

ID WATCHDOG, INC.
CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2010 AND 2009

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

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

ID WATCHDOG, INC.

CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 819,660	\$ 488,689
Restricted cash (Note 2)	277,661	171,752
Accounts receivable	227,403	89,175
Prepaid expenses and other	190,896	161,428
Debt offering costs, net (Note 5)	191,257	224,109
Total current assets	1,706,877	1,135,153
Furniture and equipment, net (Note 3)	316,429	376,411
Total assets	\$ 2,023,306	\$ 1,511,564
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 1,341,800	\$ 1,530,859
Accrued liabilities	460,711	595,536
Current portion of capital lease obligation (Note 5)	2,290	2,290
Deferred revenue	427,262	378,056
Derivative contract liabilities	234,000	879,721
10% Senior extendible deferred convertible notes, net of unamortized discount of \$66,956 and \$384,116 at March 31, 2010 and December 31, 2009, respectively	1,636,924	1,319,764
10% extendible deferred convertible notes, net of unamortized discount of \$156,461 at March 31, 2010	1,343,539	—
Total current liabilities	5,446,526	4,706,226
Capital lease obligation, net of current portion (Note 5)	4,698	5,406
Total liabilities	5,451,224	4,711,632
Commitments and Contingencies		
SHAREHOLDERS' EQUITY (DEFICIT)		
Share capital: (Note 6)		
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 March 31, 2010 and December 31, 2009	—	—
Series B redeemable convertible preferred shares; \$2.00 stated value; 500,000 shares authorized; no shares outstanding at March 31, 2010 and December 31, 2009	—	—
Ordinary shares; no par value; 450,000,000 shares authorized, 62,916,107 shares issued and outstanding at March 31, 2010 and December 31, 2009	21,221,314	21,206,376
Accumulated deficit	(24,649,232)	(24,406,444)
Total shareholders' (deficit) equity	(3,427,918)	(3,200,068)
Total liabilities and shareholders' equity or deficit	\$ 2,023,306	\$ 1,511,564

See notes to unaudited consolidated financial statements

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

	Quarter Ended March 31,	
	2010	2009
Revenue	\$ 1,189,602	\$ 1,214,021
Cost of revenue	144,379	263,904
Gross profit	1,045,224	950,117
Operating expense:		
Marketing expense	647,167	2,493,981
General and administrative expense	808,904	1,377,822
	1,456,071	3,871,803
Operating loss	(410,847)	(2,921,686)
Other income (expense):		
Gain (Loss) on derivative contract liabilities	857,501	(866,617)
Interest income	1,561	9,133
Interest expense	(691,003)	(203,503)
	168,059	(1,060,987)
Net loss applicable to ordinary shares	\$ (242,788)	\$ (3,982,673)
Basic and diluted net loss per share applicable to ordinary shares ...	\$ (0.00)	\$ (0.08)
Weighted average number of shares outstanding - basic and diluted	62,916,107	50,017,938

See notes to unaudited consolidated financial statements

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

	<u>Ordinary Shares</u> (#)	<u>Amount</u>	<u>Accumulated Deficit</u>	<u>Total Shareholders' Equity</u>
Balances, December 31, 2009	62,916,107	\$ 21,206,376	\$ (24,406,444)	\$ (3,200,068)
Net loss	—	—	(242,788)	(242,788)
Share-based compensation expense and stock options issued for services	—	14,938	—	14,938
Balances, March 31, 2010	<u>62,916,107</u>	<u>\$ 21,221,314</u>	<u>\$ (24,649,232)</u>	<u>\$ (3,427,918)</u>

See notes to unaudited consolidated financial statements

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

	Quarter Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net loss	\$ (242,788)	\$ (3,982,673)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	59,982	64,678
Amortization of debt offering costs and convertible notes/debenture discount	636,411	124,140
Share-based compensation expense to employees, directors and consultants....	14,938	24,649
(Gain) Loss on derivative contracts	(857,501)	866,617
Changes in assets and liabilities:		
Increase in accounts receivable	(138,228)	(44,703)
Increase in prepaid expenses and other	(29,468)	(96,759)
(Decrease) increase in accounts payable and accrued liabilities	(274,678)	409,166
Net cash used in operating activities	<u>(831,332)</u>	<u>(2,634,885)</u>
Cash flows from investing activities:		
Capital expenditures	—	(44,880)
Net cash used in investing activities	<u>—</u>	<u>(44,880)</u>
Cash flows from financing activities:		
Proceeds from issuance of 10% extendible deferred convertible notes and warrants, net	1,500,000	—
Deferred financing costs	(231,080)	—
Change in restricted cash.....	(105,909)	—
Repayment of capital lease obligation	(708)	(718)
Net cash provided by financing activities	<u>1,162,303</u>	<u>(718)</u>
Net increase (decrease) increase in cash	\$ 330,971	\$ (2,680,483)
Cash and cash equivalents, beginning of period	\$ 488,689	\$ 5,117,596
Cash and cash equivalents, end of period	<u>\$ 819,660</u>	<u>\$ 2,437,113</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 54,592	\$ 79,953
Supplemental disclosure of non-cash investing and financing activities:		
Ordinary shares issued upon conversion of debt	\$ —	\$ 25,000

See notes to unaudited consolidated financial statements

ID WATCHDOG, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010
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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.

On September 5, 2008, the Company completed its initial public offering (the "IPO") and its ordinary shares are listed on the TSX Venture Exchange (the "TSXV") trading under the symbol "IDW."

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.

Interim reporting:

The accompanying consolidated financial statements of the Company are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial statements. Accordingly, they do not necessarily include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements include all adjustments, which are normal and recurring in nature, considered necessary to present fairly the Company's financial position as of March 31, 2010, the results of operations for the three months ended March 31, 2010 and 2009, and cash flows for the three months ended March 31, 2010 and 2009. The results of operations for the three months ended March 31, 2010, are not necessarily indicative of those to be expected for the entire year. For a more complete understanding of the Company's operations, financial position and accounting policies, these consolidated financial statements and the notes thereto should be read in conjunction with the audited financial statements of ID Watchdog, Inc. for the year ended December 31, 2009.

Liquidity and Going Concern:

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.

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The Company has \$3.2 million of convertible notes outstanding at March 31, 2010 and these notes mature in September 2010 and August 2010 with a maturity extension to February 2011 on \$1.5 million of the outstanding notes.

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 7 for more information.

In March 2010, the Company completed a private placement for the sale of \$1,500,000 in convertible notes with an interest rate of 10% (the "2010 10% Notes"). After underwriting expenses, the Company received \$1,173,500 plus an additional amount of \$172,500 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 2,055,000 ordinary shares 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 than 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 or an additional 2,055,000 warrants. Agents for the Company received 410,959 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 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. See Note 5 for additional information.

Our business plan for 2010 calls for maintaining our current level of customers while we structure the Company for a cash-flow neutral and then a positive cash flow position from operations and then returning to growing our customers base beginning in the third quarter of 2010. We were not able to maintain our level of customers during the first quarter of 2010 and our customer base decreased to 25,000 at March 31, 2010 from 27,000 at December 31, 2009. We plan to hold gross margins steady and plan to decrease general and administrative expenses and marketing expenses to achieve a positive cash flow from operations.

We are dependent upon our existing cash balances, along with our expected cash flow generated from gross profits to satisfy our marketing expenditures, general and administrative expenses, debt payments, and cash interest payments relating to our current operations and planned growth during the short term. Based on the Company's current operating plan, its existing working capital will not be sufficient to meet the cash requirements to fund the Company's operating expenses, required and potential payments under the Senior Extendible Deferred Convertible Notes (the "10% Notes"), and the 2010 10% Notes, and working capital requirements through December 31, 2010 without additional sources of cash and/or the deferral, reduction or elimination of significant planned expenditures.

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These factors raise substantial doubt about our ability to continue as a going concern. The consolidated financial statements do not include any adjustments related to the recoverability of assets or classifications of liabilities that might be necessary should we be unable to continue as a going concern.

The Company intends to secure additional working capital through the sale of additional debt or equity securities. 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. No arrangements or commitments for any such financing are in place at this time, and we cannot give any assurances about the availability or terms of any future financing.

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 8.

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 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.

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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 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 March 31, 2010, the Company has \$277,661 of restricted funds invested in an interest bearing bank account. As part of the private placements completed in the first quarter of 2010 and 2009, a deduction was made from the proceeds of the private placements and funds placed in escrow to pay interest on the 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.

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Long-lived assets:

Management assesses the carrying values of long-lived assets for impairment when circumstances indicate that such amounts may not be recoverable from future operations. Generally, long-lived assets are considered impaired if the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. At March 31, 2010, 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 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 8. 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

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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 \$427,262 and \$378,056 at March 31, 2010 and December 31, 2009, respectively, and is included in liabilities on the consolidated balance sheets.

In addition, the Company has established a reserve for charge-backs and discretionary refunds based on actual experience. This reserve was \$16,868 and \$18,964 at March 31, 2010 and December 31, 2009, respectively, and is included in accrued liabilities on the consolidated balance sheets.

Advertising:

Advertising costs are expensed as incurred. For the three months ended March 31, 2010 and March 31, 2009, advertising costs were \$1,518 and \$382,448, respectively. 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 6. 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.

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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 March 31, 2010 and December 31, 2009; nor were any income tax expenses recognized during the three months ended March 31, 2010 and 2009, 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.

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 March 31, 2010, a total of 57,358,645 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:

Potentially Dilutive Securities as of March 31, 2010	
	(shares)
Convertible notes	10,742,029
Warrants	41,461,140
Stock options	5,155,476
Total	57,358,645

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 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

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ending after December 15, 2009. We adopted the provisions of this update as of January 1, 2010 and it did not have a material impact to our condensed consolidated financial statements.

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 adopted the provisions this update as of January 1, 2010 and it did not have an impact to our condensed consolidated financial statements.

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 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.

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.

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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.

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 March 31, 2010 and December 31, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

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	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
At March 31, 2010:				
Derivative contract liabilities – warrants ..	\$ 199,000	\$ —	\$ 199,000	\$ —
Derivative contract liabilities – Beneficial conversion feature – 10% Notes	\$ 35,000	\$ —	\$ 35,000	\$ —
At December 31, 2009:				
Derivative contract liabilities – warrants..	\$ 564,721	\$ —	\$ 564,721	\$ —
Derivative contract liabilities –Beneficial conversion feature – 10% Notes	\$ 315,000	\$ —	\$ 315,000	\$ —

Accounting Standards Updates Not Yet Effective:

In March 2010, an update was made to “*Derivatives and Hedging*”. This update provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breath of the embedded credit derivative scope exception. This update is effective for each reporting entity at the beginning of the first fiscal quarter beginning after June 15, 2010. We will adopt the provisions of this update and do not anticipate a material impact to our consolidated financial statements.

In January 2010, an update was made to “*Fair Value Measurements and Disclosures*”. This update requires new disclosures of transfers in and out of Levels 1 and 2 and of activity in Level 3 fair value measurements. The update also clarifies the existing disclosures for levels of disaggregation and about inputs and valuation techniques. This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for disclosures about purchases, sales, innuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We will adopt the provisions of this update and do not anticipate a material impact to our consolidated financial statements.

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.

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3. Furniture and Equipment:

Furniture and equipment consists of the following at March 31, 2010 and December 31, 2009:

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Office equipment	\$ 199,259	\$ 199,259
Furniture and fixtures	44,203	44,203
Computer software	629,649	629,649
Total furniture and equipment.....	<u>873,111</u>	<u>873,111</u>
Less: accumulated depreciation and amortization	<u>(556,682)</u>	<u>(496,700)</u>
Furniture and equipment, net	<u>\$ 316,429</u>	<u>\$ 376,411</u>

Office equipment at March 31, 2010 and December 31, 2009 includes \$14,470 of assets under a capital lease. Accumulated depreciation at March 31, 2010 and December 31, 2009 includes \$7,958 and \$7,235 in each period, respectively, of accumulated depreciation applicable to office equipment assets under capital lease.

Depreciation and amortization expense for the three months ended March 31, 2010 and March 31, 2009 was \$59,982, and \$64,678, 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>Three Months Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Chief executive officer, cash compensation	\$ 54,846	\$ 49,797
Director, cash compensation	—	18,000
Veracity Credit Consultants, LLC, cash compensation	—	14,993
Total consulting services expense – related parties	<u>\$ 54,846</u>	<u>\$ 82,780</u>

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

Marketing expense – related party:

During 2010 and 2009, the Company has a month-to-month services agreement with Veracity Credit Consultants, LLC (“VCC”) an entity controlled by certain executives of the Company, to provide call center facilities and call center services. The Company incurred \$57,068 and \$47,676 of call center marketing expense to this related party during the three months ended March 31, 2010 and 2009, respectively. Marketing expense – related party is included in marketing expense in the consolidated statements of operations.

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Note receivable – related party:

In February 2010, the Company entered into a note receivable of \$67,220 with VCC with an advance of \$50,000 and a transfer of a previous prepayment for VCC to provide call center facilities and services as mentioned above. The note receivable has an interest rate of 10% per annum and matures on June 30, 2010. At March 31, 2010 the note receivable balance is \$62,029 and is included in the consolidated balance sheet as a current asset.

Accounts receivable – related parties:

At March 31, 2010 and December 31, 2009, accounts receivable to related parties was \$10,000 and \$16,500, respectively.

Accounts payable – related parties:

At March 31, 2010 and December 31, 2009, accounts payable to related parties was \$27,667 and \$44,846, respectively.

5. Borrowings:

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

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Current borrowings:		
Current portion of capital lease obligation.....	\$ 2,290	\$ 2,290
10% Senior extendible deferred convertible notes ...	1,703,880	1,703,880
Unamortized discount on 10% Senior extendible deferred convertible notes	(66,956)	(384,116)
10% extendible deferred convertible notes	1,500,000	—
Unamortized discount on 10% extendible deferred convertible notes	(156,461)	—
Total current borrowings.....	<u>\$ 2,982,753</u>	<u>\$ 1,322,054</u>
Long-term borrowings:		
Capital lease obligation, net of current portion.....	\$ 4,698	\$ 5,406
Total long-term borrowings	<u>\$ 4,698</u>	<u>\$ 5,406</u>

During the three months ended March 31, 2010 and 2009, the Company recognized \$372,479 and \$42,456, respectively, of debt discount amortization applicable to the convertible debentures.

During the three months ended March 31, 2010 and 2009, the Company recognized \$263,932 and \$81,685 respectively, of debt offering costs amortization applicable to the convertible debentures.

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

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Convertible notes:

10% Senior Extendible Deferred 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 extendible, subject to certain provision, to September 30, 2010. During April 2010, the Company exercised the provision to extend the maturity of the 10% Notes until September 30, 2010 by paying the 2.5% extension fee and issuing 3,315,750 additional warrants per the terms of the agreement. 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. 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. 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 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

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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 March 31, 2010 and December 31, 2009, the fair value of these derivative instruments is \$118,000 and 554,000, respectively which resulted in a gain of \$436,000 for the three months ended March 31, 2010.

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 March 31, 2010 and December 31, 2009, the fair value of these derivative instruments is 35,000 and \$315,000, respectively which resulted in a gain of \$280,000 for the three months ended March 31, 2010.

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 March 31, 2010 and December 31, 2009:

	<u>Assumptions</u>	
	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Expected term	4.56 years	4.79 years
Estimated volatility	50%	50%
Risk-free interest rate	2.55%	2.69%
Dividend yield	0%	0%

The fair value of the beneficial conversion feature was calculated using the Black-Scholes valuation model with the following assumptions as of March 31, 2010 and December 31, 2009:

	<u>Assumptions</u>	
	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Expected term	2.50 years	2.75 years
Estimated volatility	50%	50%
Risk-free interest rate	1.31%	2.69%
Dividend yield	0%	0%

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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.

10% Extendible Deferred Convertible Notes:

In March 2010, the Company completed a private placement for the sale of \$1,500,000 in convertible notes with an interest rate of 10% (the "2010 10% Notes"). After underwriting expenses, the Company received \$1,173,500 plus an additional amount of \$172,500 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 extendible, 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 2,055,000 ordinary shares 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 or an additional 2,055,000 warrants. Agents for the Company received 410,959 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 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.

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 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 \$10,000. The Company paid the firm \$160,000 in fees during 2010. Total costs related to the issuance of the 10% Notes (\$231,000) were capitalized as debt offering costs on the consolidated balance sheets and are 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 410,959 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 2.35%, estimated

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expected volatility of 50% and no dividends. The value assigned to the detachable warrants and placement agent warrants during February 2010 is \$211,780 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 March 31, 2010, the fair value of these derivative instruments is \$81,000 which resulted in a gain of \$130,780 for the three months ended March 31, 2010.

The 10% Notes were determined not to have a beneficial conversion feature because the conversion price was greater than the estimated market value of the Company's ordinary shares at the time of issuance.

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 March 31, 2010 and February 12, 2010:

	Assumptions	
	March 31, 2010	February 12, 2010
Expected term	4.87 years	5.00 years
Estimated volatility	50%	50%
Risk-free interest rate	2.55%	2.35%
Dividend yield	0%	0%

The debt discount attributed to the detachable warrants and placement agent warrants and the debt offering costs are being amortized to interest expense over the six month term of the 2010 10% Notes using the straight-line method which approximates the effective interest method.

6. 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 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

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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 warrant to purchase ordinary shares at \$0.60 per share and 0.205 warrant 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 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

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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 three months ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	2009
Expected term	3.3 years	2.9 – 5.0 years
Estimated volatility	38%	38%
Risk-free interest rate	1.44%	1.8% - 3.7%
Dividend yield	0%	0%

During the three months ended March 31, 2010, the Company granted 25,000 options to an employee at an exercise price of \$0.56. During the three months ended March 31, 2009, the Company granted 795,000 options to employees and consultants at an exercise price of CDN\$0.60 per share.

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A summary of stock option activity for the three months ended March 31, 2010 and 2009 follows:

Stock Options Denominated in U.S. Dollars

	Three Months Ended March 31,			
	2010		2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	5,171,944	\$ 0.43	3,375,000	\$ 0.43
Granted	25,000	0.56	—	—
Exercised	—	—	—	—
Forfeited	(1,146,944)	0.39	(151,250)	0.40
Expired	—	—	—	—
Outstanding, end of period	<u>4,050,000</u>	<u>\$ 0.43</u>	<u>3,223,750</u>	<u>\$ 0.43</u>
Exercisable, end of period	<u>3,170,972</u>	<u>\$ 0.42</u>	<u>1,894,167</u>	<u>\$ 0.33</u>
Exercisable and expected to vest as of March 31, 2009	<u>4,050,000</u>	<u>\$ 0.45</u>		

Stock Options Denominated in Canadian Dollars

	Three Months Ended March 31,			
	2010		2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	1,324,258	\$ 0.60	647,000	\$ 0.60
Granted	—	0.60	795,000	0.60
Forfeited.....	(218,782)	0.60	—	—
Outstanding, end of period	<u>1,105,476</u>	<u>\$ 0.60</u>	<u>1,442,000</u>	<u>\$ 0.60</u>
Exercisable, end of period	<u>848,837</u>	<u>\$ 0.60</u>	<u>335,250</u>	<u>\$ 0.60</u>
Exercisable and expected to vest as of March 31, 2009	<u>1,105,476</u>	<u>\$ 0.60</u>		

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A summary of stock options outstanding and stock options exercisable at March 31, 2010 follows:

Stock Options Denominated in U.S. Dollars			
Exercise Prices	Stock Options Outstanding		Stock Options Exercisable
	Shares	Weighted Average Remaining Contractual Term (years)	Shares
\$0.15	900,000	1.18	900,000
\$0.28	250,000	2.10	245,833
\$0.40	310,000	4.62	302,500
\$0.42	200,000	4.35	38,889
\$0.48	150,000	3.15	150,000
\$0.56	325,000	4.62	300,000
\$0.57	175,000	4.70	—
\$0.58	125,000	4.54	—
\$0.60	1,615,000	3.21	1,233,750
	<u>4,050,000</u>	<u>3.07</u>	<u>3,170,972</u>

Stock Options Denominated in Canadian Dollars			
Exercise Prices	Stock Options Outstanding		Stock Options Exercisable
	Shares	Weighted Average Remaining Contractual Term (years)	Shares
\$0.60	1,105,476	3.71	848,837
	<u>1,105,476</u>	<u>3.71</u>	<u>848,837</u>

Share-based compensation expense:

A summary of share-based compensation expense follows:

	Three Months Ended March 31,	
	2010	2009
Share-based compensation expense – employees and directors	\$ 14,938	\$ 21,949
Share-based compensation expense – consultants	—	2,700
Total share-based compensation expense	<u>\$ 14,938</u>	<u>\$ 24,649</u>

As of March 31, 2010, there were 1,114,278 nonvested employee stock options outstanding and the total unrecognized share-based compensation expense relating to these options was \$314,816. This expense is expected to be recognized over a weighted average period of 1.13 years.

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Warrants:

A summary of warrant activity for the three months ended March 31, 2010 and 2009 follows:

	Warrants Denominated in U.S. Dollars			
	Three Months Ended March 31,			
	2010		2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	23,853,870	\$ 0.37	19,898,284	\$ 0.40
Issued	2,465,959	0.365 ^(b)	—	—
Exercised	—	—	—	—
Canceled.....	(22,306)	0.26	—	—
Outstanding, end of period	<u>26,297,523</u>	<u>\$ 0.37</u>	<u>19,898,284</u>	<u>\$ 0.40</u>

	Warrants Denominated in Canadian Dollars			
	Three Months Ended March 31,			
	2010		2009	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	15,163,617	\$ 0.87	15,183,528	\$ 0.87
Issued	—	—	—	—
Exercised	—	—	—	—
Outstanding, end of period	<u>15,163,617</u>	<u>\$ 0.87</u>	<u>15,183,528</u>	<u>\$ 0.87</u>

The following tables present the composition of warrants outstanding as of March 31, 2010:

Warrants Denominated in U.S. Dollars		
Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.26 ^(a)	3,933,280	4.56
\$0.36 ^(b)	13,091,560	2.88
\$0.40.....	7,625,601	2.25
\$0.48.....	486,848	3.44
\$0.60	639,401	3.20
\$0.90	520,833	0.47
Outstanding as of March 31, 2010	<u>26,297,523</u>	<u>2.92</u>

^(a)The exercise price of the warrants issued with the 10% Notes may be determined by future events and therefore, for this presentation, an assumed exercise price of \$0.26 is used.

^(b)Includes 2,465,959 warrants issued with the 2010 10% Notes with an exercise price that may be determined by future events and therefore, for this presentation, an assumed exercise price of \$0.365 is used for the 2010 10% Note warrants.

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Warrants Denominated in Canadian Dollars

Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.60	1,340,100	0.47
\$0.90	13,823,517	0.47
Outstanding as of March 31, 2010	<u>15,163,617</u>	<u>0.47</u>

Ordinary shares reserved for future issuance:

The following ordinary shares are reserved for future issuance at March 31, 2010:

	Shares
Stock option plan	12,000,000
Warrants	46,831,891
Convertible notes	10,742,029
Total	<u>69,573,920</u>

7. Commitments and Contingencies:

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:

Contract Year	Minimum Spending Commitment
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:

Contract Year	Minimum Marketing Spending Commitment
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

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The agreement has certain cancellation 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.

8. 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 March 31, 2010 and at December 31, 2009 and the three months ended March 31, 2010 and 2009 are as follows:

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 2010 and 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 2010 and 2009, at March 31, 2010, current liabilities would decrease and consolidated shareholders' (deficit) equity would decrease by \$234,600. In addition, consolidated statement of operations net loss would decrease by \$857,501.

Had the Company followed Canadian GAAP, certain items in the March 31, 2010, March 31, 2009 and the three months then ended consolidated statements of operations, consolidated statements of shareholders' equity and consolidated balance sheet would have been reported as follows:

Consolidated Balance Sheet	March 31, 2010	March 31, 2010
	Canadian GAAP	U.S. GAAP
Deferred offering costs.....	\$ —	\$ 191,257
Total current assets.....	\$ 1,515,620	\$ 1,706,877
10% Senior extendible deferred convertible notes.....	\$ 1,599,720	\$ 1,636,924
10% extendible deferred convertible notes	\$ 1,189,486	\$ 1,343,539
Derivative contract liabilities	\$ —	\$ 234,600
Total current liabilities	\$ 5,021,269	\$ 5,446,526
Ordinary shares	\$ 22,969,118	\$ 21,221,314
Accumulated deficit	\$ (25,283,314)	\$ (24,649,232)
Total shareholders' deficit	\$ (2,314,196)	\$ (3,427,918)

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Consolidated Statement of Operations	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net loss under U.S. GAAP	\$ (242,788)	\$ (3,982,673)
(Gain)/Loss on derivative contract liabilities recognized	(857,501)	866,617
Net loss under Canadian GAAP	<u>\$ (1,100,289)</u>	<u>\$ (3,116,056)</u>

Had the Company followed Canadian GAAP, certain items in the December 31, 2009 consolidated balance sheet and consolidated statement of shareholders' equity would have been reported as follows:

Consolidated Balance Sheet	December 31, 2009	December 31, 2009
	Canadian GAAP	U.S. GAAP
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)

Consolidated Statement of Shareholders' Equity	December 31, 2009	December 31, 2009
	Canadian GAAP	U.S. GAAP
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