

**ID WATCHDOG, INC.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**THIRD QUARTER 2008**

The accompanying unaudited interim consolidated financial statements have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for review of interim financial statements by an entity's auditor.

**ID WATCHDOG, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

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**ID WATCHDOG, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**  
**(Expressed in U.S. Dollars)**

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 7,447,830	\$ 631,665
Accounts receivable .....	49,940	8,083
Prepaid expenses and other .....	312,128	66,098
Total current assets .....	7,809,898	705,846
Furniture and equipment, net (Note 3) .....	511,011	212,429
Debt offering costs, net (Note 5) .....	241,756	486,810
Intangible assets, net .....	3,053	3,300
Total assets .....	\$ 8,565,718	\$ 1,408,385
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 274,726	\$ 204,823
Accrued liabilities .....	495,816	256,955
Current portion of capital lease obligation (Note 5) .....	2,290	2,290
Total current liabilities .....	772,832	464,068
Convertible debentures, net of unamortized discount of \$129,820 and \$269,155 at September 30, 2008 and December 31, 2007, respectively (Note 5) .....	3,436,380	3,456,136
Capital lease obligation, net of current portion (Note 5) .....	8,484	10,289
Total liabilities .....	4,217,696	3,930,493
Commitments and Contingencies (Note 6) .....		
<b>SHAREHOLDERS' EQUITY (Note 8):</b>		
Preferred shares; no par value; 450,000,000 shares authorized, no shares issued and outstanding at September 30, 2008 and December 31, 2007 .....	—	—
Ordinary shares; no par value; 450,000,000 shares authorized, 49,999,089 and 19,912,408 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively .....	18,203,630	2,188,756
Accumulated deficit .....	(13,855,608)	(4,710,864)
Total shareholders' equity (deficit) .....	4,348,022	(2,522,108)
Total liabilities and shareholders' equity or deficit .....	\$ 8,565,718	\$ 1,408,385

See notes to unaudited consolidated financial statements

**ID WATCHDOG, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(Expressed in U.S. Dollars)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2008</b>	<b>September 30, 2007</b>	<b>September 30, 2008</b>	<b>September 30, 2007</b>
Revenue.....	\$ 1,282,631	\$ 16,176	\$ 3,278,331	\$ 23,388
Cost of revenue.....	363,721	5,611	807,633	13,006
Gross profit.....	918,910	10,565	2,470,698	10,382
Operating expense:				
Marketing expense.....	1,817,081	312,344	6,152,526	414,086
General and administrative expense .....	760,785	461,924	2,074,602	1,011,223
Research and development expense.....	—	40	—	32,952
	2,577,866	774,308	8,227,128	1,458,261
Operating loss.....	(1,658,956)	(763,743)	(5,756,430)	(1,447,879)
Other income (expense):				
Interest income.....	14,108	27,371	40,490	30,255
Interest expense .....	(210,790)	(189,651)	(634,936)	(224,357)
Foreign exchange loss .....	(10,662)	—	(10,662)	—
Loss on sale of equipment .....	—	(2,720)	(502)	(2,720)
	(207,344)	(165,000)	(605,610)	(196,822)
Net loss .....	(1,866,300)	(928,743)	(6,362,040)	(1,644,701)
Dividends on redeemable convertible preferred shares .....	(99,300)	—	(285,388)	—
Deemed dividends on redeemable convertible preferred shares .....	(1,204,394)	—	(2,077,051)	—
Accretion of discount related to redeemable convertible preferred shares .....	(194,710)	—	(420,265)	—
Net loss applicable to ordinary shares .....	(3,364,704)	(928,743)	(9,144,744)	(1,644,701)
Basic and diluted net loss per share.....	\$ (0.11)	\$ (0.05)	\$ (0.39)	\$ (0.09)
Weighted average number of shares outstanding - basic and diluted.....	29,669,047	19,548,767	23,304,505	18,396,013

See notes to unaudited consolidated financial statements

**ID WATCHDOG, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**(Unaudited)**  
**(Expressed in U.S. Dollars)**

	<b>Ordinary Shares</b>	<b>Ordinary Shares</b>	<b>Accumulated Deficit</b>	<b>Total Shareholders ' Equity</b>
	(#)			
Balances, December 31, 2007 .....	19,912,408	\$ 2,188,756	\$ (4,710,864)	\$ (2,522,108)
Net loss .....	—	—	(6,362,040)	(6,362,040)
Dividends on Series A and Series B redeemable convertible preferred shares .....	—	—	(285,388)	(285,388)
Deemed dividends on series A and series B redeemable convertible preferred shares .....	—	—	(2,077,051)	(2,077,051)
Accretion of discount on Series A and series B redeemable convertible preferred shares .....	—	—	(420,265)	(420,265)
Ordinary shares issued – IPO .....	17,000,000	9,202,522	—	9,202,522
Ordinary shares issued – IPO – Corporate Finance Units .....	50,000	27,066	—	27,066
Ordinary shares issued – IPO – conversion of redeemable convertible preferred shares .....	9,964,425	4,272,476	—	4,272,476
Ordinary shares issued – IPO – payment of dividends payable Series A and Series B redeemable convertible preferred shares .....	632,643	271,261	—	271,261
Ordinary shares issued – private placement .....	1,041,667	452,050	—	452,050
Ordinary shares issued in satisfaction of accrued interest .....	59,954	16,787	—	16,787
Ordinary shares issued upon conversion of convertible debentures .....	568,181	159,091	—	159,091
Ordinary shares issued upon exercise of stock options .....	55,556	8,334	—	8,334
Ordinary shares issued upon exercise of warrants .....	714,284	267,856	—	267,856
Warrants issued in connection with IPO, sale of Series A and series B redeemable convertible preferred shares and private placement of ordinary shares.....	—	1,343,064	—	1,343,064
Share-based compensation expense and stock options issued for services .....	—	178,366	—	178,366
Beneficial conversion feature on Series A and Series B redeemable convertible preferred shares .....	—	2,077,051	—	2,077,051
Equity issuance costs - IPO .....	—	(2,253,014)	—	(2,253,014)
Equity issuance costs applicable to warrant conversions .....	—	(8,036)	—	(8,036)
Cancellation of fractional shares .....	(29)	—	—	—
Balances, September 30, 2008 .....	<u>49,999,089</u>	<u>\$ 18,203,630</u>	<u>\$ (13,855,608)</u>	<u>\$ 4,348,022</u>

See notes to unaudited consolidated financial statements

**ID WATCHDOG, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(Expressed in U.S. Dollars)**

	Nine Months Ended	
	September 30,	
	2008	2007
Cash flows from operating activities:		
Net loss .....	\$ (6,362,040)	\$ (1,644,701)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense .....	106,488	32,836
Amortization of debt offering costs and convertible debenture discount .....	384,389	118,588
Share-based compensation expense to employees, directors and consultants.....	171,428	29,169
Ordinary shares issued in payment of interest .....	16,787	45,483
Compensation paid by officer/shareholder .....	—	96,850
Loss on sale of equipment .....	502	2,720
Changes in assets and liabilities:		
Increase in accounts receivable .....	(41,857)	(10,125)
Increase in prepaid expenses and other .....	(246,031)	(9,232)
Increase in accounts payable and accrued liabilities .....	308,764	194,177
Net cash used in operating activities .....	(5,661,570)	(1,144,235)
Cash flows from investing activities:		
Capital expenditures .....	(405,324)	(84,414)
Proceeds from sale of equipment .....	—	17,744
Net cash used in investing activities .....	(405,324)	(66,670)
Cash flows from financing activities:		
Proceeds from convertible debentures and warrants, net .....	—	3,177,365
Proceeds from issuance of convertible notes .....	—	402,484
Repayment of convertible debt .....	—	(426,027)
Proceeds from issuance of redeemable convertible preferred shares and warrants .....	4,495,000	—
Proceeds from issuance of ordinary shares and warrants .....	500,000	—
Proceeds from IPO, net .....	9,585,960	—
IPO issuance costs .....	(1,964,250)	—
Proceeds from exercise of warrants and stock options, net .....	268,154	—
Repayment of capital lease obligation .....	(1,805)	(1,321)
Net cash provided by financing activities .....	12,883,059	3,152,501
Net increase in cash .....	\$ 6,816,165	\$ 1,941,596
Cash and cash equivalents, beginning of period .....	\$ 631,665	\$ 308
Cash and cash equivalents, end of period .....	\$ 7,447,830	\$ 1,941,904
Supplemental disclosure of cash flow information:		
Cash paid for interest .....	\$ 234,628	\$ 12,244
Supplemental disclosure of non-cash investing and financing activities:		
Ordinary shares issued upon conversion of debt .....	\$ 124,257	\$ 255,800
Fair value of beneficial conversion feature issued with redeemable convertible preferred shares .....	\$ 2,077,051	\$ —
IPO Units issued upon conversion of redeemable preferred shares .....	\$ 4,495,000	\$ —
IPO Units issued in satisfaction of dividends payable .....	\$ 285,388	\$ —
Warrants issued for IPO issuance costs .....	\$ 253,632	\$ —
IPO Units issued for IPO issuance costs .....	\$ 28,194	\$ —
Stock options issued for IPO issuance costs .....	\$ 6,938	\$ —
Placement agent warrants issued for debt offering costs .....	\$ —	\$ 77,167
Capital lease obligation incurred for new equipment .....	\$ —	\$ 14,469

See notes to unaudited consolidated financial statements

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**September 30, 2008**  
**(Unaudited)**  
**(Expressed in U.S. Dollars)**

**1. Organization, Basis of Presentation, Liquidity and Management's Plans:**

**Organization:**

ID Watchdog, Inc. ("ID Watchdog" or the "Company") provides a variety of identity theft detection, protection and resolution services primarily to individual consumers on a subscription basis, through its wholly owned subsidiary, ID Rehab Corporation ("ID Rehab"). During the quarter ended December 31, 2007, the Company transitioned from a development stage enterprise to an operating company.

ID Watchdog is a limited liability exempted company incorporated on May 13, 2008, under the laws of the Cayman Islands.

The Company was originally formed on July 27, 2005, as ID Rehab, LLC ("LLC"), a Colorado limited liability company. On December 12, 2005, the sole member of LLC formed ID Rehab, a Colorado corporation, and transferred all of the assets, net of certain liabilities (at historical cost) of LLC to ID Rehab and merged LLC into ID Rehab in exchange for 10,000,000 ordinary shares of ID Rehab.

Pursuant an Agreement and Plan of Merger dated as of June 24, 2008, among Identity Rehab, ID Watchdog (then a wholly-owned subsidiary of Identity Rehab) and Mergeco, Inc. ("Mergeco") (then a wholly-owned subsidiary of ID Watchdog), Mergeco merged into Identity Rehab, and Identity Rehab became a wholly-owned subsidiary of ID Watchdog (the "Reorganization"). Upon the completion of the Reorganization on June 25, 2008, former shareholders of Identity Rehab exchanged their securities of Identity Rehab for equivalent securities of ID Watchdog on a one-for-one basis. Convertible debentures of Identity Rehab remain the obligation of Identity Rehab but are convertible into ordinary shares of ID Watchdog.

The accompanying consolidated financial statements include the results of operations of LLC from July 27, 2005, through December 12, 2005, and those of ID Rehab subsequent to that date.

**Interim reporting:**

The accompanying consolidated financial statements of the Company are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial statements. Accordingly, they do not necessarily include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements include all adjustments, which are normal and recurring in nature, considered necessary to present fairly the Company's financial position as of September 30, 2008, the results of operations for the three and nine months ended September 30, 2008 and 2007, and cash flows for the nine months ended September 30, 2008 and 2007. The results of operations for the three and nine months ended September 30, 2008, are not necessarily indicative of those to be expected for the entire year. For a more complete understanding of the Company's operations, financial position and accounting policies, these consolidated financial statements and the notes thereto should be read in conjunction with the audited financial statements of ID Rehab for the year ended December 31, 2007.

**Liquidity:**

On September 5, 2008, the Company completed its initial public offering (the "IPO"). The IPO consisted of 17,000,000 units ("Units") at a price of CDN\$0.60 per Unit, resulting in gross proceeds of CDN\$10,200,000.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
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Each Unit consisted of one ordinary share of the Company and one-half of one ordinary share purchase warrant. Each warrant entitles the holder to purchase one additional ordinary share at a price of CDN\$0.90 per share for a period of 24 months from September 18, 2008, the date the Company listed its ordinary shares (the "Listing Date") on the TSX Venture Exchange (the "TSXV"). On September 17, 2008, the TSXV approved the listing of the ordinary shares and the classification of the Company as a "Tier 1 Industrial or Technology Issuer." The Company's ordinary shares trade under the symbol "IDW."

The Company has incurred significant losses from operations, and has funded its operations primarily through its IPO and private placements of debt and equity including loans from related parties. The Company also has a limited operating history and has only recently had significant revenue producing operations beginning in the fourth quarter of 2007. The net proceeds from the IPO and private placements will provide working capital for use principally in connection with the Company's growth plan and programs during the short and long term.

**2. Summary of Significant Accounting Policies:**

**Use of estimates in the preparation of financial statements:**

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

**Cash and cash equivalents:**

Cash and cash equivalents are highly liquid investments that consist primarily of short-term money market instruments with insignificant interest rate risk and original maturities of three months or less at the time of purchase. We utilize and invest with financial institutions that are sound and of high credit quality. Our investments are in low-risk instruments and we limit our credit exposure in any one institution or type of investment instrument based upon criteria including credit worthiness.

**Furniture, equipment, leasehold improvements, depreciation and amortization:**

Furniture, equipment, leasehold improvements and computer software are stated at cost and are depreciated and amortized using the straight-line method over the estimated useful lives of the assets ranging from three to five years.

**Debt offering costs:**

Debt offering costs are amortized to interest expense over the life of the related debt instrument using the straight-line method which approximates the effective interest method.

**Intangible assets:**

Intangible assets represent the costs of trademarks and are amortized over the shorter of the lives of the trademarks or the estimated useful lives using the straight-line method, subject to periodic evaluation for possible impairment.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**September 30, 2008**  
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**Long-lived assets:**

Management assesses the carrying values of long-lived assets for impairment when circumstances indicate that such amounts may not be recoverable from future operations. Generally, long-lived assets are considered impaired if the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. At September 30, 2008 and December 31, 2007, management believes that no impairment exists.

**Fair value of financial instruments:**

The fair value of the Company's cash, accounts receivable, accounts payable, accrued liabilities and other current liabilities approximate their carrying amounts due to the short-term nature of these instruments. The Company's 9% convertible debentures and Series A and series B redeemable convertible preferred shares are carried at amortized cost, which approximates fair value. See also Notes 5 and 7.

**Convertible securities:**

The Company accounts for conversion options embedded in its convertible securities in accordance with the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133") and the FASB's Emerging Issues Task Force ("EITF") Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("EITF 00-19") and related interpretations. SFAS No. 133 generally requires companies to bifurcate conversion options embedded in convertible securities from their host instruments and to account for them as free-standing derivative instruments in accordance with EITF 00-19. SFAS No. 133 provides an exception to this rule when convertible notes, as host instruments, are deemed to be conventional convertible debt as that term is described in the implementation guidance under Appendix A to SFAS No. 133 and further clarified in EITF Issue No. 05-2 "The Meaning of Conventional Convertible Debt Instrument in Issue No. 00-19." SFAS No. 133 also provides an exception to this rule when convertible preferred shares have a mandatory redemption feature. Accordingly, the Company has evaluated its convertible securities and has determined that bifurcation is not required.

The Company also accounts for its convertible securities in accordance with the provisions of EITF Issue No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features" ("EITF 98-5") and EITF Issue No. 00-27 "Application of EITF 98-5 to Certain Convertible Instruments" (EITF 00-27"). Accordingly, the Company records, as a discount to convertible securities, the intrinsic value of such beneficial conversion features based upon the differences between the fair value of the underlying ordinary shares at the commitment date of the security transaction and the effective conversion price embedded in the instrument. Discounts under these arrangements are amortized over the expected term to the redemption date of the related security.

**Revenue recognition:**

The Company recognizes revenue on identity theft detection and resolution services. The Company's services are offered to consumers principally on a monthly subscription basis or to consumers as the service is delivered, such as the Company's identity resolution product. Subscription fees are generally billed directly to the subscriber's credit card or demand deposit account. At times, as a means of allowing customers to become familiar with the Company's services, the Company offers free trial or guaranteed refund periods. No revenue is recognized until these applicable periods are completed.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**September 30, 2008**  
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The point in time at which the Company recognizes revenue from services is determined in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in Financial Statements," as amended by SAB No. 104 "Revenue Recognition." Consistent with the requirements of these SABs: a.) persuasive evidence of arrangement exists, b.) delivery has occurred once the product is transmitted, c.) the seller's price to the buyer is fixed, as sales are generally based on contract or list prices, and d.) collectability is reasonably assured, as individual customers pay by credit card which has limited the Company's risk of non-collection. Revenue for monthly subscriptions is recognized in the month the subscription fee is earned.

Revenue for annual subscription fees is deferred if the subscriber has the right to cancel the service. Annual subscriptions include subscribers with full refund provisions at any time during the subscription period and pro-rata refund provisions. Revenue related to annual subscriptions with full refund provisions is recognized on the expiration of these refund provisions. Revenue related to annual subscribers with pro-rata provisions is recognized based on a pro-rata share of revenue earned. An allowance for subscription refunds is established based on actual refund experience for estimated future charge-backs and refunds applicable to previously recognized revenue under the aforementioned policies. The allowance for subscription refunds was \$20,425 and \$5,489 at September 30, 2008 and December 31, 2007, respectively.

**Advertising:**

Advertising costs are expensed as incurred. For the three and nine months ended September 30, 2008, advertising costs were \$267,838 and \$1,899,079, respectively, and for the three and nine months ended September 30, 2007, advertising costs were \$110,486 and \$122,542, respectively. Advertising costs are included in marketing expense in the consolidated statements of operations.

**Share-based compensation:**

We grant stock options to employees, members of our board of directors and consultants in connection with our various business activities. These are accounted for in accordance with the provisions of SFAS No. 123 (revised 2004) "Share-Based Payment" ("SFAS No. 123R") and Emerging Issues Task Force Abstract No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods or Services" as well as other authoritative accounting pronouncements. We are required to make estimates of the fair value of the related instruments and recognize share-based compensation expense over the period benefited, usually the vesting period. Share-based compensation expense is included in general and administrative expense in the consolidated statements of operations.

We use the Black-Scholes option pricing model to value stock options. The Black-Scholes model requires the use of a number of assumptions, including the volatility of our share price, a risk-free interest rate, and the expected term of the options. The expected term of stock options represents the period of time that the stock options granted are expected to be outstanding. The estimated volatility is based on historical volatility of a similar entity with publicly-traded securities. The risk-free interest rate represents the U.S. Treasury bill rate for the expected term of the related stock options. As we do not pay dividends, the dividend rate variable in the Black-Scholes model is zero.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**September 30, 2008**  
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The following table summarizes the assumptions used to value stock options granted during the nine months ended September 30, 2008 and September 30, 2007:

	<u>Nine Months Ended September 30, 2008</u>	<u>Nine Months Ended September 30, 2007</u>
Expected term .....	3.3 – 5.0 years	2.8 - 3.3 years
Estimated volatility .....	38%	45%
Risk-free interest rate .....	2.3% - 3.7%	4.5 – 4.9%
Dividend yield .....	0%	0%

**Research and development:**

The Company includes in research and development expense: payroll and other expense items directly attributable to research and development. The Company does not contract its research and development work, nor does it perform research and development work for others.

**Income taxes:**

The Company recognizes deferred tax assets and liabilities based on the differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that may result in taxable or deductible amounts in future years. The measurement of deferred tax assets may be reduced by a valuation allowance based upon management’s assessment of available evidence if it is deemed more likely than not some or all of the deferred tax assets will not be realizable. Currently, a valuation allowance of 100% is provided for the deferred tax asset resulting from the Company’s net operating loss carry forward in each of the reporting years.

The Company recognizes interest and penalties accrued on any uncertain tax positions as a component of income tax expense. The Company did not have any accrued interest or accrued penalties associated with any uncertain tax positions at September 30, 2008 and December 31, 2007; nor were any income tax expenses recognized during the three and nine months ended September 30, 2008 and 2007, respectively, associated with uncertain tax positions.

**Loss per share:**

Basic net loss per ordinary share (“EPS”) is computed by dividing net loss applicable to ordinary shares by the weighted-average number of ordinary shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. Currently, all potentially dilutive securities have an anti-dilutive effect on EPS and accordingly, basic and dilutive weighted average shares are the same. As of September 30, 2008, a total of 51,564,971 shares of potentially dilutive securities have been excluded from the calculation of EPS, as the effect of including these securities would be anti-dilutive, as follows:

<u>Potentially Dilutive Securities as of September 30, 2008</u>	
	(shares)
Convertible debentures .....	12,736,430
Warrants .....	34,993,541
Stock options .....	3,551,666
Total .....	<u>51,281,637</u>

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**September 30, 2008**  
**(Unaudited)**  
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**Reclassifications:**

Certain amounts in the 2007 financial statements have been reclassified to conform to the 2008 presentation.

**Recently adopted accounting pronouncements:**

Effective January 1, 2008, the Company adopted SFAS No. 157 “Fair Value Measurements” (“SFAS No. 157”), which defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosure about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. The adoption of SFAS No. 157 did not have an impact on the Company’s financial statements.

Effective January 1, 2007, the Company adopted FSAB Interpretation No. 48 “Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109” (“FIN 48”), which prescribes a comprehensive model for how the Company should recognize, measure, present and disclose in its financial statements uncertain tax positions taken or expected to be taken on a tax return. The Company has evaluated its tax positions and has determined that the adoption of FIN 48 did not have an impact on its financial statements.

**Recently issued accounting pronouncements:**

In March 2008 the FASB issued SFAS No. 161 “Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133” which requires enhanced disclosures on the effect of derivatives on a Company’s financial statements. These disclosures will be required for the Company beginning with the first quarter fiscal 2009 financial statements.

In February 2008 the FASB issued FASB Staff Position No. SFAS 157-2 “Effective Date of FASB Statement No. 157”, which provides a one year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In accordance with this interpretation, the Company has only adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities that are measured at fair value within the financial statements as of September 30, 2008, and the provisions of SFAS No. 157 have not been applied to non-financial assets and non-financial liabilities as the Company does not have any non-financial assets or liabilities to which the deferral applies.

In December 2007 the FASB issued SFAS No. 141 (revised 2007) “Business Combinations” (“SFAS No. 141R”) which becomes effective for fiscal periods beginning after December 15, 2008 (fiscal 2009 for the Company). SFAS No. 141R requires all business combinations completed after the effective date to be accounted for by applying the acquisition method (previously referred to as the purchase method). Companies applying this method will have to identify the acquirer, determine the acquisition date and purchase price and recognize at their acquisition date fair values of the identifiable assets acquired, liabilities assumed, and any non-controlling interests in the acquiree. In the case of a bargain purchase the acquirer is required to reevaluate the measurements of the recognized assets and liabilities at the acquisition date and recognize a gain on that date if an excess remains. The adoption of SFAS No. 141R is not expected to have an impact on the Company’s financial statements.

In December 2007 the FASB issued SFAS No. 160 “Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51” (SFAS No. 160”), which becomes effective for fiscal periods beginning after December 15, 2008 (fiscal 2009 for the Company). This statement amends Accounting Research Bulletin

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No. 51 to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement requires ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. The statement also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest with disclosure on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. In addition this statement establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation and requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. The adoption of SFAS No. 160 is not expected to have an impact on the Company's financial statements.

In February 2007 the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 are elective; however, the amendment to SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" applies to all entities with available for sale or trading securities. SFAS No. 159 is elective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, (fiscal 2008 for the Company). The Company has elected not to adopt this pronouncement and as a result it did not have a material impact on the Company's financial statements.

**3. Furniture and Equipment:**

Furniture and equipment consists of the following at September 30, 2008 and December 31, 2007:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Office equipment .....	\$ 129,718	\$ 236,419
Furniture and fixtures .....	63,532	42,079
Computer software .....	495,470	6,200
Total furniture and equipment .....	<u>688,720</u>	<u>284,698</u>
Less: accumulated depreciation and amortization	<u>(177,709)</u>	<u>(72,269)</u>
Furniture and equipment, net .....	<u>\$ 511,011</u>	<u>\$ 212,429</u>

Office equipment at September 30, 2008 and December 31, 2007, includes \$18,670 of assets under a capital lease.

Depreciation and amortization expense for the three and nine months ended September 30, 2008, was \$46,620 and \$106,240, respectively, and for the three and nine months ended September 30, 2007, was \$12,264 and \$32,836, respectively, and is included in general and administrative expense.

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**4. Related Party Transactions:**

**Consulting services expense – related parties:**

The Company recorded consulting services expense - related parties as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2008</b>	<b>September 30, 2007</b>	<b>September 30, 2008</b>	<b>September 30, 2007</b>
Chief executive officer .....	\$ 55,726	\$ 21,250	\$ 112,501	\$ 73,750
President, cash compensation .....	—	3,000	—	39,000
Director, cash compensation .....	15,000	15,000	45,000	15,000
Director, share-based compensation .....	—	—	33,000	—
Advisory board member – former president, share –based compensation .....	—	—	—	74,500
Advisory board members – all other, cash compensation ..	—	17,500	—	62,940
Share-based compensation – employees (previously classified as related party expenses) .....	—	8,127	—	32,517
<b>Total consulting services expense – related parties .....</b>	<b>\$ 70,726</b>	<b>\$ 64,877</b>	<b>\$ 190,501</b>	<b>\$ 297,707</b>

Consulting services expense – related parties is included in general and administrative expense in the consolidated statements of operations.

**Marketing expense – related parties:**

In January 2008 the Company entered into a month-to-month services agreement with Veracity Credit Consultants, LLC (“VCC”) an entity controlled by the majority shareholder of the Company, to provide call center facilities and call center services at prevailing market rates. The Company incurred \$47,498 and \$192,498 of call center marketing expense during the three and nine months ended September 30, 2008, respectively. Marketing expense – related parties is included in marketing expense in the consolidated statements of operations.

**Interest expense – related party:**

During 2006 and 2007 the Company received cash advances from VCC and incurred \$250 and \$17,890 of interest expense to VCC during the three and nine months ended September 30, 2007, respectively. The Company did not incur related party interest expense in 2008. Interest expense – related party is included in interest expense in the consolidated statements of operations.

**Prepaid expenses – related party:**

In September 2008 the Company entered into a one year non- cancellable agreement with VCC to provide call center facilities and services during the period October 1, 2008, through September 30, 2009, at prevailing market rates. In September 2008 the Company prepaid \$252,336 of the estimated cost of these services and this amount is included in prepaid expenses and other on the September 30, 2008, consolidated balance sheet.

**Accounts payable – related parties:**

At September 30, 2008 and December 31, 2007, accounts payable to related parties was \$0 and \$21,152, respectively.

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**5. Borrowings:**

At September 30, 2008 and December 31, 2007, our borrowings net of discounts, consisted of the following:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Current borrowings:		
Current portion of capital lease obligation.....	\$ 2,290	\$ 2,290
Total current borrowings.....	<u>\$ 2,290</u>	<u>\$ 2,290</u>
Long-term borrowings:		
Convertible debentures .....	\$ 3,566,200	\$ 3,725,291
Unamortized discount .....	(129,820)	(269,155)
Convertible debentures, net.....	<u>3,436,380</u>	<u>3,456,136</u>
Long-term capital lease obligation, net of current portion.....	8,484	10,289
Total long-term borrowings .....	<u>\$ 3,444,864</u>	<u>\$ 3,466,425</u>

During the three and nine months ended September 30, 2008, the Company recognized \$45,955 and \$139,335, respectively, of debt discount amortization applicable to the convertible debentures. During the three and nine months ended September 30, 2008, the Company recognized \$81,685 and \$245,054, respectively, of debt offering costs amortization applicable to the convertible debentures.

During the three and nine months ended September 30, 2007, the Company recognized \$42,732 and \$46,467 respectively, of debt discount amortization applicable to the convertible debentures. During the three and nine months ended September 30, 2007, the Company recognized \$65,737 and \$72,121, respectively, of debt offering costs amortization applicable to the convertible debentures.

Debt discount amortization and debt offering cost amortization is included in interest expense in the Company's consolidated statements of operations.

**6. Commitments and Contingencies**

**Contingencies:**

On June 4, 2008, the Company received notice from the New York City Department of Consumer Affairs (the "DCA") alleging violations of the New York City Consumer Protection Law and Rules. The notice alleges the Company used its advertisements in print media, television, the internet and other media to deceive or mislead consumers.

Upon receiving the notice from the DCA, the Company has taken action to remove its advertisement, suspend sales in New York and continue to service its existing New York customers, without charge, while this matter is pending or until the Company believes it has resolved the claims. After communications with the DCA and revisions to the Company's advertisements and other sales materials, in August 2008 the Company resumed its advertising and sales efforts in New York. The company continues to be in correspondence with the DCA to resolve any remaining issues.

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**7. Redeemable Convertible Preferred Shares and Warrants**

**Series A and Series B redeemable convertible preferred shares:**

On January 28, 2008, the ID Rehab amended its Articles of Incorporation authorizing 1,750,000 shares of Series A Convertible Preferred Stock with a stated value of \$2.00 per share (“Stated Value”).

On June 9, 2008, ID Rehab further amended its Articles of Incorporation authorizing 500,000 shares of Series B Convertible Preferred Stock with a Stated Value of \$2.00 per share to be pari passu with the Series A Convertible Preferred Stock in all respects except that the Series B Convertible Preferred Stock did not have voting rights and was not deemed “Junior Securities” as defined in the Amended Articles of Incorporation.

As part of the Reorganization, on June 25, 2008, all shares of ID Rehab’s Series A Convertible Preferred Stock and Series B Convertible Preferred Stock were exchanged for Series A Convertible Preferred shares (“Series A Preferred”) and Series B Convertible Preferred shares (“Series B Preferred”) of the Company on a one-for-one basis. On August 1, 2008, the Company filed its Amended and Restated Articles of Association (“Amended Articles of Association”) adopting the same terms and conditions applicable to the Company’s Series A Preferred and Series B Preferred shares that were adopted by ID Rehab when the shares were originally issued.

In accordance with the Amended Articles of Association, all Series A Preferred and Series B Preferred shares outstanding and all related accrued dividends payable as of September 5, 2008, were converted into IPO Units in accordance with the terms of the automatic conversion rights included in the Amended Articles of Association.

The Series A and Series B Preferred shares included the following preferences, limitations and rights.

**Dividends:**

Dividends on Series A and Series B Preferred shares accrued at 12% per annum on the Stated Value, were cumulative, and were payable in cash on the first day of each quarter when the Company becomes profitable. Series A and Series B Preferred dividends had priority over dividends on ordinary shares and any other share capital of the Company. Series A and Series B Preferred shares were participating in ordinary share dividends on the same terms and in the same fashion as if all of the Series A and Series B Preferred shares were converted into ordinary shares.

**Liquidation preferences:**

Series A and Series B Preferred shares had a liquidation preference in an amount equal to the greater of: a.) the Stated Value per share plus any accrued and unpaid dividends, or, b.) the amount per share that would have been payable had each share been converted into ordinary shares immediately prior to liquidation.

**Voting rights:**

Series A Preferred shares had voting rights and powers equal to the voting rights of ordinary shares on an “as if” converted to ordinary shares basis. As long as one-third of the series A Preferred shares were outstanding, the Company was obligated to obtain a waiver from the holders of the majority of the outstanding Series A Preferred shares before: a.) declaring or paying cash dividends on ordinary shares or other share capital of the Company, b.) authorizing or issuing additional shares of Series A Preferred, c.) amending the rights, preferences or privileges of the Series A Preferred, d.) authorizing any equity security senior to or on parity with the Series A Preferred, e.) merging or consolidating with any other company, or selling all or substantially all of the

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Company's assets, or, f.) effecting any transaction in which the holders of the Company's voting interest prior to such transaction hold less than 50% of the voting interest in the Corporation following such transaction. Series B Preferred shares are non-voting.

**Conversion rights:**

During the period January 28, 2008, through December 31, 2008, the Series A and Series B Preferred shares and accrued and unpaid dividends thereon were required to automatically convert into IPO Units at a rate equal to 0.8 times the price paid per Unit by investors purchasing IPO Units.

Subsequent to December 31, 2008, Series A and Series B Preferred shares, at Stated Value (plus any dividends accrued and unpaid dividends per share) were convertible into ordinary shares, at the option of the shareholder, at a price that would be the lesser of: a.) \$0.28 per ordinary share, or, b.) the market price (as defined in the Amended Articles of Association) of the ordinary shares at the date of conversion, but in no event less than \$0.15 per ordinary share (the "Conversion Price").

Conversion rates were subject to certain anti-dilution adjustments as defined in the Amended Articles of Association.

**Redemption:**

On or before December 31, 2008, the Company could call, with 70 days prior written notice, all Series A and Series B Preferred shares at an amount equal to 120% of the Stated Value per share (plus accrued and unpaid dividends per share) as of the redemption date. Upon or prior to giving notice, the Company was required to set aside a redemption fund in an amount equal to the total sum payable to the shareholders on the redemption date.

Any Series A and series B Preferred shares outstanding on January 28, 2011, would have been, at the option of the holder, either: a.) mandatorily converted into ordinary shares at the Conversion Price in effect on January 28, 2011, or, b.) mandatorily redeemed in cash equal to the Stated Value plus all accrued and unpaid dividends.

The Series A and Series B Preferred shares were considered to be contingently redeemable shares and were classified as temporary equity on the Company's balance sheet as the IPO was anticipated to occur prior to December 31, 2008, and the Series A and Series B Preferred shares would not become mandatorily convertible unless the Next Round of Financing (defined to be the issuance of ordinary or preferred shares of the Company resulting in gross proceeds of at least \$5.0 million) failed to occur on or before December 31, 2008.

**Series B redeemable convertible preferred shares and warrants:**

During May and June 2008 ID Rehab issued 497,500 shares of Series B Preferred shares and five-year warrants to purchase 425,860 shares of the Company's ordinary shares for gross proceeds of \$995,000. The warrants have an exercise price of \$0.60 per share.

In accordance with EITF 00-27, the ID Rehab allocated the \$995,000 gross proceeds between the warrants and the Series B Preferred shares on a basis of the relative fair values of each on the date of issuance. Using a ordinary share market price of \$0.50 per share, estimated annual volatility of 38% and a discount rate of 3.41%, the warrants were valued at \$0.162 per warrant using the Black-Scholes model. The amount of gross proceeds allocated to the warrants was \$64,516 on the dates of issuance and this amount was recorded as an increase in ordinary shares and as a discount to the Series B Preferred shares. This discount was being accreted over the period from the issuance dates to the contractual date of automatic conversion of the Series B Preferred shares

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(estimated to be December 31, 2008) on a straight-line basis which approximated the effective interest method. The discount accretion was recorded as accretion of discount applicable to redeemable convertible preferred shares (an increase to net loss applicable to ordinary shares) in the consolidated statement of operations. The remaining unamortized discount of \$34,810 on the date of conversion was also charged to accretion of discount applicable to redeemable convertible preferred shares.

Accretion of Series B preferred shares discount was \$54,914 and \$64,516 during the three and nine months ended September 30, 2008, respectively. There was no accretion of Series B Preferred shares discount during the three and nine months ended September 30, 2007.

The fair value of the equity securities into which the Series B Preferred was convertible on the dates of issuance, \$1,776,786, exceeded the proceeds allocated to the Series B Preferred by \$846,302, resulting in beneficial conversion features totaling the same amount that were recorded as increases in ordinary shares and as further discounts to the Series B Preferred shares. These discounts were being amortized over the period from the issuance dates to the contractual date of automatic conversion on a straight-line basis which approximated the effective interest method. Amortization was recorded as a deemed dividends on redeemable convertible preferred shares (an increase to net loss applicable to ordinary shares) in the consolidated statement of operations. Remaining unamortized discounts of \$456,609 on the date of conversion were also charged to deemed dividends on redeemable convertible preferred shares.

Deemed dividends on Series B redeemable convertible preferred shares were \$720,924 and \$846,302 during the three and nine months ended September 30, 2008, respectively. There were no deemed dividends on Series B redeemable convertible preferred shares during the three and nine months ended September 30, 2007.

The Series B Preferred shares earned cumulative dividends at 12% per annum. Dividends on the Series B Preferred shares were \$21,918 and \$31,087 during the three and nine months ended September 30, 2008. There were no dividends on the Series B Preferred shares during the three and nine months ended September 30, 2007. No cash dividends were paid during the nine months ended September 30, 2008, because of losses sustained by the Company. In accordance with the terms of the Company's Amended Articles of Association, accrued dividends payable in the amount of \$31,087 on the date of conversion were converted into 68,912 IPO Units.

**Series A redeemable convertible preferred shares and warrants:**

On January 28, 2008, the Company issued 1,750,000 shares of its Series A Preferred shares and five-year warrants to purchase 3,000,000 shares of the Company's ordinary shares for gross proceeds of \$3,500,000. The warrants have an exercise price of \$0.35 per share.

In accordance with EITF 00-27, the ID Rehab allocated the \$3,500,000 gross proceeds between the warrants and the Series A Preferred shares on a basis of the relative fair values of each on the date of issuance. Using a ordinary share market price of \$0.35 per share, estimated annual volatility of 38% and a discount rate of 2.8%, the warrants were valued at \$0.132 per warrant using the Black-Scholes model. The amount of gross proceeds allocated to the warrants was \$355,749 on the dates of issuance and this amount was recorded as an increase in ordinary shares and as a discount to the Series A Preferred shares. This discount was being accreted over the period from the issuance date to the contractual date of automatic conversion of the Series A Preferred shares (estimated to be December 31, 2008) on a straight-line basis which approximated the effective interest method. The discount accretion was recorded as accretion of discount applicable to redeemable convertible preferred shares (an increase to net loss applicable to ordinary shares) in the consolidated statement of operations. The remaining unamortized discount of \$88,427 on the date of conversion was also charged to accretion of discount applicable to redeemable convertible preferred shares.

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Accretion of Series A preferred shares discount was \$139,500 and \$355,749 during the three and nine months ended September 30, 2008, respectively. There was no accretion of Series A Preferred shares discount during the three and nine months ended September 30, 2007.

The fair value of the equity securities into which the Series A Preferred was convertible on the dates of issuance, \$4,375,000, exceeded the proceeds allocated to the Series B Preferred by \$1,230,749, resulting in a beneficial conversion feature in the same amount that was recorded as an increase in ordinary shares and as a further discount to the Series A Preferred shares. This discount was being amortized over the period from the issuance date to the contractual date of automatic conversion on a straight-line basis which approximated the effective interest method. Amortization was recorded as a deemed dividends on redeemable convertible preferred shares (an increase to net loss applicable to ordinary shares) in the consolidated statement of operations. The remaining unamortized discount of \$305,906 on the date of conversion was also charged to deemed dividends on redeemable convertible preferred shares.

Deemed dividends on Series A redeemable convertible preferred shares were \$483,470 and \$1,230,749 during the three and nine months ended September 30, 2008, respectively. There were no deemed dividends on Series A redeemable convertible preferred shares during the three and nine months ended September 30, 2007.

The Series A Preferred shares earned cumulative dividends at 12% per annum. Dividends on the Series A Preferred shares were \$77,382 and \$254,301 during the three and nine months ended September 30, 2008. There were no dividends on the Series A Preferred shares during the three and nine months ended September 30, 2007. No cash dividends were paid during the nine months ended September 30, 2008, because of losses sustained by the Company. In accordance with the terms of the Company's Amended Articles of Association, accrued dividends payable in the amount of \$254,301 on the date of conversion were converted into 563,731 IPO Units.

## **8. Shareholders' Equity:**

### **Ordinary shares:**

On September 5, 2008, the Company completed its IPO consisting of 17,000,000 IPO Units at a price of CND\$0.60 per Unit, resulting in gross proceeds of CND\$10,200,000.

Each Unit consisted of one ordinary share of the Company and one-half of one ordinary share purchase warrant. Each warrant entitles the holder to purchase one additional ordinary share at a price of CND\$0.90 per share for a period of 24 months from the Listing Date (the "IPO Warrants").

Bolder Investment Partners, Ltd. ("Bolder") acted as agent for the IPO in Canada and Green Drake, Inc. (together with Bolder, the "Agents") acted as agent for the offering of Units to qualified purchasers on a private placement basis in the United States. In connection with the IPO, the Company paid the Agents an 8% cash commission of CND\$816,000 and issued warrants to purchase an aggregate of 1,360,000 ordinary shares at a price of CND\$0.60 per share for a period of 24 months from the Listing Date (the "Agents Warrants"). The Company also issued 50,000 Units to Bolder (the "Corporate Finance Units"), paid Bolder a corporate finance fee of CND\$150,000 and paid Green Drake a similar fee in the amount of \$140,000 as additional compensation in connection with the IPO.

Concurrent with the completion of the IPO, the Company's issued and outstanding preferred shares, consisting of 1,750,000 Series A Convertible Preferred shares and 497,500 Series B Convertible Preferred shares, together with accrued dividends payable totaling \$285,388, were automatically converted in accordance with the special

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rights and restrictions of such shares and dividends payable into a total of 10,597,068 ordinary shares and 5,298,528 warrants, each warrant having the same terms as the IPO Warrants. The Company also issued to the Agents, as consideration applicable to the conversion transaction, warrants to purchase an aggregate of 398,577 ordinary shares at a price of CND\$0.48 per share for a period of five years from the Listing Date (the “Agents’ Conversion Warrants”).

The Company incurred IPO equity issuance costs totaling \$2,253,014 (including the aforementioned Agents commissions and fees). IPO equity issuance costs include noncash costs of \$288,764 representing the fair market value of the Agents Warrants, the Agents’ Conversion Warrants, the Corporate Finance Units and stock options issued for consulting services. The fair values of the IPO Warrants, Agents Warrants and Agents’ Conversion Warrants were calculated using the Black Scholes valuation model with the following assumptions as of September 5, 2008:

Expected term .....	2.0 – 5.0 years
Estimated volatility .....	38%
Risk-free interest rate .....	2.23 – 2.91%
Dividend yield .....	0%

On June 24, 2008, the Company completed a private placement of 1,041,667 ordinary shares and detachable warrants to purchase 734,374 ordinary shares at exercise prices ranging from \$0.60 to \$0.90. Each unit, priced at \$0.48 per unit, consisted of one ordinary share and 0.5 five-year warrant to purchase ordinary shares at \$0.60 per share and 0.205 two-year warrant to purchase ordinary shares at \$0.90 per share. The term of the two-year \$0.90 warrant expires on the earlier of December 31, 2010, or 24 months from the Listing Date. Total proceeds from the private placement were \$500,000 and the proceeds were allocated to the warrants and ordinary shares based on the relative fair market value of each on the date the offering closed; the allocated amounts were \$47,950 and \$452,050, respectively. The fair values of the warrants were calculated using the Black Scholes valuation model with the following assumptions on June 24, 2008:

Expected term .....	2.1 – 5.0 years
Estimated volatility .....	38%
Risk-free interest rate .....	2.87% - 3.52%
Dividend yield .....	0%

**Stock options:**

On September 18, 2008, the Company adopted the ID Watchdog Stock Option Plan (the “Plan”) authorizing a pool of up to 7.2 million stock options available for grant. The exercise prices of the options granted are determined by the Plan Committee, which members are appointed by the Board of Directors, and are generally established at or above the estimated market price of the Company’s ordinary shares at the date of grant. Options granted may have a term of up to ten years but will generally expire five years from the grant date and vest in accordance with the terms of the specific option agreement, generally over a period of 18 to 36 months. The Plan replaced the Identity Rehab Corporation Stock Option Plan and all outstanding stock options to purchase ID Rehab’s common stock were exchanged for stock options with the same terms to purchase the Company’s ordinary shares effective September 18, 2008.

During the nine months ended September 30, 2008, the Company granted 2,235,000 options to employees and consultants at exercise prices ranging from \$0.35 to \$0.60 per share. Employee options generally vest over 36

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months as long as the optionee remains in the Company's employ. Share-based compensation expense is recognized over the period that the stock options vest. Consultant options generally vest over 18 months and share-based compensation expense is recognized during periods that the services are rendered.

A summary of stock option activity for the nine months ended September 30, 2008, follows:

	<b>Shares Under Option</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (in years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding as of January 1, 2007 .....	1,655,556	\$ 0.20	3.86	\$ 124,223
Granted .....	2,235,000	0.58		
Exercised .....	(55,556)	0.15		11,111
Forfeited .....	(283,334)	0.38		
Cancelled .....	—	—		
Outstanding as of September 30, 2008 ...	<u>3,551,666</u>	<u>\$ 0.43</u>	<u>4.04</u>	<u>\$ 214,175</u>
Exercisable at September 30, 2008 .....	<u>1,558,749</u>	<u>\$ 0.27</u>	<u>3.32</u>	<u>\$ 202,388</u>

A summary of share-based compensation expense follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30, 2008</b>	<b>September 30, 2007</b>	<b>September 30, 2008</b>	<b>September 30, 2007</b>
Share-based compensation expense – employees and directors .....	\$ 17,494	\$ —	\$ 37,778	\$ 24,390
Share-based compensation expense – consultants - related parties .....	—	8,127	33,000	82,627
Share-based compensation expense – consultants – other .....	—	—	100,650	—
Total share-based compensation expense .....	<u>\$ 17,494</u>	<u>\$ 8,127</u>	<u>\$ 171,428</u>	<u>\$ 107,017</u>
Share-based compensation expense charged to ordinary shares as part of equity issuance costs.....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 6,938</u>	<u>\$ —</u>

As of September 30, 2008, there were 1,992,917 unvested stock options outstanding and the total unrecognized share-based compensation expense relating to these options was \$151,637. The weighted average term of unrecognized share-based compensation expense was 2.6 years at September 30, 2008

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**Warrants:**

A summary of warrant activity for the nine months ended September 30, 2008, follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding as of January 1, 2007 .....	15,965,486	\$ 0.38
Issued .....	19,742,339	0.78
Exercised .....	(714,284)	0.38
Cancelled .....	—	—
Outstanding as of September 30, 2008 .....	<u>34,993,541</u>	<u>\$ 0.60</u>

The following table presents the composition of warrants outstanding as of September 30, 2008:

<u>Range of Exercise Prices</u>	<u>Shares</u>	<u>Weighted Average Remaining Contractual Life (years)</u>
\$0.35 .....	10,625,601	3.93
\$0.40.....	7,625,601	3.77
\$0.48.....	398,577	4.93
\$0.60 .....	1,999,401	2.84
\$0.90 .....	14,344,361	1.90
Outstanding as of September 30, 2008 .....	<u>34,993,541</u>	<u>3.01</u>

**Ordinary shares reserved for future issuance:**

The following ordinary shares are reserved for future issuance at September 30, 2008:

	<u>Shares</u>
Stock option plan .....	7,200,000
Warrants .....	34,993,541
Convertible debentures .....	12,736,430
Total .....	<u>54,929,971</u>

**9. Generally Accepted Accounting Principles in Canada:**

The Company prepares its financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). There are no differences between U.S. GAAP and Canadian generally accepted accounting principles that would have a material effect on the Company’s financial statements.