMPLIANCE AND BASIS OF PRESENTATION

These consolidated financial statements of the Company, approved by the Board of Directors on April 10, 2014, have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

Subsidiaries are entities controlled by LED. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries listed in the following table:

Name of Subsidiary	Country of Incorporation	Ownership Interest December 31, 2013	Ownership Interest December 31, 2012
LED Dental Inc.	Canada	100%	100%
LED Dental (U.S.) Ltd.	USA	100%	100%

Significant accounting judgments, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

The estimates used in determining the recorded amounts in these consolidated financial statements include the following:

Revenue recognition

The Company recognizes revenue from sales made both through distributors and directly to customers when all revenue recognition criteria are met which includes the ability to determine a fixed fee. Management uses its best estimate of expected sales incentives to estimate the final sales price. If a reasonable estimate cannot be made, the Company defers revenue and costs relating to the sales at the time the goods are shipped. In these cases, revenue is recognized upon the distributor remitting product resale price and customer shipment information, which is upon sale to the end customer.

Impairment of long-lived assets and patents and intellectual property

The determination of intellectual property impairment requires significant estimates and assumptions to determine the recoverable amount of an asset and/or cash-generating-unit ("CGU"), wherein the recoverable amount is the higher of fair value less costs to sell and value in use. The value in use method involves estimating the net present value of future cash flows derived from the use of the asset and/or CGU, discounted at an appropriate rate.

The estimates of future cash flows require a number of key assumptions about future business performance. These assumptions and estimates are primarily based on the relevant business' historical experience and economic trends. These key estimates include the future revenue levels and operating expenses. The estimates are subject to a number of factors and it is possible that actual results could vary materially from management's estimates. Significant changes in the key assumptions utilized in the estimate of future cash flows could result in an impairment loss or reversal of an impairment loss.

Estimated useful lives of long-lived assets

Judgment is used to determine the components of an asset and the component's useful and is based on an analysis of all pertinent factors including, but not limited to, the expected use of the asset and in the case of an intangible asset, contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost, and renewal history. If the estimated useful lives were incorrect, this could result in an increase or decrease in the annual amortization expense, and future impairment charges or recoveries.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Equity-settled stock-based compensation

The Company estimates the cost of equity-settled stock-based compensation using the Black-Scholes option pricing model. The model takes into account an estimate of the expected life of the option, the current price of the underlying common share, the expected volatility, an estimate of future dividends on the underlying common share, the risk-free rate of return expected for an instrument with a term equal to the expected life of the option, and the expected forfeiture rate.

Warranty

The Company estimates warranty expense based on historical records, taking into account the likelihood of a warranty issue, estimated costs of warranty repair and total units in the market. The Company records a liability in respect of estimated future warranty costs. The actual cost that the Company may incur and the timing of the repairs to be carried out may differ significantly from the estimated accrual.

Contingencies

Provisions are accrued for liabilities with uncertain timing or amounts, if, in the opinion of management, it is both likely that a future event will confirm that a liability had been incurred at the date of the financial statements and the amount can be reasonably estimated. In cases where it is not possible to determine whether such a liability has occurred, or to reasonably estimate the amount of loss until the performance of some future event, no accrual is made until that time. In the ordinary course of business, the Company may be party to legal proceedings which include claims for monetary damages asserted against the Company and its subsidiaries. The adequacy of provisions is regularly assessed as new information becomes available.

The Company does not record contingent assets.

The judgments used in applying the Company's significant accounting policies include the following:

Determination of CGUs

The Company's assets are grouped into CGUs based on their ability to generate separate identifiable cash flows. The determination of CGUs involves an assessment regarding the interdependency of cash inflows, and the Company's organizational structure.

Foreign currency translation

The consolidated financial statements are presented in U.S. dollars. The functional currency of each of the Company's operating entities is determined using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in U.S. dollars which is the functional and presentation currency of the parent. The functional currencies of the subsidiaries are as follows:

Name of Subsidiary	Functional currency ($)
LED Dental Inc.	U.S.
LED Dental (U.S.) Ltd.	U.S.

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the period-end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items or on settlement of monetary items are recognized in profit or loss in the statement of operations in the period in which they arise, except where deferred in equity as a qualifying cash flow or net investment hedge.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

The financial results and position of subsidiaries whose functional currency is different from the Company's presentation currency are translated as follows:

- Assets and liabilities are translated at period-end exchange rates prevailing at that reporting date; and
- Income and expenses are translated at average exchange rates for the year.

Exchange differences arising on translation of foreign operations are transferred directly to the Company's foreign currency translation reserve in the statement of operations and comprehensive loss. These differences will be recognized in profit or loss in the year in which the operation is disposed.

Financial instruments

The Company classifies its financial instruments in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments or available-for-sale financial assets and financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. Management determines the classification of its financial instruments at initial recognition.

Financial assets are classified at fair value through profit or loss when they are either held for trading for the purpose of short-term profit taking, derivatives not held for hedging purposes, or when they are designated as such to avoid an accounting mismatch or to enable performance evaluation where a group of financial assets is managed by key management personnel on a fair value basis in accordance with a documented risk management or investment strategy. Such assets are subsequently measured at fair value with changes in carrying value being included in profit or loss. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are subsequently measured at amortized cost. They are included in current assets, except for maturities greater than twelve months after the end of the reporting period. These are classified as non-current assets.

Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and it is the Company's intention to hold these investments to maturity. They are subsequently measured at amortized cost.

Held-to-maturity investments are included in non-current assets, except for those which are expected to mature within twelve months after the end of the reporting period.

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not suitable to be classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity investments and are subsequently measured at fair value. These are included in current assets. Unrealized gains and losses are recognized in other comprehensive income, except for impairment losses and foreign exchange gains and losses.

Non-derivative financial liabilities (excluding financial guarantees) are subsequently measured at amortized cost.

Regular purchases and sales of financial assets are recognized on the trade-date – the date on which the Company commits to purchase the asset.

Financial assets are derecognized when the rights to receive cash flows from the instruments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

At each reporting date, the Company assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a significant and prolonged decline in the value of the instrument is considered to determine whether impairment has arisen.

Cash and cash equivalents

Cash and cash equivalents include highly liquid Canadian dollar denominated guaranteed investment certificates which are readily convertible to contracted amounts of cash without penalty. Cash equivalents are classified as loans and receivables and are recorded at amortized cost.

The Company has no cash equivalents as of December 31, 2013 or December 31, 2012.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Inventory and inventory held by the distributor

Inventory consists of finished goods and is valued at the lower of cost and net realizable value with the cost being determined on a first in, first out basis. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to complete the sale. The amount of any write-down of inventories to net realizable value and all loss of inventories is recognized as an expense in the period the write-down or loss occurs. The Company defers recognition of revenue and costs relating to shipments to distributors if there are sales incentives or right to return that cannot be reasonably estimated at the time the goods are shipped. In these instances, the inventory is recorded as held by distributor until the products are sold to the end customers.

Property and equipment

Property and equipment is stated at historical cost less accumulated depreciation and accumulated impairment losses.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of operations and comprehensive loss during the financial period in which they are incurred. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in profit or loss.

Depreciation is calculated on a straight-line method to write off the cost of the assets over their estimated useful lives. The depreciation rates applicable to each category of equipment are as follows:

Office equipment	5 years	straight-line method
Computer equipment	3 years	straight-line method
Manufacturing tooling	2 years	straight-line method
Leasehold improvements	term of lease	straight-line method

Intangible assets

Intangible assets, whether purchased or self-created, are recognized if it is probable that the future economic benefits that are attributable to the asset will flow to the Company and the cost of the asset can be measured reliably.

Intangible assets, which consist of acquired patents, intellectual property and related know-how, have finite lives and are measured at cost less accumulated amortization and accumulated impairment losses over their useful lives. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. If any such indication exists, the asset's recoverable amount is estimated and an impairment loss is recognized whenever the carrying amount of the intangible assets exceed their recoverable amount.

Intangible assets are being amortized using the straight-line method over a 13 year period commencing in 2004.

Research and development costs

Research costs are expensed as incurred. Development costs are expensed as incurred unless the specific criteria for deferral and amortization have been met. To date, the Company has not capitalized any development costs.

Impairment of non-financial assets

The carrying amount of the Company's non-financial assets (which include property and equipment and patents and intellectual property) is reviewed at each reporting date to determine whether there is any indication of impairment. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. An impairment loss is recognized whenever the carrying amount of an asset or its CGU exceeds its recoverable amount. Impairment losses are recognized in the statement of operations.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Impairment of non-financial assets (cont'd)

The recoverable amount of assets is the greater of an asset's fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversal of impairment loss

An impairment loss is only reversed if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount, however, not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognized in previous years. Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment.

Deferred revenue

The Company defers revenue and costs relating to sales if there is a right to return or sales incentives that cannot be reasonably estimated at the time the goods are shipped. In these cases, revenue is recognized upon the maturation of the distributor's right to return or the distributor remitting product resale price and customer shipment information, which is upon sale to the end customer. When cash has been received from the distributor for the goods shipped, the Company defers the revenue as advances from the distributor. The future revenues that will ultimately be recognized in the Company's consolidated statement of operations may be different than the amount shown on the consolidated statement of financial position as advances from the distributor, due to the actual price adjustments issued to the distributor when the product is sold to their customers. For contracts where distributors are granted only limited price credits such that that level can be reasonably estimated at the time goods are shipped, the Company recognizes revenue at the time of shipment to the distributor assuming all of the other criteria are met.

Leases

Leases of equipment where substantially all the risks and benefits incidental to the ownership of the asset are transferred to the Company are classified as finance leases.

Finance leases are capitalized by recording an asset and a liability at the lower of the fair value of the leased equipment or the present value of the minimum lease payments, including any guaranteed residual values. Lease payments are allocated between the reduction of the lease liability and the lease interest expense for the period.

Leased assets are depreciated on a straight-line basis over the shorter of their estimated useful lives and the lease term.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred.

Warranty provision

The Company provides its customers with warranty protection on its products. The warranties cover a period of one year from date in use. The Company estimates warranty expense based on past experience and records a liability in respect of estimated future warranty costs. The actual cost that the Company may incur and the timing of the repairs to be carried out may differ significantly from the estimated accrual.

Income taxes

Current income tax:

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date, in the countries where the Company operates and generates taxable income.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Current income tax: (cont'd)

Current income tax relating to items recognized directly in other comprehensive income or equity is recognized in other comprehensive income or equity and not in profit or loss. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income tax:

Deferred income tax is provided using the balance sheet method on temporary differences at the reporting date between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and is reduced only to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Changes in the expected operating results, enacted tax rates, legislation or regulations, and the Company's interpretations of income tax legislation will result in adjustments to the expectations of future timing difference reversals and may require material deferred tax adjustments.

<u>Stock-based payments</u>

The Company operates an employee stock option plan. Historically, stock-based payments to employees have been measured at the fair value of the instruments issued and amortized over the vesting periods. Stock-based payments to non-employees are measured at the fair value of goods or services received or the fair value of the equity instruments issued, if it is determined the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. The corresponding amount is recorded to the stock-based payment reserve. The fair value of options is determined using the Black–Scholes option pricing model which incorporates all market vesting conditions. The number of shares and options expected to vest is reviewed and adjusted at the end of each reporting period such that the amount recognized for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

The Black-Scholes option pricing model was developed for use in estimating the fair value of stock options and compensatory warrants that have no vesting provisions and are fully transferable. Also, option-pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates.

The Company has a Deferred Share Unit Plan ("DSU Plan") for the Company's Directors, Executive Officers and Service Providers. The Company recognizes compensation expense for Deferred Share Units ("DSUs") based on the market price of the Company's stock. A DSU is convertible to shares only, and are valued by reference to the fair value of the equity instruments granted (See Note 14).

<u>Warrants</u>

All warrants granted are valued using the fair value method which is determined by the Black-Scholes pricing model with assumptions for risk free interest rates, dividend yields, volatility factors and an expected life of the warrants. As a result of the change in functional currency to U.S. dollars on January 1, 2012, the Canadian dollar denominated warrants outstanding were reclassified from equity to liabilities and are revalued every period with change in valuation being expensed. Changes in the underlying assumptions can materially affect the fair value estimates.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Revenue recognition

The Company recognizes revenue when it has transferred significant risks and rewards of ownership, legal title has passed, it retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company generates revenues from sales made both through distributors and directly to customers. All sales are recorded at net of sales incentives such as volume rebates and other discounts. Management uses its best estimate of expected sales incentives to estimate the sales price. Estimated future volume rebates are estimated at the time of the sale of the medical devices which has been at the maximum of discounts available.

Research and development tax credits

Research and development tax credits are accounted for using the cost reduction method. Accordingly, tax credits are recorded as a reduction of the related expenses or the capitalized costs when recoverability is reasonably assured.

Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for its own shares held. Diluted EPS is determined by adjusting the profit attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for its own shares held, for the effects of all dilutive potential common shares. Dilutive share capital quantification has not been performed as the Company is in a net loss position for the periods resulting in an anti-dilutive quantification.

New Standards and Interpretations Adopted as of January 1, 2013

The Company has applied the following new and revised IFRSs in these consolidated financial statements. Other than increased disclosures, there was no impact to the Company's consolidated financial statements resulting from these IFRS standards.

Effective from January 1, 2013, IFRS 10 – Consolidated Financial Statements ("IFRS 10") supersedes SIC 12 – Consolidation – Special Purpose Entities and the requirements relating to consolidated financial statements in IAS 27 – Consolidated and Separate Financial Statements. Concurrent with the issuance of IFRS 10, the International Accounting Standards Board ("IASB") issued IFRS 11 – Joint Arrangements ("IFRS 11") and IFRS 12 – Disclosure of Interests in Other Entities ("IFRS 12") and reissued IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures.

IFRS 10 – Consolidated Financial Statements

IFRS 10 establishes control as the basis for an investor to consolidate its investees and defines control as an investor's power over an investee with exposure, or rights, to variable returns from the investee and the ability to affect the investor's returns through its power over the investee.

IFRS 11 – Joint Arrangements

IFRS 11 supersedes IAS 31 – Interests in Joint Ventures and SIC 13 – Jointly Controlled Entities – Non-Monetary Contributions by Venturers. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement ("joint operators") have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement ("joint venturers") have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognize its portion of assets, liabilities, revenues and expenses of a joint arrangement, while a joint venture recognizes its investment in a joint arrangement using the equity method.

(Expressed in U.S. Dollars)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 combines and enhances the disclosure requirements for the Company's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The requirements of IFRS 12 include enhanced reporting of the nature of risks associated with the Company's interests in other entities, and the effects of those interests on the Company's consolidated financial statements.

IFRS 13 – Fair Value Measurement

IFRS 13 defines fair value and sets out a single framework for measuring fair value which is applicable to all IFRSs that require or permit fair value measurements or disclosures about fair value measurements. IFRS 13 requires that when using a valuation technique to measure fair value, the use of relevant observable inputs should be maximized while unobservable inputs should be minimized. The Company has applied IFRS 13 on a prospective basis, commencing January 1, 2013. Additional disclosure on the fair value of certain financial instruments is included in the consolidated financial statements as a result of applying IFRS 13.

New Standards and Interpretations Not Yet Adopted

Standards issued but not yet effective up to the date of issuance of the Company's consolidated financial statements are listed below. This listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. The Company is currently assessing the impact of the following standards on the consolidated financial statements and intends to adopt these standards when they become effective.

IFRS 9 – Financial Instruments

IFRS 9 replaces the current IAS 39 - Financial Instruments Recognition and Measurement. The standard introduces new requirements for classifying and measuring financial assets and liabilities. There is no required compliance date as the IASB decided that the previous mandatory effective date of January 1, 2015, would not allow sufficient time for entities to prepare to apply the new standard because the impairment phase of the IFRS project has not yet been completed. Accordingly, the IASB has deferred the application of this standard until further notice. The Company has not yet evaluated the impact on the financial statements

IAS 32 - Financial Instruments: Offsetting Financial Assets and Financial Liabilities

IAS 32 provides further clarification on the application of the offsetting requirements. The Company will start the application of IAS 32 in the financial statements effective from January 1, 2014. The Company does not expect the application of the offsetting requirements to have a material impact on the Company's consolidated financial statements.

4. RESTRICTED CASH

Restricted cash represents deposits held at banks to partially secure the Company's credit card accounts. The imposed restrictions dictate the funds are only allowed to be used to settle the Company's debt relating to credit card accounts, if any.

5. TRADE AND OTHER RECEIVABLES

		December 31, 2013		December 31, 2012
Trade accounts receivable	**$**	**490,800**	$	1,011,172
Financing proceeds receivable *(Note 13)*		**-**		425,701
Goods and services tax receivable		**12,936**		77,704
	$	**503,736**	$	1,514,577

At December 31, 2013 and 2012, no accounts receivable is due beyond one year. The fair value of amounts receivable approximates their carrying value as at December 31, 2013 and 2012. During 2013, the Company has written down accounts receivable of $9,013 (2012 - $Nil).

(Expressed in U.S. Dollars)

6. EXCLUSIVE DISTRIBUTION AGREEMENT

On November 30, 2010, the Company entered into a two year renewable sales and marketing agreement with a distributor (the "Distributor") of medical and dental supplies whereby the Distributor would be granted exclusive rights to market the VELscope Vx in Canada, the United States, and Puerto Rico ("the original agreement"). Under the original agreement, the Distributor was entitled to receive up to 2,541,468 share purchase warrants at CDN $0.65 per share, based on the Distributor achieving certain sales milestones. The original agreement also allowed for the Distributor to return certain units of VELscope Model V2, a legacy product, at a value of $292,600, in the form of credits which shall be applied against the price of parts and accessories purchased by the Distributor for the VELscope Model V2. As at December 31, 2013 the entire credit was settled.

On September 21, 2012, the agreement was amended to become a non-exclusive distribution in limited markets which were defined in the agreement ("the amended agreement"). Further, under the amended agreement, the Company had agreed to repurchase the VELscope Vx inventory that was not sold to end customers from the Distributor over the period from September 21, 2012 to December 15, 2013. The Company will purchase from the Distributor based on the original sale price of the inventory less the manufacturer's warranty cost up to an aggregate maximum amount of $1,678,409. An amount of $45,362 of this commitment was offset against the Distributor's accounts receivable on September 21, 2012. On March 15, June 15, September 9, November 29 and December 6, 2013, the Company purchased, in five tranches, VELscope Vx inventory for a total amount of $1,527,200. An amount of $264,562 of this purchase was offset against the Distributor's accounts payable to the Company.

7. PROPERTY AND EQUIPMENT

The following table presents details of movement in the carrying value of property and equipment by asset type:

Cost

	Office Equipment	Computer Equipment	Leasehold Improvements	Total
Balance, January 1, 2012	**$ 61,325**	**$ 34,956**	**$ 2,767**	**$ 99,048**
Additions	15,451	1,307	-	16,758
Disposals	-	(1,402)		(1,402)
Balance, December 31, 2012	**$ 76,776**	**$ 34,861**	**$ 2,767**	**$ 114,404**
Additions	1,168	6,563	-	7,731
Disposals	(39,987)	(25,978)	-	(65,965)
Balance, December 31, 2013	**$ 37,957**	**$ 15,446**	**$ 2,767**	**$ 56,170**

Accumulated Depreciation

	Office Equipment	Computer Equipment	Leasehold Improvements	Total
Balance, January 1, 2012	**$ (49,060)**	**$ (23,356)**	**$ (519)**	**$ (72,935)**
Depreciation	(6,861)	(5,218)	(2,075)	(14,154)
Disposals	-	700	-	700
Balance, December 31, 2012	**$ (55,921)**	**$ (27,874)**	**$ (2,594)**	**$ (86,389)**
Depreciation	(7,390)	(5,033)	(173)	(12,596)
Disposals	39,987	25,978	-	65,965
Balance, December 31, 2013	**$ (23,324)**	**$ (6,929)**	**$ (2,767)**	**$ (33,020)**

Carrying Value

	Office Equipment	Computer Equipment	Leasehold Improvements	Total
Balance, December 31, 2013	**$ 14,633**	**$ 8,517**	**$ -**	**$ 23,150**
Balance, December 31, 2012	$ 20,855	$ 6,987	$ 173	$ 28,015

(Expressed in U.S. Dollars)

8. PATENTS AND INTELLECTUAL PROPERTY

The following table presents details of movement in the carrying value of the patents:

Cost

	Patents
Balance, January 1, 2012	**$ 335,467**
Additions	-
Balance, December 31, 2012	**$ 335,467**
Additions	-
Balance, December 31, 2013	**$ 335,467**

Accumulated Amortization

Balance, January 1, 2012	**$ (221,495)**
Amortization	(25,805)
Balance, December 31, 2012	**$ (247,300)**
Amortization	(25,805)
Balance, December 31, 2013	**$ (273,105)**

Carrying Value

Balance, December 31, 2013	**$ 62,362**
Balance, December 31, 2012	$ 88,167

On August 31, 2003, the Company signed a technology agreement amended on February 10, 2004, for the purchase of certain patents, and the related intellectual property and know-how, in respect of a fluorescence scope system for dermatologic diagnosis. The patents will expire in 2017.

At December 31, 2013, management had assessed the intellectual property and intangible assets for recoverability and no events or changes in circumstances indicated that the carrying values may not be recoverable. Therefore, there was no impairment of these assets at December 31, 2013 or 2012.

9. TRADE PAYABLES AND ACCRUED LIABILITIES

	December 31, 2013	December 31, 2012
Trade payables	**$ 511,535**	$ 1,387,747
Accrued liabilities	**268,451**	279,312
Warranty provision	**7,858**	15,550
State and Provincial sales tax payable	**5,202**	6,400
	793,046	$ 1,689,009

The Company warrants that its products will operate substantially in conformity with product documentation. The Company accrues for known warranty issues if a loss is probable and can be reasonably estimated and accrues for estimated incurred but unidentified warranty issues based on historical activity. To date, the Company has had no material warranty claims.

(Expressed in U.S. Dollars)

10. LEASE OBLIGATIONS AND COMMITMENTS

a) The Company has a finance lease with respect to the purchase of office equipment. The Company has the option to purchase the equipment for a nominal purchase price at the end of the lease.

Future minimum lease payments together with the balance of the finance lease obligation are as follows:

		December 31, 2013		December 31, 2012
Payable not later than one year	**$**	**4,820**	$	4,820
Payable later than one year and not later than five years		**3,472**		8,291
		8,292		13,111
Less: future finance charges		**(1,412)**		(3,250)
Present value of minimum lease payments		**6,880**		9,861
Current portion		**(3,690)**		(2,982)
Long-term portion	**$**	**3,190**	$	6,879

b) The Company has an operating lease with respect to its operating premises in Burnaby, BC. Future minimum lease payments as at December 31, 2013 are as follows:

Payable not later than one year	$	55,671
Payable later than one year and not later than five years		16,047
Total future minimum lease payments	**$**	**71,718**

c) The Company was paying royalties at a rate of 1.5% of VELscope sales to the British Columbia Cancer Agency prior to December 31, 2010. The rate was subsequently revised to 0.75% and retroactively applied to prior periods resulting in a reversal of previously accrued royalties. During the year ended December 31, 2013, the Company accrued royalties of $1,654 (December 31, 2012 – $32,450). As at December 31, 2013, total royalties accrued but not paid was $32,904 (2012 - $70,627), which are classified as a component of accrued liabilities.

d) On January 1, 2011, the Company entered into an employment agreement with the former CEO of the Company whereby the former CEO would be paid an annual salary of CDN $250,000 and will receive royalties of 2% of all VELscope sales until January 1, 2018. Effective January 1, 2012, annual salary was revised to CDN $295,000. Further, the former CEO will receive bonuses and options as follows:

- CDN $25,000 and 250,000 options once the annual earnings before interest, tax and amortization ("EBITDA") reaches CDN $1,000,000; and
- CDN $100,000 and 250,000 options once the annual EBITDA reaches CDN $2,000,000.

The former-CEO maintains a position with the Company maintaining the aforementioned compensation structure.

e) The Company may be subject to a variety of claims and suits that arise from time to time in the ordinary course of business. These matters are subject to inherent uncertainties. To date, the Company has accrued for a legal settlement in the amount of CDN $30,000 pertaining to a wrongful dismissal lawsuit.

11. RELATED PARTY TRANSACTIONS

Related parties include key management, the Board of Directors, close family members and enterprises which are controlled by these individuals as well as certain persons performing similar functions.

During the years ended December 31, 2013 and 2012, the Company paid or accrued the following compensation expenses to key personnel of the Company:

(Expressed in U.S. Dollars)

11. RELATED PARTY TRANSACTIONS (cont'd)

	Year ended December 31, 2013	Year ended December 31, 2012
Short-term compensation*	**$ 510,317**	$ 596,633
Share-based payments	**$ 799,594**	$ Nil

(*) The Company entered into an employment agreement (see Note 10d) with the former CEO in which the former CEO would earn royalties equal to 2% of all VELscope sales. Included in short-term benefits are accrued royalties of $29,288 during the year ended December 31, 2013 (2012 - $92,622).

During the year ended December 31, 2013, a total of 4,805,000 options were awarded to key management under the Company's stock option plan (2012 - nil).

12. WARRANTS

The following table summarizes the Canadian dollar denominated warrant transactions that occurred during the years ended:

	December 31, 2013		December 31, 2012	
	Number of Warrants	**Weighted average exercise price**	Number of Warrants	Weighted average exercise price
		(CDN$)		(CDN$)
Warrants outstanding, beginning of year	8,040,968	0.72	8,971,968	0.72
Issued	18,500,000	0.20	184,100	0.30
Exercised	(10,500)	0.30	-	-
Expired	(7,856,868)	0.73	(1,115,100)	0.65
Warrants outstanding, end of year	**18,673,600**	**0.20**	8,040,968	0.72
Warrants exercisable, end of year	**18,673,600**	**0.20**	6,134,867	0.74

The Company completed private placements in October 2013, June 2013 and December 2012. The details of these private placements are described in Note 13.

As a result of the change in functional currency, the Company values its Canadian dollar denominated warrants and records it as a liability (which is revalued at each reporting date). The following table breaks down the warrant liability at December 31, 2013 of each grant of warrants:

Number of Warrants	**Amount**	**Exercise Price**	**Expiry Date**
	(US$)	**(CDN$)**	
173,600	$ 20,960	0.30	June 21, 2014
1,500,000	-	0.20	June 14, 2015
17,000,000	3,651,998	0.20	June 14, 2015
18,673,600	**$ 3,672,958**	**0.20**	

(Expressed in U.S. Dollars)

12. WARRANTS (cont'd)

The following table breaks down the warrant liability at December 31, 2012 of each grant of warrants:

Number of Warrants	Amount	Exercise Price	Expiry Date
	(US$)	(CDN$)	
4,225,167	$ 97,671	0.65	May 22, 2013
1,725,600	17,580	1.00	May 22, 2013
1,906,101	-	0.65	November 30, 2013
184,100	25,216	0.65	June 21, 2014
8,040,968	**$ 140,467**	**0.73**	

The following table summarizes the US dollar denominated warrant transactions that occurred during the year ended:

	December 31, 2013		December 31, 2012	
	Number of Warrants	**Weighted average exercise price**	Number of Warrants	Weighted average exercise price
		(US$)		(US$)
Warrants outstanding, beginning of year	-	-	-	-
Issued	16,109,887	0.50	-	-
Exercised	-	-	-	-
Expired	-	-	-	-
Warrants outstanding, end of year	**16,109,887**	**0.50**	-	-
Warrants exercisable, end of year	**-**	**-**	-	-

The following table summarizes information about the Company's warrants outstanding at December 31, 2013:

	Warrants Outstanding		**Warrants Exercisable**	
Exercise prices	**Number Outstanding**	**Weighted Average Remaining Term (Years)**	**Number Exercisable**	**Weighted Average Remaining Term (Years)**
0.20 (CDN$)	18,500,000	1.45	18,500,000	1.45
0.30 (CDN$)	173,600	0.47	173,600	0.47
0.50 (US$)	16,109,887	1.83	-	-
	34,783,487	**1.62**	**18,673,600**	**1.44**

The following table summarizes information about the Company's warrants outstanding at December 31, 2012:

	Warrants Outstanding		**Warrants Exercisable**	
Exercise prices (CDN$)	**Number Outstanding**	**Weighted Average Remaining Term (Years)**	**Number Exercisable**	**Weighted Average Remaining Term (Years)**
0.30	184,100	1.47	184,100	1.47
0.65	6,131,270	0.39	4,225,167	0.39
1.00	1,725,598	0.39	1,725,600	0.39
	8,040,968	**0.44**	**6,134,867**	**0.44**

(Expressed in U.S. Dollars)

13. SHARE CAPITAL

Authorized share capital

Unlimited number of common shares without par value

	Number of common shares	Amount
Outstanding, January 1, 2012	**36,335,508**	**$23,713,352**
Issued for cash	4,650,000	1,170,223
Share issuance costs	-	(88,710)
Transfer value of outstanding warrants to liability	-	(136,624)
Outstanding, December 31, 2012	**40,985,508**	**$24,658,241**
Issued for cash	32,000,000	7,157,095
Share issuance costs	-	(705,495)
Transfer of value of warrants to warrant reserve	-	(4,102,819)
Issuance of shares on exercise of warrants	10,500	4,436
Issuance of deferred share units	-	230,613
Outstanding, December 31, 2013	**72,996,008**	**$27,242,071**

2013

On October 24, 2013, the Company completed a non-brokered private placement of 15,000,000 units at an issue price of CDN$0.35 per unit for gross proceeds of $5,035,971 (CDN $5,250,000). Each unit is comprised of one common share and one common share purchase warrant entitling the holder to acquire one common share at an exercise price of US$0.50 for a period of 24 months. Additionally, in accordance with a finder's fee agreement, the Company issued 1,109,887 finder's warrants (the "Finder's Warrants") to arm's length finders. Each finder's warrant is non-transferable and exercisable into one common share at an exercise price $0.50 for a period of 24 months. The Company paid share issuance costs of $442,545 (CDN $451,849) in relation to this private placement. The fair value of the 16,109,887 (15,000,000 financing and 1,109,887 finder's) warrants were calculated using the Black-Scholes pricing model and was valued at $303,579 (CDN $304,164), applying the following assumptions: grant price $0.50, expected dividend yield 0.0%, expected volatility 150.324%, risk-free interest rate 0.738% and expected life of 24 months. The Company has accounted for US dollar denominated warrants as a component of equity. All of the securities issued in connection with the private placement will be subject to a hold period that expires four months after the issuance date.

On June 14, 2013 the Company completed a non-brokered private placement of 17,000,000 units at an issue price of CDN $0.15 per unit for gross proceeds of $2,121,124 (CDN $2,550,000). Each unit is comprised of one common share and one common share purchase warrant entitling the holder to acquire one common share at an exercise price of CDN$0.20 for a period of 24 months. Additionally, in accordance with a finder's fee agreement, the Company issued 1,500,000 finder's warrants (the "Finder's Warrants") to arm's length finders. Each finder's warrant is non-transferable and exercisable into one common share at an exercise price of CDN$0.20 for a period of 24 months. The Company paid share issuance costs of $262,950 (CDN $267,394) in relation to this private placement. The fair value of the 18,500,000 (17,000,000 financing and 1,500,000 finder's) warrants were calculated using the Black-Scholes pricing model and was valued at $420,600 (CDN $427,708), applying the following assumptions: grant price CDN$0.20, expected dividend yield 0.0%, expected volatility 18.896%, risk-free interest rate 1.02% and expected life of 24 months. All of the securities issued in connection with the private placement will be subject to a hold period that expires four months after the issuance date. At December 31, 2013, the fair value was valued at $3,651,998 (CDN $3,884,266), applying the following assumptions: share price CDN$0.38, expected dividend yield 0.0%, expected volatility 84.358%, risk-free interest rate 1.259% and expected life of 18 months.

(Expressed in U.S. Dollars)

13. SHARE CAPITAL (cont'd)

2012

On December 21, 2012 the Company completed a non-brokered private placement of 4,650,000 common shares at an issue price of CDN $0.25 per share, for gross proceeds of $1,170,223 (CDN $1,162,500). In accordance with a finder's fee agreement, the Company issued 184,100 finder's warrants (the "Finder's Warrants") to arm's length finders. Each finder's warrant is non-transferrable and exercisable into one common share at an exercise price of CDN$0.30 for a period of 18 months. The Company paid share issuance costs of $88,710 (CDN$ $88,125) in relation to this private placement. The fair value of the Finder's Warrants was calculated using the Black-Scholes pricing model and was valued at $17,852 (CDN $17,734 (see Note 10)) applying the following assumptions: grant price CDN$0.30, expected dividend yield 0.0%, expected volatility 140%, risk-free interest rate 1.12% and expected life of 18 months. Outstanding proceeds receivable in relation to this private placement as at December 31, 2012 were $425,701 (see Note 5). These were received subsequent to December 31, 2012. At December 31, 2013, the fair value was valued at $20,960 (CDN $22,293), applying the following assumptions: share price CDN$0.38, expected dividend yield 0.0%, expected volatility 84.358%, risk-free interest rate 1.259% and expected life of 12 months.

Escrow shares

As of December 31, 2013, a total of 2,029,549 (2012 – 4,109,101) common shares were held under escrow. These common shares will be released from escrow at a rate of 15% every 6 months, over a period of 15 months.

14. STOCK-BASED PAYMENTS

Commencing in 2005, the Company has granted, by way of directors resolutions, share options to directors, officers, employees and other service providers at the exercise price set out at the grant date. The Company has a rolling incentive stock option plan. Under the terms of the Company's stock option plan, the Board of Directors may grant options to directors, officers, employees, consultants and service providers equal to 10% of issued and outstanding common shares of the Company from time to time on a rolling basis. The plan provides for the granting of options at the closing price of the Company's stock on the day prior to the grant date. The option plan states that the Board of Directors are the administrators of the plan with defined vesting period for options granted.

A summary of the Company's outstanding share options is presented below:

	Outstanding options	
	Number of common shares	Weighted average exercise price in (CDN$)
Outstanding, January 1, 2012	**330,000**	**$ 1.54**
Options expired	(330,000)	1.54
Outstanding, December 31, 2012	**-**	**$ -**
Options granted	6,598,000	0.36
Options forfeited	(225,000)	0.40
Options expired	(25,000)	0.40
Outstanding, December 31, 2013	**6,348,000**	**$ 0.36**

(Expressed in U.S. Dollars)

14. STOCK-BASED PAYMENTS (cont'd)

The following table illustrates the assumptions of the option pricing models:

Grant date of Share Options	Share Price	Exercise Price	Annual dividend yield of Share options	Volatility	Risk-Free Interest rate	Expected life of the Share options
January 9, 2013	$0.25	$0.30	Nil	136.43%	1.24%	3 years
January 28, 2013	$0.395	$0.30	Nil	136.02%	1.24%	3 years
September 18, 2013	$0.39	$0.40	Nil	149.63%	1.46%	3 years
October 24, 2013	$0.54	$0.54	Nil	146.76%	1.18%	3 years
November 20, 2013	$0.485	$0.49	Nil	144.75%	1.23%	3 years
December 13, 2013	$0.40	$0.49	Nil	142.92%	1.18%	3 years
December 20, 2013	$0.355	$0.45	Nil	142.48%	1.17%	3 years

For the year ended December 31, 2013, the Company recognized $907,509 of stock-based compensation expense (2012 - $Nil).

15. DEFERRED SHARE UNITS

The Company has a DSU Plan for the Company's Directors, Executive Officers and Service Providers ("Eligible Person").

DSU activity is presented below:

	Number of DSUs
Outstanding, January 1, 2012 and December 31, 2012	**-**
Granted	950,000
Outstanding, December 31, 2013	**950,000**

During the year ended December 31, 2013, the Company recorded an expense of $230,613 (2012 - $Nil).

16. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory income tax rates of 25.0% (December 31, 2012 – 25.0%) to loss before income taxes due to the following:

	December 31, 2013	December 31, 2012
Net loss before income taxes	**$ (6,943,171)**	$ (854,093)
Tax recovery at applicable rates	**(1,787,867)**	(213,523)
Non-deductible items and other	**236,797**	7,940
Effect of reduction in tax rates	**(267,837)**	-
Temporary differences not recognized	**1,656,354**	205,583
State tax	**12,046**	12,840
Foreign currency translation	**(6,882)**	-
Opening deferred income tax adjustment	**359,434**	-
True up	**8,557**	-

(Expressed in U.S. Dollars)

16. INCOME TAXES (cont'd)

	December 31, 2013	December 31, 2012
Financing fees	**(186,042)**	-
Difference between current and future rate	**(13,351)**	-
Other	**837**	-
Income tax expense	**$ 12,046**	$ 12,840

The deferred tax assets have not been recognized in these consolidated financial statements, as management does not consider it more likely than not those assets will be realized in the carry forward period.

The composition of the Company's deferred tax assets as at December 31, 2013 and 2012 is as follows:

	December 31, 2013	December 31, 2012
Deferred tax assets in relation to:		
Non-capital losses carry forward	**$6,374,559**	$5,726,142
SR&ED pool	**639,428**	692,205
Patents and intellectual property	**129,933**	117,999
Finance lease obligations	**2,145**	2,548
Warrant liability	**852,105**	-
Property and equipment	**133,669**	126,664
DSU expense not settled	**59,959**	-
Share issue costs	**160,485**	30,370
Deferred tax assets not recognized	**$8,352,283**	$6,695,928

As at December 31, 2013, the Company has net operating loss carry forwards for Canadian purposes aggregating $24,517,533 available to reduce taxable income otherwise calculated in future years. These losses may be carried forward to apply against future income for tax purposes and will expire, if not utilized as follows:

2014	$ 289,518
2015	453,056
2026	1,543,946
2027	5,997,187
2028	1,931,522
2029	3,440,518
2030	3,556,584
2031	2,764,732
2032	1,827,009
2033	2,713,461
Net operating loss carry forwards	**$24,517,533**

The Company also has $2,459,338 (CDN $2,754,700) of discretionary deductions relating to its research and development activities. These deductions can be carried forward indefinitely.

17. SEGMENTED INFORMATION

The Company operates in a single geographical segment, being Canada, and a single reporting segment, being the development and commercialization of medical devices based on its proprietary imaging platform to aid in the detection and treatment of

(Expressed in U.S. Dollars)

17. SEGMENTED INFORMATION (cont'd)

disease in human tissues.

The Company's operating segment is reported in a manner consistent with the internal reporting provided to the Chief Executive Officer ("CEO"). The CEO is considered the chief operating decision-maker ("CODM") and has the authority for resource allocation and is responsible for assessing the Company's performance.

In each respective period, revenues from customers which amounted to 10% or more of the Company's revenues accounted for the following percentages of the Company's total revenues. The majority of the Company's revenues are primarily attributable to its North American distributors:

	% of Revenues for the year ended December 31, 2013	**% of Accounts Receivable at December 31, 2013**	% of Revenues for the year ended December 31, 2012	% of Accounts Receivable at December 31, 2012
Distributor A	13%	16%	63%	23%
Distributor B	75%	65%	27%	74%
Total	**88%**	**81%**	90%	97%

The Company earned revenues attributed to the following geographical regions based on the location of the customer:

	Year ended December 31,2013	**%**	Year ended December 31, 2012	**%**
U.S.	$ 2,338,886	93%	$ 4,891,762	77%
Canada	180,688	7%	1,042,455	17%
Rest of World	-	0%	378,537	6%
	$ 2,519,574	**100%**	$ 6,312,754	100%

All of the Company's property and equipment are located in North America.

18. CAPITAL DISCLOSURES

The Company's objectives for managing capital are:

- To maintain financial strength and to protect its ability to meet its on-going liabilities;
- To safeguard the Company's ability to continue as a going concern in order to pursue further development of medical devices so that it can provide adequate returns for shareholders and benefits for other stakeholders;
- To fund capital projects for facilitation of business expansion provided there is sufficient liquidity of capital to enable the internal financing;
- To maximize returns for shareholders over the long-term; and
- To maintain a capital base so as to maintain investor, creditor and market confidence.

The Company considers the items included in shareholders' equity (deficiency) as capital. The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares or return capital to shareholders. The Company is not subject to externally imposed capital requirements. There were no changes to the approach to capital management during the year.

(Expressed in U.S. Dollars)

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board of Directors approves and monitors the risk management processes, inclusive of documented investment policies, counterparty limits, and controlling and reporting structures. The type of risk exposure and the way in which such exposure is managed is provided as follows:

Classification of financial instruments

Financial assets included in the statement of financial position are as follows:

	December 31, 2013	December 31, 2012
Cash and cash equivalents		
Cash	$ 4,358,986	$ 969,584
Restricted cash	-	5,026
Loans and receivables		
Receivables	503,736	1,514,577
	$ 4,862,722	$ 2,489,187

Financial liabilities included in the statement of financial position are as follows:

	December 31, 2013	December 31, 2012
Non-derivative financial liabilities		
Trades payable	$ 511,535	$ 1,387,747
Accrued liabilities	268,451	279,312
Warranty provision	7,858	15,550
State and Provincial sales tax payable	5,202	6,400
Advances from distributor	495,494	1,778,112
Finance lease obligations	6,880	9,861
Derivative financial liabilities		
Warrants	3,672,958	140,467
	$ 4,968,378	$ 3,617,449

Fair value

The fair value of the Company's financial assets and liabilities approximates their carrying amount.

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

Details of the Company's warrants and information about the fair value hierarchy as at December 31, 2013 are as follows:

(Expressed in U.S. Dollars)

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd)

	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Fair value at December 31, 2013
Warrants	-	$ 3,672,958	-	$ 3,672,958
Total	**-**	**$ 3,672,958**	**-**	**$ 3,672,958**

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risks arising from its cash and restricted cash and receivables. The Company manages credit risk by placing cash with major Canadian financial institutions. With respect to receivables, the Company performs ongoing credit evaluations of its customers' financial condition.

The Company monitors collectability of receivables on an on-going basis to determine credit risk. In order to mitigate credit risk, the Company offers credit terms to established customers. Other customers are required to pay in advance or by credit card, prior to shipping of the product. At December 31, 2013, no accounts receivable are due beyond one year.

As at December 31, 2013 and 2012, the Company's exposure to credit risk for these financial instruments was as follows:

	December 31, 2013	December 31, 2012
Cash	$ 4,358,986	$ 969,584
Restricted cash	-	5,026
Receivables	503,736	1,514,577
	$ 4,862,722	$ 2,489,187

Trade accounts receivable balances of $490,800 as at December 31, 2013 (December 31, 2012 - $1,011,172) were aged as follows in the below table. It does not include financing proceeds receivable of $Nil and goods and services tax receivable of $12,936 as at December 31, 2013 (2012 – $425,701 and $77,704, respectively).

	December 31, 2013	December 31, 2012
Current	$ 318,333	$ 314,365
31-60 days	75,059	565,152
Over 60 days	97,408	131,655
	$ 490,800	$ 1,011,172

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company has a planning and budgeting process in place to help determine the funds required to support the Company's normal operating requirements on an ongoing basis. The Company manages its liquidity risk associated with its financial liabilities through the use of cash flow generated from operations, and the issuance of additional equity primarily through private placements, as required to meet the payment requirements of maturing financial liabilities.

(Expressed in U.S. Dollars)

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd)

The contractual maturities of the Company's trade payables as at December 31, 2013 are listed below. Refer to the Note 9 and 10 for other contractual maturities, lease obligations and commitments that are not included in the table below.

Trade payables were as aged as follows as at December 31, 2013 and 2012 and do not include accrued liabilities of $268,451, warranty provision of $7,858 and state sales tax payable of $5,202 as at December 31, 2013 (December 31, 2012 - $279,312, $15,550, and $6,400, respectively) which are all current:

	December 31, 2013	December 31, 2012
Current	$ 118,547	$ 500,309
31-60 days	109,598	236,348
Over 60 days	283,390	651,090
	$ 511,535	$ 1,387,747

The following is an analysis of the contractual maturities of the Company's non-derivative accrued liabilities and amounts due to shareholders as at December 31, 2013:

	Within one year	**Between one and five years**
Trade payables	$ 511,535	$ -
Finance lease obligations	3,690	3,190
	$ 515,225	**$ 3,190**

The ability of the Company to make the aforementioned payment requirements related to maturing financial liabilities in the near term is dependent on the ability to obtain a line of credit and other debt instruments and the timing of cash flows from operations. The ability to obtain additional financing is dependent on continued access to debt and/or equity markets which may not be available on acceptable terms. In the event that debt or equity capital is not available on acceptable terms, the Company may need to explore other strategic alternatives.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk is limited to the portion of the Company's cash held in bank accounts that earn interest.

Due to the limited and short-term nature of these financial instruments, fluctuations in the interest rates will not have a significant impact on their fair value. As at December 31, 2013, the Company had not entered into any derivative contracts to manage this risk.

Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada and the United States. The Company's functional currency is the U.S. dollar. The Company has not hedged its exposure to currency fluctuations.

Assuming that all other variables remain constant, a 10% change in the value of the Canadian dollar against the U.S. dollar would not materially affect the loss from operations.

20. SUBSEQUENT EVENTS

On January 14, 2014, 500,000 share purchase warrants with an exercise price of CDN $0.20 were exercised for gross proceeds of CDN $100,000. In addition, 297,800 share purchase warrants with a weighted average exercise price of CDN $0.25 were exercised for gross proceeds of CDN $73,840 were exercised subsequent up to the date of the report.