

**ID WATCHDOG, INC.**  
**CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED DECEMBER 31, 2009 AND 2008**

**ID WATCHDOG, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors  
ID Watchdog, Inc.

We have audited the accompanying balance sheets of ID Watchdog, Inc. as of December 31, 2009 and 2008, and the related statements of operations, shareholders' equity (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ID Watchdog, Inc. as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has incurred significant losses from operations and its total liabilities exceeds its total assets. This raises substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

***HEIN & ASSOCIATES LLP***

Denver, Colorado  
March 3, 2010

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

	<b>December 31, 2009</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 488,689	\$ 5,117,596
Restricted cash (Note 2) .....	171,752	—
Accounts receivable .....	89,175	71,665
Prepaid expenses and other .....	161,428	245,180
Debt offering costs, net (Note 5) .....	224,109	160,072
Total current assets .....	1,135,153	5,594,513
Furniture and equipment, net (Note 3) .....	376,411	581,026
Total assets .....	\$ 1,511,564	\$ 6,175,539
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 1,530,859	\$ 306,430
Accrued liabilities .....	595,536	441,181
Convertible debentures, net of unamortized discount of \$84,523 at December 31, 2008 (Note 5) .....	—	3,481,677
Current portion of capital lease obligation (Note 5) .....	2,290	2,290
Deferred revenue .....	378,056	110,868
Derivative contract liabilities .....	879,721	21,983
10% Senior extendible deferred convertible notes, net of unamortized discount of \$384,116 at December 31, 2009 (Note 5) .....	1,319,764	—
Total current liabilities .....	4,706,226	4,364,429
Capital lease obligation, net of current portion (Note 5) .....	5,406	7,854
Total liabilities .....	4,711,632	4,372,283
Commitments and Contingencies (Note 8) .....		
<b>SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Share capital: (Note 6 and 7)		
Preferred shares; 450,000,000 shares authorized:		
Series A redeemable convertible preferred shares; \$2.00 stated value; 1,750,000 shares authorized; no shares outstanding at December 31, 2009 and December 31, 2008 .....	—	—
Series B redeemable convertible preferred shares; \$2.00 stated value; 500,000 shares authorized; no shares outstanding at December 31, 2009 and December 31, 2008 .....	—	—
Ordinary shares; no par value; 450,000,000 shares authorized, 62,916,107 and 49,999,089 shares issued and outstanding at December 31, 2009 and December 31, 2008, respectively .....	21,206,376	17,441,578
Accumulated deficit .....	(24,406,444)	(15,638,322)
Total shareholders' (deficit) equity .....	(3,200,068)	1,803,256
Total liabilities and shareholders' equity or deficit .....	\$ 1,511,564	\$ 6,175,539

See notes to consolidated financial statements

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

	<b>Year Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Revenue .....	\$ 5,907,602	\$ 4,688,290
Cost of revenue .....	1,366,101	1,128,795
Gross profit .....	4,541,501	3,559,495
Operating expense:		
Marketing expense .....	7,659,983	8,264,961
General and administrative expense .....	4,610,175	3,378,872
	12,270,158	11,643,833
Operating loss .....	(7,728,657)	(8,084,338)
Other income (expense):		
(Loss) gain on derivative contract liabilities .....	(223,418)	757,722
Interest income .....	11,460	71,318
Interest expense .....	(837,458)	(843,098)
Foreign exchange gain (loss) .....	9,951	(45,856)
Loss on sale of equipment .....	—	(502)
	(1,039,465)	(60,416)
Net loss .....	(8,768,122)	(8,144,754)
Dividends on redeemable convertible preferred shares .....	—	(285,388)
Deemed dividends on redeemable convertible preferred shares ..	—	(2,077,051)
Accretion of discount related to redeemable convertible preferred shares .....	—	(420,265)
Net loss applicable to ordinary shares .....	\$ (8,768,122)	\$ (10,927,458)
Basic and diluted net loss per share applicable to ordinary shares .....	\$ (0.15)	\$ (0.37)
Weighted average number of shares outstanding - basic and diluted .....	56,752,314	29,932,436

See notes to consolidated financial statements

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

	<u>Ordinary Shares (#)</u>	<u>Amount</u>	<u>Accumulated Deficit</u>	<u>Total Shareholders' Equity</u>
Balances, December 31, 2007 .....	19,912,408	\$ 2,188,756	\$ (4,710,864)	\$ (2,522,108)
Net loss .....	—	—	(8,144,754)	(8,144,754)
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 .....	—	578,243	—	578,243
Share-based compensation expense and stock options issued for services .....	—	196,019	—	196,019
Beneficial conversion feature on Series A and Series B redeemable convertible preferred shares .....	—	2,077,051	—	2,077,051
Equity issuance costs - IPO .....	—	(2,267,898)	—	(2,267,898)
Equity issuance costs applicable to warrant conversions .....	—	(8,036)	—	(8,036)
Cancellation of fractional shares .....	(29)	—	—	—
Balances, December 31, 2008 .....	49,999,089	\$17,441,578	\$(15,638,322)	\$ 1,803,256
Net loss .....	—	—	(8,768,122)	(8,768,122)
Ordinary shares issued upon exercise of warrants .....	19,900	9,803	—	9,803
Ordinary shares issued upon conversion of 9% convertible debentures .....	12,736,430	3,565,891	—	3,565,891
Share-based compensation expense and stock options issued for services .....	—	123,915	—	123,915
Shares issued for services .....	27,500	11,000	—	11,000
Ordinary shares issued in satisfaction of accrued interest .....	133,188	54,189	—	54,189
Balances, December 31, 2009 .....	<u>62,916,107</u>	<u>\$21,206,376</u>	<u>\$(24,406,444)</u>	<u>\$ (3,200,068)</u>

See notes to consolidated financial statements

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

	<b>Year Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Cash flows from operating activities:		
Net loss .....	\$ (8,768,122)	\$ (8,144,754)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense .....	258,832	169,732
Amortization of debt offering costs and convertible debenture discount .....	631,947	511,371
Share-based compensation expense to employees, directors and consultants .....	123,915	189,081
Ordinary shares issued in payment of interest .....	54,189	16,787
Ordinary shares issued for services .....	11,000	—
Loss (gain) on derivative contracts .....	223,418	(757,722)
Loss on sale of equipment .....	—	502
Changes in assets and liabilities:		
Increase in accounts receivable .....	(17,510)	(63,582)
Decrease (Increase) in prepaid expenses and other .....	83,752	(179,082)
Increase in accounts payable and accrued liabilities .....	1,645,971	396,701
Net cash used in operating activities .....	(5,752,608)	(7,860,966)
Cash flows from investing activities:		
Capital expenditures .....	(54,217)	(535,532)
Net cash used in investing activities .....	(54,217)	(535,532)
Cash flows from financing activities:		
Proceeds from issuance of 10% senior extendible deferred convertible notes and warrants, net .....	1,703,880	—
Deferred financing costs .....	(361,566)	—
Change in restricted cash .....	(171,752)	—
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 .....	—	9,585,960
IPO and redeemable convertible preferred shares and warrants issuance costs .....	—	(1,964,250)
Proceeds from exercise of warrants and stock options, net .....	9,803	268,154
Repayment of capital lease obligation .....	(2,448)	(2,435)
Net cash provided by financing activities .....	1,177,917	12,882,429
Net (decrease) increase in cash .....	\$ (4,628,908)	\$ 4,485,931
Cash and cash equivalents, beginning of period .....	\$ 5,117,596	\$ 631,665
Cash and cash equivalents, end of period .....	\$ 488,689	\$ 5,117,596
Supplemental disclosure of cash flow information:		
Cash paid for interest .....	\$ 133,115	\$ 315,049
Supplemental disclosure of non-cash investing and financing activities:		
Ordinary shares issued upon conversion of debt .....	\$ 3,566,200	\$ 159,091
Ordinary shares issued in satisfaction of accrued interest .....	\$ 54,189	\$ —
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 .....	\$ —	\$ 268,516
IPO Units issued for IPO issuance costs .....	\$ —	\$ 28,194
Stock options issued for IPO issuance costs .....	\$ —	\$ 6,938

See notes to consolidated financial statements

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended December 31, 2009 and 2008**  
**(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 and resolution services primarily to individual consumers on a subscription basis, through its wholly owned subsidiary, ID Rehab Corporation ("ID Rehab").

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 to an Agreement and Plan of Merger dated as of June 24, 2008, among ID Rehab, ID Watchdog (then a wholly-owned subsidiary of ID Rehab) and Mergeco, Inc. ("Mergeco") (then a wholly-owned subsidiary of ID Watchdog), Mergeco merged into ID Rehab, and ID Rehab became a wholly-owned subsidiary of ID Watchdog (the "Reorganization"). Upon the completion of the Reorganization on June 25, 2008, former shareholders of ID Rehab exchanged their securities of ID Rehab for equivalent securities of ID Watchdog on a one-for-one basis.

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 and ID Watchdog subsequent to that date.

**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.

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.

During the year ending December 31, 2009, holders of all the remaining \$3.6 million of the Company's convertible debentures were converted into ordinary shares of the Company at \$0.28 per ordinary share.

IDW's marketing expenditures are largely discretionary. In July 2009, the company entered into a five year exclusive data agreement with a major supplier of nationwide public record information to supply the Company with data for its identity theft monitoring and resolution services. In order for the Company to maintain the exclusive arrangement, the agreement calls for minimum spending commitments by the Company for the data information. See Note 8 for more information.



**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**Years Ended December 31, 2009 and 2008**  
**(Expressed in U.S. Dollars)**

In November 2009, the Company completed a private placement for the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes with an interest rate of 10% (the "10% Notes"). After underwriting expenses, the Company received \$1.342 million. Interest is paid monthly from an escrow account funded with a deduction from the proceeds of the private placement to pay the interest to the 10% Note holders for the first year. The 10% Notes mature on April 19, 2010 and are extendable, subject to certain provision, to September 30, 2010. The 10% Notes can be prepaid at any time at 110% of the principal amount if on or before the maturity date and at 120% thereafter. If the principal amount of the 10% Notes are not repaid at April 19, 2010, the 10% Notes may be convertible, at the option of the noteholder, at a price per share that is 30% below either (i) the offering price per share for shares of Ordinary Shares issued or reserved for issuance in an equity financing by the Company in the United States which is consummated after the October 21, 2009 and prior to September 30, 2010 or (ii) if clause (i) is not applicable, the average closing price of the Ordinary Shares on the TSX Venture Exchange for the 10 trading days preceding a conversion, but, so long as the Ordinary Shares are still trading on the TSX Venture Exchange, in no event shall the conversion price be less than U.S. \$0.2569 per share (the closing price of the Ordinary Shares on the TSX Exchange on October 21, 2009). Assuming the conversion price to be \$0.2569 per share, the 10% Notes may be convertible per \$1,000 in principal amount of the 10% Notes, into an aggregate of 6,632,453 Ordinary Shares. Purchasers of the 10% Notes received warrants to purchase 3,315,750 ordinary shares at an exercise price determined by formula equal to 110% of the issue price of a subsequent financing before September 30, 2010 of an amount greater than \$7.5 million or in the absence of a subsequent financing, the exercise price is \$0.2929 per share but, in no event less that the conversion price (\$0.2569 per share) of the Notes. In addition, if the 10% Notes are not repaid in full on or before the maturity date, then each purchaser shall receive warrants to purchase the same number of ordinary shares as previously received by the purchaser or an additional 3,315,750 warrants. Agents for the Company received 617,529 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible Notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 10% Notes and warrants issued with the 10% Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less that 50.1% of the securities and underlying securities included in the 10% Note private placement to demand that the Company register all included and underlying securities. See Note 5 for additional information.

The Company has taken steps to reduce its expenses and has plans for additional expense reductions to enable its operations to achieve a position of cash flow neutral or positive cash flow. Management believes that it can continue operations at a neutral or better cash flow position and finance its growth with additional debt or equity offerings.

Although the Company believes the business plan is achievable, should the Company fail to achieve the sales or gross margin levels anticipated, or if the Company were to incur significant unplanned cash outlays, it would become necessary for the Company to obtain additional sources of liquidity or make further cost cuts to fund its operations. However, there is no assurance that the Company would be able to obtain such financing on favorable terms, if at all, or to successfully further reduce costs in such a way that would continue to allow the Company to operate its business.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**Years Ended December 31, 2009 and 2008**  
**(Expressed in U.S. Dollars)**

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

**Basis of presentation:**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). In certain aspects, U.S. GAAP differs from Canadian generally accepted accounting principles ("Canadian GAAP"). The difference is summarized in Note 11.

**Principles of consolidation:**

The consolidated financial statements include the accounts of ID Watchdog and its wholly-owned subsidiaries ID Rehab and WDI Processing, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of estimates:**

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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Fair value of financial instruments:**

The fair value of the Company's cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the short-term nature of these instruments. Convertible notes and debentures are carried at amortized cost as discussed in Note 5 and the carrying amount of the convertible notes and debentures approximates fair value based on the Company's incremental borrowing rates for similar types of borrowing arrangements.

The Company also issues warrants to purchase ordinary shares that are indexed to the market price of the Company's ordinary shares denominated in Canadian dollars. The Company evaluates these contracts to determine whether certain conditions for equity classification have been achieved. In instances where derivative financial instruments require liability classification, the Company initially and subsequently measures such instruments at estimated fair value. Accordingly, the Company adjusts the estimated fair value of these derivative financial instruments at each reporting period through a charge or credit to earnings until such time as the instruments are exercised, expire or are permitted to be classified in shareholders' equity.

**Derivative financial instruments:**

The Company uses various types of financing arrangements to fund its business capital requirements, including convertible debt with registration rights, contingent conversion features and mandatory redemption features and redeemable convertible preferred shares indexed to the market price of the Company's ordinary shares. The Company evaluates these contracts to determine whether derivative features embedded in host contracts require bifurcation and fair value measurement.

**Cash equivalents:**

Cash equivalents are highly liquid investments that consist primarily of short-term money market instruments with 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

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

our credit risk exposure in any one institution or type of investment instrument in accordance with the Company's investment policy criteria which includes consideration of the credit worthiness of the institution. At times, cash balances in these accounts may exceed federally insured limits.

**Restricted Cash:**

At December 31, 2009, the Company has \$171,572 of restricted funds invested in an interest bearing bank account. As part of the private placement completed in the fourth quarter of 2009, a deduction was made from the proceeds of the private placement and funds placed in escrow to pay interest on the 10% notes for the first year.

**Accounts receivable:**

Accounts receivable represents in-process credit card billings and other miscellaneous receivables. An allowance for doubtful accounts has not been established as all accounts receivable are expected to be collected.

**Furniture and equipment:**

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.

The Company capitalizes costs related to internally developed software in accordance with the FASB Accounting Standards Codification ("Codification" or "ASC") Topic 350, "*Intangibles-Goodwill and Other*" ("Topic 350"). Only costs incurred during the development stages, including design, coding, installation and testing are capitalized. These capitalized costs primarily represent costs for consultants directly associated with the software development. Upgrades or modifications that result in additional functionality are capitalized.

**Debt offering costs:**

Debt offering costs are amortized over the life of the related debt instrument using the straight-line method which approximates the effective interest method. Debt offering costs amortization is included in interest expense in the consolidated statements of operations. When debt is repaid or settled prior to its maturity date, the write-off of the remaining unamortized debt offering costs is also reported as interest expense.

**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 December 31, 2009 and 2008, management believes that no impairment exists.

**Convertible securities:**

*Beneficial Conversion Feature*

Pursuant to ASC Topic 470, "*Debt*" ("*Topic 470*") 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

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price embedded in the instrument. Discounts under these arrangements are amortized over the expected term to the redemption date of the related security.

*Derivative Financial Instruments*

Pursuant to ASC Topic 815 *“Derivatives and Hedging”*, the Company reviews all convertible debt instruments for the existence of an embedded conversion option, which may require bifurcation, fair value accounting and a related mark to market adjustment at each reporting period end date. In addition, the Company may be required to classify certain stock equivalents issued in connection with the underlying debt instrument as derivative liabilities.

In determining the appropriate fair value, the Company uses the Black-Scholes option-pricing model. In assessing convertible debt instruments, management first reviews the guidance of ASC Topic 470, *Debt* and Topic 480 *“Distinguishing Liabilities from Equity”* (“Topic 480”) to determine if the convertible debt host instrument is conventional convertible debt and further if there is a beneficial conversion feature requiring a fair value measurement. If the instrument is not considered conventional convertible debt, the Company will continue its evaluation process of these instruments as potential derivative financial instruments.

Once determined, the Company assesses these instruments as derivative liabilities. The fair value of these instruments are adjusted to reflect fair value at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. In addition, the fair value of freestanding derivative instruments such as warrants, are also valued using the Black-Scholes option-pricing model. In assessing the nature of a financial instrument as freestanding, the Company has applied the guidance pursuant to Topic 815.

Finally, if necessary, the Company will apply the related guidance in Topic 815 and Topic 450 *“Contingencies,”* (“Topic 450”) when determining the existence of liquidated damage provisions. Liquidated damage provisions are not marked to market, but evaluated based upon the probability that a related liability should be recorded.

**Warrants:**

The Company has issued warrants to purchase ordinary shares as described in Notes 5, 6 and 7. Warrants are valued using a fair value based method, whereby the fair value of the warrant is determined at the warrant issue date using a market-based option valuation model. When warrants are issued in combination with debt or equity securities, these warrants are valued and accounted for based on the relative fair value of the warrants in relation to the total value assigned to the debt or equity securities and warrants combined. Warrants are included in ordinary shares in the consolidated balance sheets.

**Revenue recognition:**

The Company’s services are offered to consumers primarily on a monthly subscription basis. 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 periods. No revenue is recognized until these applicable periods are completed.

Revenue for annual and multi-year subscription fees is deferred and recognized on a straight-line basis over the related subscription period. Deferred revenue was \$378,056 and \$110,868 at December 31, 2009 and 2008, respectively, and is included in accrued liabilities on the consolidated balance sheets.

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In addition, the Company has established a reserve for charge-backs and discretionary refunds based on actual experience. This reserve was \$18,964 and \$21,628 at December 31, 2009 and 2008, respectively, and is included in accrued liabilities on the consolidated balance sheets.

**Advertising:**

Advertising costs are expensed as incurred. For the years ended December 31, 2009 and 2008, advertising costs were \$431,813 and \$2,860,311. Advertising costs are included in marketing expense in the consolidated statements of operations.

**Share-based compensation:**

The Company has one share-based compensation plan which is described in Note 7. The Company accounts for share-based awards that are settled through the issuance of equity using a fair value based method, whereby the fair value of the share-based award is determined at the date of grant using a market-based option valuation model. The fair value of the award is recorded as share-based compensation expense on a straight-line basis over the vesting period of the award, with a corresponding increase to ordinary shares in the consolidated balance sheets. Share-based compensation expense is included in general and administrative expense in the consolidated statements of operations.

**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 consolidated 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 the impact of uncertain tax positions if that position is more likely than not of being sustained on audit, based upon the technical merits of the position. The Company also 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 December 31, 2009 and 2008; nor were any income tax expenses recognized during the years ended December 31, 2009 and 2008 associated with uncertain tax positions.

**Comprehensive Income:**

Comprehensive income consists of net income and other gains and losses affected shareholders' equity that, under generally accepted accounting principles are excluded from net income. The Company has no items of other comprehensive income in any period presented. Therefore, net income as presented in the Company's Consolidated Statements of Operations equals comprehensive income.

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**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 December 31, 2009, a total of 48,829,440 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:

<b>Potentially Dilutive Securities as of December 31, 2009</b>	
	<b>(shares)</b>
Convertible notes .....	6,632,453
Warrants .....	39,017,487
Stock options .....	6,496,202
Total .....	52,146,142

**Reclassifications:**

Certain prior year amounts have been reclassified to conform to current year presentation. Such reclassifications had no effect on net loss.

**Accounting Standards Updates:**

In August 2009, an update was made to ASC 820, “*Fair Value Measurement and Disclosures — Measuring Liabilities at Fair Value*”, to provide clarification that, in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using the techniques stated in the update. The update also clarifies fair value calculation for a liability when a restriction exists that prevents the transfer of the liability. The update further clarifies that use of quoted market price for an identical liability or the quoted market price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. This update is effective for the first reporting period, including interim periods, beginning after issuance. We have adopted the provisions of this update as of September 30, 2009 and there is no material impact on our consolidated financial statements.

In June 2009, the Financial Accounting Standards Board (“FASB”) issued *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. The FASB Accounting Standards Codification (“Codification” or “ASC”) established the Codification as the source of authoritative U.S. GAAP, recognized by the FASB to be applied by nongovernmental entities. The FASB will no longer issue new standards in the form of statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts; instead, it will issue Accounting Standards Updates. The FASB will not consider Accounting Standards Updates as authoritative in their own right; these updates will serve only to update the Codification, provide background information about the guidance, and provide bases for conclusions on the change(s) in the Codification. The Codification is effective for interim and annual periods ending after September 15, 2009. We have updated our disclosures and consolidated financial statements to reflect the new Codification.

In May 2009, the FASB issued guidance, generally codified under ASC Topic 855 “Subsequent Events” (“Topic 855”). This statement sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure, the

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circumstances under which an entity should recognize events or transactions occurring after the balance sheet date, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. It requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. Topic 855 is effective for interim and annual periods ending after June 15, 2009. Our adoption of Topic 855 on June 30, 2009 did not have a material impact on our consolidated financial statements. See Note 12 – Subsequent Event for additional information.

Effective January 1, 2009 the Company applies Topic 815 “Derivatives and Hedging” (“Topic 815”) on how an entity should determine whether an instrument (or an embedded feature) is indexed to an entity’s own stock. This guidance provides for use of a two-step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument’s contingent exercise and settlement provisions. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of Topic 815 did not have an impact on the Company’s consolidated financial statements.

Effective January 1, 2009 the Company adopted guidance issued with ASC 815 on disclosures about derivative instruments and hedging activities which enhances the disclosure requirements about derivatives and hedging activities. Topic 815 requires additional narrative disclosure about how and why an entity uses derivative instruments, how they are accounted, and what impact they have on financial position, results of operations and cash flows.

In May 2008, the FASB issued guidance, generally codified under ASC Topic 470 on accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement. This guidance specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity’s nonconvertible debt borrowing rate. This is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted and it is to be applied retrospectively. The Company’s convertible debt does not have cash settlement conversion features and therefore the adoption of this application, effective January 1, 2009, did not have an impact on the Company’s consolidated financial statements.

Effective January 1, 2008, the Company applied Topic 820, “Fair Value Measurements and Disclosures” (“Topic 820”), for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis. Topic 820 provides a definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Company’s valuation methods used in 2008 were consistent with those used in prior years and, therefore, the application of Topic 820 did not have an impact on the Company’s consolidated financial statements.

Topic 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table presents information about the Company’s liabilities measured at fair value on a recurring basis as of December 31, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Derivative contract liabilities – warrants	\$ 564,721	\$ —	\$ 564,721	\$ —
Derivative contract liabilities – Beneficial conversion feature – 10% Notes.....	\$ 315,000	—	\$ 315,000	\$ —

Effective January 1, 2008, the Company applied Topic 825, “Financial Instruments” (“Topic 825”). Under Topic 825, entities may choose to measure at fair value certain financial instruments and other items at fair value that are not currently required to be measured at fair value. The adoption of this pronouncement did not have any effect on the Company’s consolidated financial statements, because the Company did not elect the fair value methodology permitted under this application for any financial instruments or other items that are not currently required to be measured at fair value.

**Accounting Standards Updates Not Yet Effective:**

In June 2009, an update was made to “*Consolidation — Consolidation of Variable Interest Entities*”, to replace the calculation for determining which entities, if any, have a controlling financial interest in a variable interest entity (“VIE”) from a quantitative risk based calculation, to a qualitative approach that focuses on identifying which entities have the power to direct the activities that most significantly impact the VIE’s economic performance and the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. The update requires ongoing assessment as to whether an entity is the primary beneficiary of a VIE, modifies the presentation of consolidated VIE assets and liabilities, and requires additional disclosures about a company’s involvement in VIEs. This update is effective for annual periods beginning after November 15, 2009, for interim periods within the first annual reporting period and for interim and annual periods thereafter. Earlier application is prohibited. We will adopt the provisions this update as of January 1, 2010 and do not anticipate a material impact to our condensed consolidated financial statements.

In September 2009, an update was made to “*Fair Value Measurement and Disclosures — Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*”, which permits entities to measure the fair value of an investment that is within the scope of the amendments in this update on the basis of net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles of “*Financial Services — Investment Companies*” as of the reporting entity’s measurement date, including measurement of all or substantially all of the underlying investments of the investee in accordance with “*Fair Value Measurements and Disclosures*” guidance. This update also requires disclosure by major category of investment about the attributes of investments within the scope of the update. This update is effective for interim and annual periods ending after December 15, 2009. We will adopt the provisions of this update as of January 1, 2010 and do not anticipate a material impact to our condensed consolidated financial statements.



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In October 2009, an update was made to “Revenue Recognition — Multiple-Deliverable Revenue Arrangements” This update amends the criteria in “Multiple-Element Arrangements” for separating consideration in multiple-deliverable arrangements and replaces the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. This update establishes a selling price hierarchy for determining the selling price of a deliverable, eliminates the residual method of allocation and significantly expands the disclosures related to a vendor’s multiple-deliverable revenue arrangements. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We are currently in the process of evaluating the impact on our condensed consolidated financial statements.

**3. Furniture and Equipment:**

Furniture and equipment consists of the following at December 31, 2009 and 2008:

	<u>December 31, 2009</u>	<u>December 31, 2008</u>
Office equipment .....	\$ 199,259	\$ 158,539
Furniture and fixtures .....	44,203	44,203
Computer software .....	629,649	616,185
Total furniture and equipment.....	<u>873,111</u>	<u>818,927</u>
Less: accumulated depreciation and amortization	<u>(496,700)</u>	<u>(237,901)</u>
Furniture and equipment, net .....	<u>\$ 376,411</u>	<u>\$ 581,026</u>

Office equipment at December 31, 2009 and 2008 includes \$14,470 of assets under a capital lease. Accumulated depreciation at December 31, 2009 and 2008 includes \$7,235 and \$4,341, respectively, of accumulated depreciation applicable to office equipment assets under capital lease.

Depreciation and amortization expense for the years ended December 31, 2009 and 2008 was \$258,832, and \$166,432, respectively, and is included in general and administrative expense in the consolidated statements of operations.

**4. Related Party Transactions:**

**Consulting services expense – related parties:**

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

	<u>Year Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Chief executive officer, cash compensation .....	\$ 199,664	\$ 162,288
Director, cash compensation .....	87,409	60,000
Director, share-based compensation .....	—	33,000
Veracity Credit Consultants, LLC, cash compensation .....	17,496	7,496
Bolder Venture Partners, cash compensation.....	35,000	—
Total consulting services expense – related parties .....	<u>\$ 339,569</u>	<u>\$ 262,784</u>

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

**Marketing expense – related party:**

In January 2008, the Company entered into a month-to-month services agreement with Veracity Credit Consultants, LLC (“VCC”) an entity controlled by the Company’s then President, to provide call center facilities and call center services. The Company incurred \$262,469 and \$248,599 of call center marketing expense to this related party during the year ended December 31, 2009 and 2008, respectively. Marketing expense – related party is included in marketing 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. The agreement provided for discounted fees in exchange for prepayment of approximately one year’s services and in September 2008, the Company prepaid \$252,336 of the estimated cost of these services. In February 2009, the Company renegotiated the agreement with VCC and extended the term of the agreement through January 2010. The Company advanced VCC \$100,360 with the extended term. Prepaid expense of \$33,426 and \$207,123 to this related party is included in prepaid expenses and other assets on the December 31, 2009 and 2008 consolidated balance sheet.

**Accounts payable – related parties:**

At December 31, 2009 and 2008, accounts payable to related parties was \$44,846 and \$7,497, respectively.

**Accounts receivable – related parties:**

At December 31, 2009, accounts receivable to related parties was \$16,500.

**5. Borrowings:**

At December 31, 2009 and 2008, the Company’s borrowings net of unamortized discounts consisted of the following:

	<u>December 31, 2009</u>	<u>December 31, 2008</u>
Current borrowings:		
Current portion of capital lease obligation.....	\$ 2,290	\$ 2,290
10% Senior extendible deferred convertible notes ....	1,703,880	—
Unamortized discount on 10% Senior extendible deferred convertible notes.....	(384,116)	—
Convertible debentures .....	—	3,566,200
Unamortized discount .....	—	(84,523)
Total current borrowings.....	<u>\$ 1,322,054</u>	<u>\$ 3,483,967</u>
Long-term borrowings:		
Capital lease obligation, net of current portion.....	5,406	7,854
Total long-term borrowings .....	<u>\$ 5,406</u>	<u>\$ 7,854</u>

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During the years ended December 31, 2009 and 2008, the Company recognized \$334,419 and \$184,632, respectively, of debt discount amortization applicable to the convertible debentures and notes.

During the years ended December 31, 2009 and 2008, the Company recognized \$297,529 and \$326,739 respectively, of debt offering costs amortization applicable to the convertible debentures and notes.

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

**Convertible debentures and warrants:**

In July 2007, ID Rehab completed a private placement of two-year, 9% unsecured convertible debentures with detachable warrants to purchase up to 13,304,610 ordinary shares of the Company with gross proceeds of \$3,725,291. All of the 9% convertible debentures were converted into ordinary shares of the Company during or prior to the second quarter of 2009 at a conversion price of \$0.28 per ordinary share at the election of the holder.

Each of the detachable warrants entitles the holder to acquire one ordinary share of the Company for each \$0.28 of the face amount of the holder's convertible debenture. One-half of each warrant has an exercise price of \$0.35 per share and the other one-half has an exercise price of \$0.40 per share. The warrants may be exercised at any time until the fifth-year anniversary of their issuance (either June or July 2012, respective of the closing date). The warrants may be exercised on a cashless basis beginning one year after their issuance if ID Rehab fails to have a current U.S. prospectus available for immediate resale of the conversion shares and ID Rehab's common stock underlying the warrants. Provided an effective registration statement is in effect covering ID Rehab's common stock underlying the warrants, all of the warrants will be callable by the Company at \$0.01 per share at any time after the closing price of ID Rehab's common stock exceeds 250% of the debenture conversion price (\$0.28 per share) for any 20 consecutive trading days and average daily volume during the same period exceeds 200,000 shares per day.

ID Rehab is obligated under the Convertible Debenture agreement which contains a registration rights agreement (the "Registration Rights Agreement") related to the 9% convertible debentures and warrants (the "Securities"). The Registration Rights Agreement requires, among other things, that a registration statement be filed on Form SB-2 or such other form as may be required or available covering the conversion shares and the shares of common stock underlying the warrants issued in the offering within 30 days of the closing of the offering on July 17, 2007 (the "Closing"). The Registration Rights Agreement also states that ID Rehab will use its best efforts to have such registration statement declared effective by the SEC within 150 days of Closing and will cause an appropriate response to any comments on the form or content of the registration statement from the staff of the SEC to be submitted to the SEC within 30 days after receipt by ID Rehab or its counsel of such comments. If ID Rehab is unable to meet this obligation in accordance with the requirements contained in the Registration Rights Agreement, then ID Rehab will be obligated to pay the holders of the Securities a liquidated damages payment equal to 1.5% of the stated value of their convertible debentures for each 30 day period following the applicable filing and registration deadlines until such filing or effectiveness is achieved or resumed. The Registration Rights Agreement also contains a provision which eliminates the payment of liquidated damages if ID Rehab receives a comment from the SEC pertaining to Rule 415 under the Securities Act. ID Rehab did receive such a comment from the SEC pertaining to Rule 415.

Based on the Company's evaluation of the provisions of the Topic 815 no accrual for liquidated damages was determined to be necessary at December 31, 2009 and 2008 as ID Rehab received the aforementioned comment letter from the SEC pertaining to Rule 415 and there have been no events or circumstances since the receipt of that comment letter that would require ID Rehab to recognize a liability relating to the convertible debenture registration rights.

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ID Rehab engaged a firm to assist the Company in completing the private placement of Securities. In July 2007, the placement agent received a five-year warrant to purchase up to 2,660,918 ordinary shares; one-half of which are exercisable at \$0.35 per share and one-half of which are exercisable at \$0.40 per share. The detachable warrants and placement agent warrants have been valued separately at fair value using the Black-Scholes methodology. The fair value calculations assumed a risk-free interest rate of 4.9%, estimated expected volatility of 45% and no dividends. The value assigned to the detachable warrants and placement agent warrants, \$363,172 and \$77,167, respectively, is included in share capital on the Company's consolidated balance sheets. The convertible debentures were determined not to have a beneficial conversion feature because the conversion price was greater than the estimated fair value of ID Rehab's common stock at the time of issuance. The debt discount attributed to the detachable warrants and the debt offering costs attributable to the placement agent warrants were amortized to interest expense over the two year term of the convertible debentures using the straight-line method which approximated the effective interest method.

**Convertible notes:**

In November 2009, the Company completed a private placement for the sale of \$1,703,880 in Senior Extendible Deferred Convertible Notes with an interest rate of 10% (the "10% Notes"). After underwriting expenses, the Company received \$1.342 million. Interest is paid monthly from an escrow account funded with a deduction from the proceeds of the private placement to pay the interest to the 10% Note holders for the first year. The 10% Notes mature on April 19, 2010 and are extendable, subject to certain provision, to September 30, 2010. The 10% Notes can be prepaid at any time at 110% of the principal amount if on or before the maturity date and at 120% thereafter. If the principal amount of the 10% Notes are not repaid at April 19, 2010, the 10% Notes may be convertible, at the option of the noteholder, at a price per share that is 30% below either (i) the offering price per share for shares of Ordinary Shares issued or reserved for issuance in an equity financing by the Company in the United States which is consummated after the October 21, 2009 and prior to September 30, 2010 or (ii) if clause (i) is not applicable, the average closing price of the Ordinary Shares on the TSX Venture Exchange for the 10 trading days preceding a conversion, but, so long as the Ordinary Shares are still trading on the TSX Venture Exchange, in no event shall the conversion price be less than U.S. \$0.2569 per share (the closing price of the Ordinary Shares on the TSX Exchange on October 21, 2009). Assuming the conversion price to be \$0.2569 per share, the 10% Notes may be convertible per \$1,000 in principal amount of the 10% Notes, into an aggregate of 6,632,453 Ordinary Shares. Purchasers of the 10% Notes received warrants to purchase 3,315,750 ordinary shares at an exercise price determined by formula equal to 110% of the issue price of a subsequent financing before September 30, 2010 of an amount greater than \$7.5 million or in the absence of a subsequent financing, the exercise price is \$0.2929 per share but, in no event less that the conversion price (\$0.2569 per share) of the Notes. In addition, if the 10% Notes are not repaid in full on or before the maturity date, then each purchaser shall receive warrants to purchase the same number of ordinary shares as previously received by the purchaser or an additional 3,315,750 warrants. Agents for the Company received 617,529 warrants as part of their compensation with the same terms as the warrants issued to the noteholders. These convertible Notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 10% Notes and warrants issued with the 10% Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less that 50.1% of the securities and underlying securities included in the 10% Note private placement to demand that the Company register all included and underlying securities.

If, on or before December 31, 2013, (i) the Ordinary Shares are not trading on a major United States trading market (including the OTC.OB market) and (ii) the conversion shares and warrant shares (x) have not been registered for resale with the United States Securities and Exchange Commission by such date or (y) are not able to be resold pursuant to Rule 144 under the *United States Securities Act of 1933*, as amended (assuming cashless

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exercise of the warrants), then, during the period beginning on January 1, 2014 and ending on March 31, 2014, the holders of conversion shares and warrant shares will have the right to deliver a put notice (the “**Put Notice**”) to the Company and it will then be obligated, on or before December 31, 2014, to purchase the subject conversion shares and warrants held by those holders who tender a Put Notice at the respective put price. For the conversion shares, the put price would be equal to, 75% of the market price of the Ordinary Shares and for the applicable warrants, 75% of the applicable warrant value determined by a formula stated in the agreement.

The Company engaged a firm to assist in completing the private placement of the Securities. This firm was paid a success fee based on gross proceeds received of 10% on proceeds received from investors. The Company also agreed to pay the investment firm an activation fee of \$15,000, an expense reimbursement allowance equal to 2% of the gross proceeds up to \$30,000 and a monthly financial advisory fee of \$5,000 for twelve months. The Company paid the firm \$209,448 in fees, allowances and reimbursable expenses in 2009. In addition, the Company incurred \$10,000 in monthly financial advisory fees to the firm in 2009. Total costs related to the issuance of the 10% Notes (\$361,566) were capitalized as debt offering costs on the consolidated balance sheets and were charged to interest expense using the straight-line method which approximates the effective interest method over the life of the 10% Notes. In addition, the placement agent received a five-year warrant to purchase up to 617,529 ordinary shares as mentioned above.

The detachable warrants and placement agent warrants have been valued separately at fair value using the Black-Scholes methodology. The fair value calculations assumed a risk-free interest rate of 2.3%, estimated expected volatility of 38% and no dividends. The value assigned to the detachable warrants and placement agent warrants during October 2009 is \$310,530 using the Black-Scholes option-pricing model and is included in derivative contract liabilities on the Company’s consolidated balance sheets. The warrants are adjusted to reflect fair value, using the Black-Scholes option-pricing model, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. At December 31, 2009, the fair value of these derivative instruments is \$554,000 which resulted in a loss of \$243,470 for the year ended December 31, 2009.

The 10% Notes were determined to have a beneficial conversion feature because the conversion price was less than the market value of the Company’s ordinary shares at the time of issuance. The intrinsic value assigned to the beneficial conversion feature during October 2009 is \$323,790 and is included in derivative contract liabilities on the Company’s consolidated balance sheets. The beneficial conversion feature is adjusted to reflect fair value, using the Black-Scholes option-pricing model, at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. At December 31, 2009, the fair value of these derivative instruments is \$315,000 which resulted in a gain of \$8,790 for the year ended December 31, 2009.

The fair values of the detachable warrants and placement agent warrants were calculated using the Black-Scholes valuation model with the following assumptions as of December 31, 2009 and October 21, 2009:

	<b>Assumptions</b>	
	<b>December 31, 2009</b>	<b>October 21, 2009</b>
Expected term .....	4.79 years	5.00 years
Estimated volatility .....	50%	38%
Risk-free interest rate .....	2.69%	2.30%
Dividend yield .....	0%	0%

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The fair value of the beneficial conversion feature was calculated using the Black-Scholes valuation model with the following assumptions as of December 31, 2009 and October 21, 2009:

	Assumptions	
	December 31, 2009	October 21, 2009
Expected term .....	2.75 years	5.00 years
Estimated volatility .....	50%	38%
Risk-free interest rate .....	2.69%	2.30%
Dividend yield .....	0%	0%

The debt discount attributed to the detachable warrants and placement agent warrants, the value of the beneficial conversion feature and the debt offering costs are being amortized to interest expense over the six month term of the 10% Notes using the straight-line method which approximates the effective interest method.

**6. Redeemable Convertible Preferred Shares and Warrants:**

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

On January 28, 2008, 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 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 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 include the following preferences, limitations and rights.

**Dividends:**

Dividends on Series A and Series B Preferred shares accrue at 12% per annum on the Stated Value, are cumulative, and are payable in cash on the first day of each quarter when the Company becomes profitable. Series A and Series B Preferred dividends have priority over dividends on ordinary shares and any other share capital of the Company. Series A and Series B Preferred shares are 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.

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**Liquidation preferences:**

Series A and Series B Preferred shares have liquidation preferences in amounts 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 have 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 are outstanding, the Company is 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 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 Company 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 on the date of closing (September 5, 2008) at a rate equal to 0.8 times the price paid per Unit by investors purchasing IPO Units.

Subsequent to December 31, 2008, the Series A and Series B Preferred shares, at Stated Value (plus any dividends accrued and unpaid dividends per share) are convertible into ordinary shares, at the option of the shareholder, at a price that is 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 are 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.

Any Series A and Series B Preferred shares outstanding on January 28, 2011, will be, 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 are considered to be contingently redeemable shares and were originally 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.

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

During May and June 2008, the Company issued 497,500 shares of its Series B Preferred and five-year warrants to purchase 425,860 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 Topic 470, the Company 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 an 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 accreted over the period from the issuance dates to the contractual date of automatic conversion of the Series B Preferred shares (September 5, 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 September 5, 2008 was also charged to accretion of discount applicable to redeemable convertible preferred shares.

Accretion of Series B Preferred shares discount totaled \$0 and \$64,516 during the years ended December 31, 2009 and 2008, respectively.

The fair value of the equity securities into which the Series B Preferred shares were convertible on the dates of issuance, \$1,776,786, exceeded the proceeds allocated to the Series B Preferred shares 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 amortized over the period from the issuance dates to the contractual date of automatic conversion (September 5, 2008) on a straight-line basis which approximated the effective interest method. Amortization was recorded as 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 September 5, 2008 were also charged to deemed dividends on redeemable convertible preferred shares.

Deemed dividends on Series B redeemable convertible preferred shares were \$0 and \$846,302 during the year ended December 31, 2009 and 2008, respectively.

The Series B Preferred shares earned cumulative dividends at 12% per annum. Dividends on the Series B Preferred shares were \$0 and \$31,087 during the years ended December 31, 2009 and 2008, respectively. No cash dividends were paid during the years ended December 31, 2009 and 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 and five-year warrants to purchase 3,000,000 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 Topic 470, the Company 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 an



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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 date 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 accreted over the period from the issuance date to the contractual date of automatic conversion of the Series A Preferred shares (September 5, 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 September 5, 2008 was also charged to accretion of discount applicable to redeemable convertible preferred shares.

Accretion of Series A Preferred shares discount totaled \$0 and \$355,749 during the years ended December 31, 2009 and 2008.

The fair value of the equity securities into which the Series A Preferred shares were convertible on the date of issuance, \$4,375,000, exceeded the proceeds allocated to the Series A Preferred shares 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 amortized over the period from the issuance date to the contractual date of automatic conversion (September 5, 2008) on a straight-line basis which approximated the effective interest method. Amortization was recorded as 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 September 5, 2008 was also charged to deemed dividends on redeemable convertible preferred shares.

Deemed dividends on Series A redeemable convertible preferred shares were \$0 and \$1,230,749 during the years ended December 31, 2009 and 2008, respectively.

The Series A Preferred shares earned cumulative dividends at 12% per annum. Dividends on the Series A Preferred shares were \$0 and \$254,301 during the years ended December 31, 2009 and 2008, respectively. No cash dividends were paid during the years ended December 31, 2009 and 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.

## **7. Shareholders' Equity:**

### **Ordinary shares:**

On September 5, 2008, the Company completed its IPO consisting of 17,000,000 IPO Units at a price of CDN\$0.60 per Unit, resulting in gross proceeds of CDN\$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 CDN\$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 CDN\$816,000 and issued warrants to purchase an aggregate of 1,360,000 ordinary shares at a price of CDN\$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

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fee of CDN\$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 Preferred shares and 497,500 Series B Preferred shares, together with accrued dividends payable totaling \$285,388, were automatically converted in accordance with the special 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 486,848 ordinary shares at a price of \$0.48 per share for a period of five years (the "Agents' Conversion Warrants").

The Company incurred IPO equity issuance costs totaling \$2,267,898 (including the aforementioned Agents' commissions and fees). IPO equity issuance costs include noncash costs of \$303,648 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:

<u>Assumptions</u>	
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 warrants to purchase ordinary shares at \$0.60 per share and 0.205 warrants to purchase ordinary shares at \$0.90 per share. The term of the \$0.90 warrants 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:

<u>Assumptions</u>	
Expected term .....	2.2 – 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. On January 8, 2010, shareholders of the Company

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voted to amend the Plan to authorize up to 12 million stock options available for grant, authorize a cashless exercise provision and other provisions to the Plan. 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 closing price of the Company's ordinary shares on the TSXV on 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. 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. Shares issued under these plans are newly issued shares.

Employee options generally vest over 18 to 36 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.

The Company uses the Black-Scholes option pricing model to value stock options. The Black-Scholes model requires the use of a number of assumptions, including expected share price volatility, risk-free interest rates, 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 expected share price volatility is based on the historical expected share price volatility of a similar entity with publicly-traded securities. The risk-free interest rate is based on the U.S. Treasury bill rate for the expected term of the related stock options. As the Company does not pay dividends, the dividend rate variable in the Black-Scholes model is zero.

The following table summarizes the assumptions used to value stock options granted during the years ended December 31, 2009 and 2008:

	<b>Year Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Expected term .....	1.65 – 5.0 years	2.9 – 5.0 years
Estimated volatility .....	38%	38%
Risk-free interest rate .....	1.1% - 2.0%	1.8% - 3.7%
Dividend yield .....	0%	0%

During the year ended December 31, 2009, the Company granted 2,100,000 options to employees and consultants at exercise prices ranging from \$0.36 to \$0.58 per share and 795,000 options to employees and consultants at an exercise price of CDN\$0.60. During the year ended December 31, 2008, the Company granted 2,235,000 options to employees and consultants at exercise prices ranging from \$0.35 to \$0.60 per share and 647,000 options to employees and consultants at an exercise price of CDN\$0.60.

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A summary of stock option activity for the years ended December 31, 2009 and 2008 follows:

**Stock Options Denominated in U.S. Dollars**

	Year Ended December 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period .....	3,375,000	\$ 0.43	1,655,556	\$ 0.21
Granted .....	2,100,000	0.45	2,235,000	0.58
Exercised .....	—	—	(55,556)	0.15
Forfeited .....	(190,833)	0.50	(343,334)	0.42
Expired .....	(112,223)	0.49	(116,666)	0.30
Outstanding, end of period .....	<u>5,171,944</u>	<u>\$ 0.43</u>	<u>3,375,000</u>	<u>\$ 0.43</u>
Exercisable, end of period .....	<u>3,310,000</u>	<u>\$ 0.41</u>	<u>1,769,583</u>	<u>\$ 0.32</u>
Exercisable and expected to vest as of December 31, 2009 .....	<u>5,171,944</u>	<u>\$ 0.43</u>		

**Stock Options Denominated in Canadian Dollars**

	Year Ended December 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period .....	647,000	\$ 0.60	—	\$ —
Granted .....	795,000	0.60	647,000	0.60
Forfeited .....	(117,742)	0.60	—	—
Outstanding, end of period .....	<u>1,324,258</u>	<u>\$ 0.60</u>	<u>647,000</u>	<u>\$ 0.60</u>
Exercisable, end of period .....	<u>769,583</u>	<u>\$ 0.60</u>	<u>35,000</u>	<u>\$ 0.60</u>
Exercisable and expected to vest as of December 31, 2009 .....	<u>1,324,258</u>	<u>\$ 0.60</u>		

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A summary of stock options outstanding and stock options exercisable at December 31, 2009 follows:

<b>Stock Options Denominated in U.S. Dollars</b>			
<b>Exercise Prices</b>	<b>Stock Options Outstanding</b>		<b>Stock Options Exercisable</b>
	<b>Shares</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Shares</b>
\$0.15 .....	900,000	1.42	900,000
\$0.28 .....	362,500	2.42	345,833
\$0.36 .....	90,000	2.56	90,000
\$0.40 .....	1,210,000	4.86	300,000
\$0.42 .....	200,000	4.60	22,222
\$0.48 .....	150,000	3.39	150,000
\$0.56 .....	300,000	4.85	300,000
\$0.57 .....	175,000	4.95	—
\$0.58 .....	125,000	4.78	—
\$0.60 .....	1,659,444	3.46	1,201,944
	<u>5,171,944</u>	<u>3.55</u>	<u>3,310,000</u>

<b>Stock Options Denominated in Canadian Dollars</b>			
<b>Exercise Prices</b>	<b>Stock Options Outstanding</b>		<b>Stock Options Exercisable</b>
	<b>Shares</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Shares</b>
\$0.60 .....	1,324,258	3.99	769,583
	<u>1,324,258</u>	<u>3.99</u>	<u>769,583</u>

The weighted average remaining contractual term for all stock options outstanding and all stock options exercisable at December 31, 2009 is 3.64 years and 3.22 years, respectively.

The total intrinsic value of options exercised is the difference between the exercise price of the option and the market price of the Company's ordinary shares on the exercise date. All options exercised during the year ended December 31, 2008 were denominated in U.S. dollars and the total intrinsic value of options exercised was \$7,222 during this period. No options were exercised during the year ended December 31, 2009.

The aggregate intrinsic value of stock options is the difference between the closing price of the Company's ordinary shares on the TSXV on December 31, 2009 and the exercise price multiplied by the number of options. On December 31, 2009, the aggregate intrinsic value of outstanding options, exercisable options and exercisable and expected to vest options denominated in U.S. dollars was \$245,050 and \$243,383, respectively. All outstanding options, exercisable options and exercisable and expected to vest options denominated in Canadian dollars had exercise prices greater than the closing price of the Company's ordinary shares on December 31, 2009. As a result, these stock options had no intrinsic value at December 31, 2009.

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We granted 2,895,000 and 2,882,000 stock options to employees, directors and consultants during the years ended December 31, 2009 and 2008, respectively. The weighted-average grant date fair values of options granted during the years ended December 31, 2009 and 2008 were \$0.07 and \$0.11, respectively. During the year ended December 31, 2009, 2,275,000 stock options vested with a total grant date fair value of \$188,741. During the year ended December 31, 2008, 698,749 stock options vested with a total grant date fair value of \$86,652.

**Share-based compensation expense:**

A summary of share-based compensation expense follows:

	<u>Year Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Share-based compensation expense – employees and directors .....	\$ 82,545	\$ 54,066
Share-based compensation expense – consultants - related parties .....	—	33,000
Share-based compensation expense – consultants – other .....	41,370	102,015
Total share-based compensation expense .....	<u>\$ 123,915</u>	<u>\$ 189,081</u>
Share-based compensation expense charged to ordinary shares as part of equity issuance costs .....	<u>\$ —</u>	<u>\$ 6,938</u>

As of December 31, 2009, there were 1,484,397 nonvested employee stock options outstanding and the total unrecognized share-based compensation expense relating to these options was \$150,387. This expense is expected to be recognized over a weighted average period of 1.64 years.

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**Warrants:**

A summary of warrant activity for the years ended December 31, 2009 and 2008 follows:

	<b>Warrants Denominated in U.S. Dollars</b>			
	<b>Year Ended December 31,</b>			
	<b>2009</b>		<b>2008</b>	
	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding, beginning of period .....	19,898,284	\$ 0.40	15,965,486	\$ 0.38
Issued .....	3,955,586	0.26	4,647,082	0.46
Exercised .....	—	—	(714,284)	0.38
Outstanding, end of period .....	<u>23,853,870</u>	<u>\$ 0.37</u>	<u>19,898,284</u>	<u>\$ 0.40</u>

	<b>Warrants Denominated in Canadian Dollars</b>			
	<b>Year Ended December 31,</b>			
	<b>2009</b>		<b>2008</b>	
	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding, beginning of period .....	15,183,517	\$ 0.87	—	\$ —
Issued .....	—	—	15,183,517	0.87
Exercised .....	19,900	0.60	—	—
Outstanding, end of period .....	<u>15,163,617</u>	<u>\$ 0.87</u>	<u>15,183,517</u>	<u>\$ 0.87</u>

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The following tables present the composition of warrants outstanding as of December 31, 2009:

**Warrants Denominated in U.S. Dollars**

Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.26.....	3,955,586	4.81
\$0.35 .....	10,625,601	2.66
\$0.40.....	7,625,601	2.50
\$0.48.....	486,848	3.68
\$0.60 .....	639,401	3.44
\$0.90 .....	520,833	0.72
Outstanding as of December 31, 2009 .....	<u>23,853,870</u>	<u>2.97</u>

**Warrants Denominated in Canadian Dollars**

Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.60 .....	1,340,100	0.72
\$0.90 .....	13,823,528	0.72
Outstanding as of December 31, 2009 .....	<u>15,163,617</u>	<u>0.72</u>

**Ordinary shares reserved for future issuance:**

The following ordinary shares are reserved for future issuance at December 31, 2009:

	Shares
Stock option plan .....	12,000,000
Warrants .....	39,017,487
Convertible notes .....	6,632,453
Total .....	<u>57,649,940</u>



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**8. Commitments and Contingencies:**

**Commitments:**

The Company leases office facilities and equipment under a non-cancelable operating leases expiring in 2010. Future minimum lease payments are as follows:

	<u>Amount</u>
2010 .....	\$ 37,759
Thereafter .....	—
Total .....	<u>\$ 37,759</u>

Rent expense for the years ended December 31, 2009 and 2008 was \$103,031 and \$96,641, respectively.

In July 2009, the Company entered into a five year exclusive data agreement with a major supplier of nationwide public record information to supply the Company with its data for its identity theft monitoring and resolution services. The agreement calls for minimum spending commitments by the Company for the data information as follows:

<u>Contract Year</u>	<u>Minimum Spending Commitment</u>
Contract Year 1.....	\$4,000,000
Contract Year 2.....	\$6,000,000
Contract Year 3.....	\$8,000,000
Contract Year 4 and 5 and each annual renewal period .....	\$10,000,000

In addition to the commitment for data information, the Company has committed to spend monies on marketing and promotion expenses on an annual amount beginning per the terms of the agreement in order to maintain an exclusive arrangement and corresponding with the contract year of the agreement as follows:

<u>Contract Year</u>	<u>Minimum Marketing Spending Commitment</u>
Contract Year 1.....	\$25,000,000
Contract Year 2.....	\$50,000,000
Contract Year 3.....	\$75,000,000
Contract Year 4 and 5 and each annual renewal period .....	\$100,000,000

The agreement has certain cancelation provisions if the commitments are not met. The Company is currently not on track to meet its marketing and promotion expense annual commitment and therefore, may lose its exclusive arrangement.

**Contingencies:**

The Company is involved in various claims and legal actions in the ordinary course of business. In the opinion of management, the ultimate disposition of all of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

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**9. Income taxes:**

The Company's provision for income taxes during the years ended December 31, 2009 and 2008 were different from the amount expected by applying the statutory federal income tax rate to the Company's net loss as reported in the consolidated statement of operations. The approximate differences are as follows:

	<b>Year Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Expected tax benefit computed at statutory rate .....	\$ (3,069,000)	\$ (2,851,000)
Expected state tax benefit, net .....	(264,000)	(245,000)
Effect of permanent differences .....	110,000	(168,000)
Other .....	(6,000)	(18,000)
Increase in valuation allowance .....	3,229,000	3,282,000
	<u>\$ —</u>	<u>\$ —</u>

Deferred tax assets consisted of the following at December 31, 2009 and 2008:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Non-current deferred tax assets:		
Net operating loss carryforwards .....	\$ 7,924,000	\$ 4,878,000
Share-based compensation .....	103,000	79,000
Other .....	182,000	23,000
Valuation allowance .....	(8,209,000)	(4,980,000)
Net deferred tax assets .....	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2009, the Company has net operating loss carryforwards of approximately \$20,846,000 which, if not utilized, begin to expire in 2025. As a result of certain changes in the Company's ownership, the future utilization of the net operating loss and credit carryforwards may be limited under Internal Revenue Code Section 382. As the Company is unable to determine that it is more likely than not that future taxable income of the Company will be sufficient to utilize the net operating loss carryforwards, a valuation allowance has been established against those deferred tax assets.

The Company files income tax returns in the U.S. federal jurisdiction and the State of Colorado. The Company is subject to U.S. federal and state examinations for 2005 through 2009. Management does not believe there will be any material changes in its uncertain tax positions over the next twelve months.

**10. Benefit Plans:**

During 2006, the Company established a 401(k) plan which provides retirement savings options for all eligible employees. The Company makes a matching contribution based on the participants' eligible wages. During the years ended December 31, 2009 and 2008, the Company made matching contributions of \$14,722 and \$8,352, respectively.

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**Years Ended December 31, 2009 and 2008**  
**(Expressed in U.S. Dollars)**

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

The consolidated financial statements have been prepared in accordance with U.S. GAAP which differs in certain respects from those principles that the Company would have followed had its consolidated financial statements been prepared in accordance with Canadian GAAP. Significant measurement differences that materially affect the consolidated financial statements at December 31, 2009 and 2008 or the years then ended are as follows:

Under U.S. GAAP, offering costs are capitalized as an asset and amortized over the debt period, whereas, under Canadian GAAP, the offering costs are netted as part of the carrying value of the debt.

The Company has issued warrants to purchase ordinary shares that are denominated in Canadian dollars, which results in the Company having warrants outstanding that are denominated outside its U.S. dollar functional currency. Under U.S. GAAP warrants with exercise prices denominate in a currency other than its functional currency cannot be classified as equity. As a result, these instruments are treated as derivatives and are recorded as liabilities which are carried at fair value with changes in the fair value recorded in the consolidated statement of operations.

During 2008, the Company recorded its Series A and Series B redeemable convertible preferred shares as temporary equity and classified the amortization of the discount related to the redeemable convertible preferred shares beneficial conversion features, the accretion of the discount related to detachable warrants issued in conjunction with the redeemable convertible shares and the dividends on the redeemable convertible preferred shares as an expense applicable to ordinary shares. Had the Company followed Canadian GAAP, the Series A and Series B redeemable convertible preferred shares would have been classified as liabilities and the aforementioned expenses would have been classified as interest expense under Canadian GAAP.

During 2009, the Company issued convertible notes with detachable warrants to purchase ordinary shares. Both the warrants and the beneficial conversion feature related to the convertible notes are treated as a derivative under U.S. GAAP and recorded as a derivative liability and carried at fair value with changes in the fair value recorded in the consolidated statement of operations. Had the Company followed Canadian GAAP, as it relates to the derivative instruments issued in 2009 and 2008, at December 31, 2009, current liabilities would decrease and consolidated shareholders' (deficit) equity would decrease by \$879,721. In addition, consolidated statement of operations net loss would decrease by \$223,418.

Had the Company followed Canadian GAAP, certain items in the 2009 consolidated statements of operations, consolidated statements of shareholders' equity and consolidated balance sheet would have been reported as follows:

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**Years Ended December 31, 2009 and 2008**  
**(Expressed in U.S. Dollars)**

<b>Consolidated Balance Sheet</b>	<b>December 31, 2009</b>	
	<b>Canadian GAAP</b>	<b>U.S. GAAP</b>
Deferred offering costs	\$ —	\$ 224,109
Total current assets	\$ 911,044	\$ 1,135,153
10% Senior extendible deferred convertible notes	\$ 1,095,655	\$ 1,319,764
Derivative contract liabilities .....	\$ —	\$ 879,721
Total current liabilities .....	\$ 3,602,396	\$ 4,706,226
Ordinary shares .....	\$ 22,642,384	\$ 21,206,376
Accumulated deficit .....	\$ (24,940,747)	\$ (24,406,444)
Total shareholders' deficit .....	\$ (2,298,363)	\$ (3,200,068)

<b>Consolidated Statement of Shareholders' Equity</b>	<b>December 31, 2009</b>	
	<b>Canadian GAAP</b>	<b>U.S. GAAP</b>
Warrants issued in connection with IPO and Notes of private placement, sale of Series A and Series B redeemable convertible preferred shares and private placement of ordinary shares.....	\$ 2,014,251	\$ 578,243

<b>Consolidated Statement of Operations</b>	<b>Year Ended December 31, 2009</b>
Net loss under U.S. GAAP .....	\$ (8,768,122)
Loss on derivative contract liabilities recognized .....	223,418
Net loss under Canadian GAAP .....	\$ (8,544,704)

Had the Company followed Canadian GAAP, certain items in the 2008 consolidated statements of operations, consolidated statements of shareholders' equity and consolidated balance sheet would have been reported as follows:

<b>Consolidated Balance Sheet</b>	<b>December 31, 2008</b>	
	<b>Canadian GAAP</b>	<b>U.S. GAAP</b>
Deferred offering costs	\$ —	\$ 160,072
Total current assets	\$ 5,434,441	\$ 5,594,513
Convertible debentures	\$ 3,321,605	\$ 3,481,677
Derivative contract liabilities .....	\$ —	\$ 21,983
Total current liabilities .....	\$ 4,182,374	\$ 4,364,429
Ordinary shares .....	\$ 18,221,283	\$ 17,441,578
Accumulated deficit .....	\$ (16,396,043)	\$ (15,638,321)
Total shareholders' equity .....	\$ 1,825,239	\$ 1,803,256

**ID WATCHDOG, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
**Years Ended December 31, 2009 and 2008**  
**(Expressed in U.S. Dollars)**

<b>Consolidated Statement of Shareholders' Equity</b>	<b>December 31, 2008</b>	<b>December 31, 2008</b>
	<b>Canadian GAAP</b>	<b>U.S. GAAP</b>
Warrants issued in connection with IPO, sale of Series A and Series B redeemable convertible preferred shares and private placement of ordinary shares.....	\$ 1,357,948	\$ 578,243
		<b>Year Ended December 31, 2008</b>
<b>Consolidated Statement of Operations</b>		
Net loss under U.S. GAAP .....		\$ (8,144,754)
Gain on derivative contract liabilities recognized .....		(757,722)
Additional interest expense under Canadian GAAP .....		(2,782,704)
Net loss under Canadian GAAP .....		\$ (11,685,180)

**12. Subsequent Event:**

In February 2010, the Company completed the first closing of \$767,100 in a private placement for the sale of \$1,500,000 in convertible notes with an interest rate of 10% (the "2010 10% Notes"). From the first closing and after underwriting expenses, the Company received \$593,173 plus an additional amount of \$88,216 which was deposited into an escrow account to for interest payments. Interest is paid monthly from an escrow account funded by a deduction from the proceeds of the private placement to pay the interest to the 2010 10% Note holders for the first year. The 2010 10% Notes mature on August 10, 2010 and are extendable, subject to certain provisions, to February 6, 2011. The 2010 10% Notes can be prepaid at any time at 110% of the principal amount if on or before the maturity date and at 120% thereafter. Purchasers of the 2010 10% Notes received warrants to purchase 1,370 ordinary shares per \$1,000 invested in the 2010 10% Notes at an exercise price determined by formula equal to 110% of the issue price of a subsequent financing before February 6, 2011 of an amount greater than \$7.5 million or in the absences of a subsequent financing, the exercise price is \$0.365 per share but, in no event less that the conversion price of the Notes. In addition, if the 2010 10% Notes are not repaid in full on or before the maturity date, then each purchaser shall receive warrants to purchase the same number of ordinary shares as previously received by the purchaser. These convertible notes and warrants have anti-dilution provisions that upon the subsequent sale or issuance of securities may cause a reduction of the outstanding convertible notes' conversion price and warrants' exercise price. The 2010 10% Notes and warrants issued with the 2010 10% Notes agreement has a registration rights agreement that call for at any time during the period beginning December 31, 2011, until December 30, 2014, holders have a one-time right by written notice of no less than 50.1% of the securities and underlying securities included in the 2010 10% Note private placement to demand that the Company register all included and underlying securities.