

ENVIRONMENTAL WASTE INTERNATIONAL INC.
UNAUDITED INTERIM FINANCIAL STATEMENTS
For The Six Month Period Ended June 30, 2010

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**ENVIRONMENTAL WASTE INTERNATIONAL INC.
Unaudited Interim Financial Statements
For The Six Month Period Ended June 30, 2010**

Responsibility for consolidated unaudited interim financial statements

The accompanying financial statements for Environmental Waste International Inc. have been prepared by management in accordance with Canadian generally accepted accounting principles consistently applied. The most significant of these accounting principles have been set out in the December 31, 2009 audited financial statements.

Auditor involvement

The auditor of Environmental Waste International Inc. has not performed a review of these unaudited interim financial statements.

Ajax, Ontario
August 27, 2010

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Consolidated Balance Sheet
As At June 30, 2010 and December 31, 2009

ASSETS		
	As at June 30 2010	As at December 31 2009
	(Unaudited)	(Audited)
Current Assets		
Cash and cash equivalents	\$ 2,604,798	\$ 1,189,585
Accounts receivable (Note 5)	364,399	318,505
Prepaid expenses and sundry	282	18,310
	<u>2,969,479</u>	<u>1,526,400</u>
Property and equipment (Note 6)	37,849	8,590
Technology Rights (Note 7)	<u>125,000</u>	<u>150,000</u>
Long term investments (Note 12)	<u>1,483,724</u>	<u>588,724</u>
Total Assets	<u>\$ 4,616,052</u>	<u>\$ 2,273,714</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 1,137,302	\$ 765,845
Loans payable (Note 8)	345,873	345,873
Deferred income - current (Note 9)	43,307	43,307
Deferred revenue (Note 10)	2,603,863	522,324
	<u>4,130,345</u>	<u>1,677,349</u>
Long-term Liabilities		
Deferred income (Note 9)	20,347	42,001
Non-Controlling Interests (Note 11)	918,560	902,345
	<u>938,907</u>	<u>944,346</u>
Total Liabilities	<u>5,069,252</u>	<u>2,621,695</u>
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Capital Stock (Note 14)	36,304,467	36,178,267
Contributed surplus (Note 14)	1,802,868	1,802,868
Warrants (Note 14)	926,141	926,141
Convertible debt	169,127	169,127
Deficit	(39,655,803)	(39,424,384)
	<u>(453,200)</u>	<u>(347,981)</u>
Total Liabilities and Shareholders' Equity (Deficiency)	<u>\$ 4,616,052</u>	<u>\$ 2,273,714</u>

ON BEHALF OF THE BOARD

_____, "William Bateman", Director

_____, "Stephen Simms", Director

The accompanying notes are an integral part of these financial statements.
Prepared by Management - without audit

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Consolidated Statement of Operations
For The Six Month Period Ended June 30, 2010 and 2009

	Three months ended June 30		Six months ended June 30	
	2010 (Unaudited)	2009 (Unaudited)	2010 (Unaudited)	2009 (Unaudited)
REVENUE				
Sales	\$ 6,832	\$ 27,629	\$ 14,525	\$ 46,209
Amortization of deferred income (Note 9)	10,827	10,827	21,654	21,654
Consulting fees	593,424	-	718,461	-
	<u>611,083</u>	<u>38,456</u>	<u>754,640</u>	<u>67,863</u>
EXPENSES				
Manufacturing expenses	370,767	3,136	448,889	6,186
Research & development	-	92,294	-	166,020
Salaries, wages & benefits	148,720	23,072	259,837	41,493
Operations, general & administration	161,318	78,766	240,373	193,659
Foreign exchange	(1,580)	13,291	(1,580)	(2,592)
Interest on debt	15,450	18,804	30,900	36,100
Amortization of property & equipment & Technology Rights	12,962	12,963	25,925	25,925
	<u>707,637</u>	<u>242,326</u>	<u>1,004,344</u>	<u>466,791</u>
INCOME (LOSS) BEFORE THE FOLLOWING:	(96,554)	(203,870)	(249,704)	(398,928)
GAIN (LOSS) ON SALE OF PARTNERSHIP UNITS	18,285	84,108	18,285	247,296
NET INCOME (LOSS)	\$ (78,269)	\$ (119,762)	\$ (231,419)	\$ (151,632)
Income (loss) per share	<u>(\$0.001)</u>	<u>(\$0.002)</u>	<u>(\$0.003)</u>	<u>(\$0.002)</u>
Weighted average number of common shares outstanding	<u>77,481,694</u>	<u>71,398,324</u>	<u>77,481,694</u>	<u>71,398,324</u>

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

Prepared by Management - without audit

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Consolidated Statement of Deficit
For The Six Month Period Ended June 30, 2010 and 2009

	Six months ended	
	June 30 2010	June 30 2009
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
DEFICIT - BEGINNING OF PERIOD	\$ (39,424,384)	\$ (38,549,812)
Net income (Loss) for the period	<u>(\$231,419)</u>	<u>(\$151,632)</u>
DEFICIT - END OF PERIOD	<u>\$ (39,655,803)</u>	<u>\$ (38,701,444)</u>

The accompanying notes are an integral part of these financial statements.
 Prepared by Management - without audit

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Consolidated Statement of Cash Flows
For The Six Month Period Ended June 30, 2010 and 2009

	Three months ended June 30		Six months ended June 30	
	2010 (Unaudited)	2009 (Unaudited)	2010 (Unaudited)	2009 (Unaudited)
OPERATING ACTIVITIES				
Net Income (loss) for the period	(\$78,269)	(\$119,762)	(\$231,419)	(\$151,632)
Items not affecting cash:				
Amortization of property, equipment and technology rights	12,962	12,963	25,925	25,925
Amortization of deferred income	(10,827)	(10,827)	(21,654)	(21,654)
	(76,134)	(117,626)	(227,148)	(147,361)
Changes in non-cash working capital items:				
Accounts receivable	1,022,051	7,510	(45,894)	(12,911)
Prepaid expenses and sundry	2,677	(4,200)	18,028	11,049
Accounts payable & accrued liabilities	(535,051)	(11,062)	371,457	(21,445)
Deferred revenue	2,206,576	100,000	2,081,539	100,000
Non-Controlling Interests	16,215	74,589	16,215	219,301
	2,712,468	166,837	2,441,345	295,994
 CASH PROVIDED FROM (USED IN) OPERATING ACTIVITIES	2,636,334	49,211	2,214,197	148,633
 INVESTING ACTIVITIES				
Purchase of capital assets	(29,382)	-	(30,184)	-
Ellsin Environmental Limited	(895,000)	-	(895,000)	-
	(924,382)	-	(925,184)	-
 FINANCING ACTIVITIES				
Exercise of Options	126,200	-	126,200	-
 NET INCREASE (DECREASE) IN CASH	1,838,152	49,211	1,415,213	148,633
 CASH - BEGINNING OF PERIOD	766,646	443,646	1,189,585	344,224
 CASH - END OF PERIOD	\$ 2,604,798	\$ 492,857	\$ 2,604,798	\$ 492,857

The accompanying notes are an integral part of these financial statements.
Prepared by Management - without audit

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

1 NATURE OF BUSINESS

Environmental Waste International Inc. ("EWS") is incorporated under the Ontario Business Corporations Act. The Company's business is the design, development and sale of environmentally sound devices utilizing EWS's patented Reverse Polymerization process and dealing with environmental waste disposal, including the development, advancement, licensing and sale of its technology and related machines throughout the world.

2 GOING CONCERN

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Recurring sources of revenue have not yet proven to be sufficient. The Company needs to obtain additional financing to enable it to continue its business. In the absence of additional financing, the Company may not have sufficient funds to meet its obligations. Management continues to monitor the cash needs and consider various alternatives to raise additional financing. However, management is reasonably confident but can offer no guarantee that it will be able to secure the necessary financing to enable the Company to continue as a going concern. These financial statements do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern. There is no assurance that this will be successful.

If the going-concern basis is not appropriate, material adjustments may be necessary in the carrying amounts and/or classification of assets and liabilities and the loss for the period reported in these financial statements.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Financial Statements and Use of Estimates

The accompanying financial statements for EWS for the quarters ended June 30, 2010 and 2009 in the opinion of management, include all adjustments necessary for their fair presentation in conformity with Canadian generally accepted accounting principles (Canadian GAAP). These statements should be read in conjunction with the audited financial statements for the year ending December 31, 2009.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the period. Such estimates include providing for amortization of property, plant and equipment and technology rights. Actual results could differ from these estimates.

(b) Basis of Consolidation of Subsidiaries and Variable Interest Entity ("VIE")

The consolidated financial statements include the accounts of the Company and its 100% owned subsidiaries, Environmental Waste Management Corporation "EWMC", Jaguar Carbon Sales Limited, EWI Rubber Inc. and 2228641 Ontario Limited and a variable interest entity, Environmental Waste International Limited Partnership ("EWILP") for which the Company is the primary beneficiary. All inter-company transactions and balances have been eliminated on consolidation.

In general a VIE is a corporation, partnership, limited - liability corporation, trust or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that lack the power to make significant decisions about activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (3(b) Continued)

Accounting Guideline 15 (AcG-15) requires a VIE to be consolidated if a variable interest holder (a party with an ownership, contractual or other financial interest in the VIE) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became a primary beneficiary.

Please refer to notes 10 and 13. EWS does not have legal control of the assets and liabilities of EWILP.

(c) Investments Subject to Significant Influence

Investment in entities where the Company exercises significant influence are accounted for using the equity method. These investments are recorded at cost plus the Company's share of income or loss to date less dividends received.

Other investments, where the Company exercises neither significant influence nor control or joint control are carried at cost. If there is other than a temporary decline in value, investments carried at cost are written down to provide for the loss.

The consolidated financial statements include the Company's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align accounting policies with those of the Company, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Company's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to nil and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the investee (see note 12).

(d) Share Issue Costs

Direct costs associated with an issue of capital stock or warrants are deducted from the related proceeds at the time of issue.

(e) Technology Rights

Technology represents the cost of acquired technology. The technology rights valuation is tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. In 2002, the Company incurred a charge of \$2,659,587 representing recognition of impairment. Commencing January 1, 2003, the remaining unamortized technology rights balance is being amortized equally over a 10-year period, the estimated useful life of these rights. These rights, except for the tire and wastewater applications, were sold during fiscal 2007. Amounts related to this transaction have been eliminated on consolidation.

(f) Revenue Recognition

Revenue is recognized when all of the following criteria have been met: persuasive evidence of an arrangement exists; the services have been provided; the price is fixed or determinable; customer acceptance has been received or implied; collection of sales proceeds is reasonably assured.

For sales contracts involving production, customization and installation, revenues are recognized under the percentage-of-completion method using milestones or engineering approvals to determine the percentage complete. Provisions for estimated contract losses are recognized in the year the loss becomes probable and can be reasonably estimated. Service revenue such as maintenance and support is recognized when the services are performed. The timing of revenue recognition may differ from the contract payment schedules, resulting in revenues that have been earned but not billed.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (3(f) Continued)

Certain contracts require the customer to provide deposits. Deposits are deemed to be forfeited by the customer when certain contractual obligations are not met and are brought into revenue. When there is uncertainty as to ultimate collection, the Company's policy is to recognize the revenue only as cash is received. Any other billings or cash received in advance of sales are being recorded as deferred revenue. Royalties are recognized as earned when received from the sub-licencee or their agent. The Tire processing fees will be recognized as income on receipt of cash from the licensee or their agent. Other revenue is recognized at the time ownership transfers or services are rendered to the customer.

Provision for the potential warranty claims, if any, is provided for at the time revenue is recognized, based on warranty terms and claims experience as a deduction from revenue.

(g) Stock Based Compensation

The Company has a stock-based compensation plan. It maintains a stock-based compensation plan for employees, directors, officers and consultants of the Company. Effective January 1, 2003, the Company follows the fair-value method (using the Black-Scholes option pricing model) to record compensation expense with respect to stock options and warrants granted. The fair value of each option or warrant granted is estimated on the date of grant and provision for the cost is provided for as contributed surplus over the term of the vesting period of the respective options. The consideration received by the Company on the exercise of share options is recorded as an increase to the share capital together with corresponding amounts previously recognized in contributed surplus.

Estimates used in the fair value computation, including the expected lives of the options, risk free interest rate and volatility of the stock, were determined on the basis of available comparable market and historical data that EWS believes are reasonable.

(h) Warrants

The Company uses the fair value method of accounting for common share purchase and warrants issued as a part of a brokered and non-brokered private placement offering for common shares or as part of other compensation. Under the fair value method, warrants are measured at fair value at the date of the offering and segregated separately in shareholders' equity. When the warrants are exercised, the proceeds received by the Company together with the related amount segregated in shareholders' equity are credited to share capital. If the warrants expire without being exercised, the related amount segregated in shareholders' equity is credited to contributed surplus.

(i) Basic and Diluted earnings (loss) per share

Basic earnings (loss) per share have been computed by dividing net earnings (loss) by the weighted average shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the year that common shares have been outstanding to the total time in the year.

The Canadian Institute of Chartered Accountants ("CICA") recommends the use of the treasury stock method in computing earnings/loss per share. Diluted per share amounts are calculated using the treasury stock method. Diluted earnings (loss) per share is computed similar to basic loss per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, warrants and compensation options or dilutive instruments. In computing the loss per share on a fully diluted basis, the treasury stock method assumes that proceeds received from in-the-money stock options are used to repurchase common shares at the prevailing market rate. The weighted average number of shares outstanding is then adjusted by the net change.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Segmented Information

The Company has determined that it has two geographic segments and one operating segment. During fiscal 2009, all revenues from operations were derived from sources located in Canada and United States and all identifiable assets were located in Canada (note 18).

(k) Government Assistance/Investment Tax Credits "ITCs"

Government assistance is available to the Company through income tax investment and innovation tax credits. ITCs and other governmental incentives relating to capital assets acquired for research and development, are deducted from the cost of the assets. ITCs and other incentives relating to current research and development expenditures are disclosed as government assistance on the statement of earnings. The Company recognizes ITCs and other incentives when earned, and when there is reasonable assurance of realization.

(l) Research and Development Costs.

Research costs are expensed as incurred. Development costs that meet the criteria for deferral under Canadian generally accepted accounting principles for products that are expected to provide future benefits, with reasonable certainty, are deferred and amortized over the anticipated periods of sales revenue of the products.

(m) Translation of Foreign Currencies

Monetary assets and liabilities denominated in foreign currencies are converted to Canadian dollars at the appropriate rates of exchange ruling at the balance sheet date, while other assets and liabilities are converted at the rates of exchange applicable at the dates acquired or incurred. Revenues and expenses are translated into Canadian dollars at rates of exchange applicable during the periods in which they were earned or expensed. All gains and losses are included in the consolidated statements of operations and deficit as they arise.

(n) Leases

Leases are classified as either capital or operating leases. Leases that transfer substantially all of the benefits and inherent risks of ownership of property to the Company are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded together with its related long term obligation to reflect the acquisition and financing. Equipment recorded under capital leases is amortized on the same basis as described above. Rental payments under operating leases are expensed as incurred.

(o) Property and Equipment

Property and equipment are recorded at cost. Repairs and maintenance are charged against income as incurred. Expenditures which extend the estimated life of an asset are capitalized. When property and equipment no longer contribute to the Company's ability to provide services, its carrying amount is written down to residual value. Amortization is provided annually on property and equipment, other than land, at rates designed to charge the cost of the assets over their estimated useful lives, as follows:

Leasehold Improvements	30%	declining balance
Computer equipment	30-55%	declining balance
Equipment	30%	declining balance

One-half of annual depreciation and amortization is charged on net assets acquired during the fiscal year. Government assistance is recorded as a reduction of the related assets. No amortization has been taken on leasehold improvements to date.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Impairment of Long-Lived Assets

Long-lived assets, including capital assets, are amortized over their useful lives. The Company reviews long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the undiscounted cash flows expected to result from the use and eventual disposition of a group of assets is less than its carrying amount, it is considered impaired. An impairment loss is measured as the amount by which the carrying amount of the group of assets exceeds its fair value. At June 30, 2010, no such impairment has occurred.

(q) Cash Equivalents

Cash equivalents consist principally of highly liquid interest-bearing short-term deposits. The Company defines cash equivalents as highly liquid investments which are readily convertible into a known amount of cash, are subject to an insignificant risk of changes in value and have a maturity date of one year or less from the date of acquisition.

(r) Income Taxes

The Company uses the asset and liability method of accounting for income taxes, under which future tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Future tax assets and liabilities are measured using substantively enacted tax rates in effect in the year in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized as part of the provision for income taxes in the year that includes the enactment date. A valuation allowance is recorded to the extent there is uncertainty regarding realization of future tax assets.

(s) Product Warranty:

Environmental Waste International Inc.

The warranty period for the products typically is 1 year. The product warranty accrual reflects management's best estimate of probable liability under its product warranties. Management determines the warranty provision based on known product failures (if any), historical experience, and other currently available evidence.

EWI Rubber Inc.

The standard warranty for Tire Processing Systems covers all components for the first year except high ware items such as magnetrons are covered only for the first two months. Optional warranties for all components, including high ware items, are available. Special warranty arrangements have been made for the TR900 Prototype System.

The product warranty accrual reflects management's best estimate of probable liability under its product warranties. Management determines the warranty provision based on known product failures (if any), historical experience, and other currently available evidence.

Based on the above, no accrual was provided for the fiscal year December 31, 2009.

(t) Concentration of Credit Risk

In 2009, the Company derived net sales and fees from 2 (2008 -1) major customer amounting to approximately \$735,444 representing 92% of total revenues (2008 - \$120,333 representing 57% of total revenues).

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

4 CHANGES IN ACCOUNTING POLICIES

As of January 1, 2009, the Company adopted CICA Handbook Section 3064 Goodwill and Intangible Assets which replaces CICA Handbook Sections 3062 Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs. The adoption of this new section did not have an impact on its consolidated financial statements for the year ended December 31, 2009.

On January 20, 2009, the CICA Accounting Standards Board ("AcSB") issued Emerging Issues Committee Abstract 173: Credit Risk and the Fair Value of Financial Assets and Financial Liabilities ("EIC – 173"). EIC – 173 supplements CICA Handbook Section 3855 ("Section 3855"). The EIC affirms that an entity's own credit risk (in the case of financial liabilities) and a counterparty's credit risk (in the case of financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments.

This guidance is applicable to fiscal periods ending on or after January 12, 2009. The Company is continually evaluating its counterparties and their credit risks. The adoption of this guidance does not have a significant impact on the Company's consolidated financial statements.

In June 2009, the Canadian Accounting Standards Board issued an amendment to the CICA Handbook Section 3862, "Financial Instruments Disclosures" in an effort to make Section 3862 consistent with IFRS Section 7 - Disclosures ("IFRS 7"). The purpose was to establish a framework for measuring fair value in Canadian GAAP and expand disclosures about fair value measurements. The amendments require an entity to classify fair value measurements using a fair value hierarchy in levels ranging from 1 to 3 that reflect the significance of the inputs used in making these measurements. Level 1 represents fair value measurements for which the inputs are quoted prices in active markets for identical assets or liabilities. Level 2 represents inputs other than quoted prices that are observable either directly or indirectly. Level 3 represents inputs that are not based on observable market data. The use of observable and unobservable inputs is reflected in the fair value hierarchy assessment.

The availability of observable inputs can vary based upon the financial instrument and a variety of factors, such as the instrument type, market liquidity, and other specific characteristics particular to the financial instrument. To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment by management. The amendments also provide clarification about the required liquidity risk disclosures. The adoption of the new standard resulted in additional disclosures in note 20 to the consolidated financial statements.

FUTURE CHANGE IN ACCOUNTING POLICIES

On January 2009, CICA issued new Handbook Section 1582 "Business Combinations", replaces Section 1581 - "Business Combinations" and provides the Canadian equivalent to International Financial Reporting Standards ("IFRS") 3 - Business Combinations. This applies to a transaction in which the acquirer obtains control of one or more businesses. Most assets acquired and liabilities assumed, including contingent liabilities that are considered to be improbable, will be measured at fair value. Any interest in the acquiree owned prior to obtaining control will be remeasured at fair value at the acquisition date, eliminating the need for guidance on step acquisitions. Additionally, a bargain purchase will result in recognition of a gain and acquisition costs must be expensed. The Company expects to adopt this standard on January 1, 2011.

In January 2009, the CICA issued the new handbook Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", effective for fiscal years beginning on or after January 1, 2011. Earlier adoption of these recommendations is permitted. These pronouncements further align Canadian GAAP with US GAAP and IFRS.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

4 CHANGES IN ACCOUNTING POLICIES (Continued)

Sections 1601 and 1602 change the accounting and reporting for ownership interest in subsidiaries held by parties other than the parent. Non-controlling interests are to be presented in the consolidated statement of financial position within equity but separate from the parent's equity.

The amount of consolidated net income attributable to the parent and to the non-controlling interest is to be clearly identified and presented on the face of the consolidated statement of income. In addition, these pronouncements establish standards for a change in the parent's ownership interest in a subsidiary and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. They also establish reporting requirements for providing sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. The Company is currently considering the impact of adopting these pronouncements on its consolidated financial statements in 2010 in connection with the conversion to IFRS.

In January 2006, the Canadian Accounting Standards Board ("AcSB") announced its decision to replace Canadian GAAP with IFRS. On February 13, 2008 the AcSB confirmed January 1, 2011 as the mandatory changeover date to IFRS for all Canadian publically accountable enterprises. This means that the Company will be required to prepare IFRS financial statements for the interim periods and fiscal year ends beginning in 2011. The conversion to IFRS will impact the Company's accounting policies, information technology and data systems, internal controls over financial reporting and disclosure controls and procedures.

The Company has identified the following four phases of its conversion plan: scoping and planning, detailed assessment, operations implementation and post implementation. The scoping and planning phase ("Phase 1") involves establishing a project management team, mobilizing organizational support for the conversion plan, obtaining stakeholder support for the project, identifying major areas affected and developing an implementation plan and communication strategy. The detailed assessment phase ("Phase 2") will result in the accounting policies and transitional exemptions decisions, quantification of financial statement impact, preparation of shell financial statements and identification of business processes and resources impacted.

The operations implementation phase ("Phase 3") includes the design of business, reporting and system processes to support the compilation of IFRS compliant financial data for the opening balance sheet at January 1, 2010, fiscal 2010 and thereafter. Phase 3 also includes ongoing training, testing of the internal control environment and updated processes for disclosure controls and procedures. Post implementation ("Phase 4") will include sustainable IFRS compliant financial data and processes for fiscal 2011 and beyond.

The current focus of the project is identification of local level impacts for the opening balance sheet in each of the Company's operations, and finalization of the IFRS 1 transition exemptions to be taken. The following summary of opening balance sheet transitional provisions to be adopted and their likely impacts indicates the progress of our work in each topic area identified as having a potential high impact. It is not an exhaustive list; if further transitional elections are found to be beneficial to the transition process as the opening balance sheet preparation progresses, then such exemptions may be taken.

- Fixed assets: No transitional elections will be taken. The Company will retain assets at historical costs upon transition rather than taking the allowed election to recognize assets at fair value.

The technical analysis completed by the Company has indicated that the transition to IFRS will not have a material impact on the Company's fixed asset or associated accumulated amortization balance upon transition.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
For The Six Month Period Ended June 30, 2010

5 ACCOUNTS RECEIVABLE

Accounts receivable are recorded at cost less provision for doubtful accounts.

6 PROPERTY AND EQUIPMENT

	Cost	Accumulated Amortization	<u>June 30 2010</u> Net Book Value	December 31 2009 Net Book Value
Leasehold Improvements	\$ 27,500	\$ -	\$ 27,500	\$ -
Computer Equipment	18,837	(13,570)	5,267	3,200
Equipment	12,234	(7,152)	5,082	5,390
	<u>\$ 58,571</u>	<u>\$ (20,722)</u>	<u>\$ 37,849</u>	<u>\$ 8,590</u>

7 TECHNOLOGY RIGHTS

	<u>June 30, 2010</u>	December 31, 2009
2002 Value	\$ 500,000	\$ 500,000
Accumulated amortization	(375,000)	(350,000)
	<u>\$ 125,000</u>	<u>\$ 150,000</u>

8 LOANS PAYABLE

All loans bear monthly interest at the rate of 12%. The interest is payable monthly. The loans consist of the following:

	<u>June 30, 2010</u>	December 31, 2009
(a) Loan from a relative of the president of the Company convertible for common shares at the rate of \$0.25 per share and due September 30, 2010	\$ 186,000	\$ 186,000
(b) Loans from directors convertible to common shares at the rate of \$0.25 per share, due on September 30, 2010.	62,373	62,373
(c) Loans from directors convertible to common shares at the rate of \$0.13 per share, due on September 30, 2010	97,500	97,500
Total long-term debt	-	-
Less: current portion	(345,873)	(345,873)
	<u>\$ (345,873)</u>	<u>\$ (345,873)</u>

In 2004, as required by Canadian generally accepted accounting principles, the Company classified the convertible loans as having both a liability component and an equity component. The classification between debt and equity was determined using the relative fair value approach, with fair value determined by discounting estimated cash flows at a rate of 20%, for a debt instrument of comparable maturity and credit facility. The equity component, which consists of a conversion feature, was determined using the Black-Scholes option pricing model, and was based on a risk free annual interest rate of 3.68%, an expected life of approximately 2 years, an expected volatility of 136% and a dividend yield rate of nil.

As a result, the Company had allocated \$267,000 of the gross proceeds received to debt and \$163,000 to equity (\$20,000 of such debt was repaid in 2008 (2007 - \$10,000)).

ENVIRONMENTAL WASTE INTERNATIONAL INC.
Notes to Consolidated Financial Statements
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8 LOANS PAYABLE (Continued)

In 2007, the Company borrowed \$115,000 from five directors of the Company. The loan is in the form of \$55,200 as a 12% secured loan and a 12% convertible debentures for the balance of the principal amount of \$59,800. The debenture expired on December 31, 2008. As required by Canadian generally accepted accounting principles, the Company classified the convertible loans as having both a liability component and an equity component. The classification between debt and equity was determined using the relative fair value approach, with fair value determined by discounting estimated cash flows at a rate of 20%, for a debt instrument of comparable maturity and credit facility.

The equity component, which consists of a conversion feature, was determined using the Black-Scholes option pricing model, and was based on a risk free annual interest rate of 4.25%, an expected life of approximately 1 year, an expected volatility of 100% and a dividend yield rate of nil. As a result, the Company had allocated \$97,500 of the gross proceeds received to debt and \$17,500 to equity.

Interest payments in the year on the convertible loan were allocated between interest expense on the liability component, and the distributions paid on the equity component, by proportioning the liability component to the face value over the term of the convertible loans, based on an annual interest rate of 12%. During 2009, \$22,574 interest paid on the equity portion was allocated to equity as a distribution on the equity component.

Last year, the Company negotiated an extension of its \$515,000 debt due on September 30, 2009 to September 30, 2010. As an incentive to extend the repayment date, the Company issued 515,000, two year \$0.20 warrants. The fair value of these warrants was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: expected dividend yield 0%; expected volatility of 100%; risk free interest rate of 1.36% and an average expected life of 2 years, and \$8,046 has been recorded as Stock-based compensation.

9 DEFERRED INCOME

The amortization is calculated on a straight line basis over the initial lease term of the Company's premises, being 60 months.

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Opening Balance	\$ 85,308	\$ 128,615
Amortization during the period	<u>(21,655)</u>	<u>(43,307)</u>
	63,654	85,308
Less: current portion	<u>(43,307)</u>	<u>(43,307)</u>
Long-term portion	<u>\$ 20,347</u>	<u>\$ 42,001</u>

10 DEFERRED REVENUE

The Company, through its subsidiary EWI Rubber Inc., is building a Prototype tire processing system based on the Reverse Polymerization Process developed by EWS. Deferred Revenue and Work in Progress has been recognized based on the percentage of completion method. An amount of \$718,461 for the six month period ended June 30, 2010 (December 31, 2009 - \$677,676) is reflected as Revenue, \$2,603,863 (December 31, 2009 - \$522,324) as Deferred Revenue and cost \$448,889 (December 31, 2009 - \$423,407) of designing and building of the system has been reflected as Manufacturing expenses.

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11 NON-CONTROLLING INTERESTS

The assets, liabilities, revenues and expenses of EWILP have been consolidated into these financial statements. The interest in the current period loss and net equity of EWILP not owned by the Company, is disclosed as non-controlling interests on the statement of operations and retained earnings and the balance sheet. The gain on sale of partnership units represents the Company's share of gain on sale of partnership units to arm's length investors in the partnership.

(a) Reconciliation of Non-Controlling Interest:

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Opening Balance	\$ 902,345	\$ 442,364
Share of gain on sale of partnership units	16,215	637,852
Share of loss	-	(177,871)
	<u>\$ 918,560</u>	<u>\$ 902,345</u>

12 LONG-TERM INVESTMENTS

During 2009 the Company acquired 37.5% of the common shares of Ellsin Environmental Ltd.

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Opening Balance	\$ 588,724	\$ 900,000
Loss on equity investment during the period	-	(311,276)
Loan receivable	750,000	-
Second mortgage receivable	145,000	-
Total long-term investments	<u>\$ 1,483,724</u>	<u>\$ 588,724</u>

The Company has two directors in common with Ellsin Environmental Ltd ("Ellsin"). The Company accounts for this investment using the equity accounting method as the Company has determined that significant influence exists. The Company has recorded its equity share of Ellsin's loss of \$311,276 during the year ended December 31, 2009 (2008 - \$0). The \$750,000 loan receivable is expected to be repaid by July, 2011. The \$145,000 second mortgage is on Ellsin's property located at 155 Yates Avenue, Sault Ste. Marie, Ontario facility. The Company owns 745,000 two year warrants issued by Ellsin at a \$2 exercise price.

13 ENVIRONMENTAL WASTE INTERNATIONAL LIMITED PARTNERSHIP

On June 1, 2007, Environmental Waste International Inc. (EWS) entered into a Technology and Intellectual Property Purchase and Sale Agreement with a newly formed arms' length Limited Partnership, Environmental Waste International Limited Partnership ("EWILP"). EWILP was formed as a Limited Partnership to commercially exploit EWS's product lines and expand market penetration. All rights to EWS's patents, proprietary software and system design portfolio, except for the tire and wastewater applications, were sold for \$9,600,000 with EWS taking notes receivable as consideration.

EWILP has syndicated subscriptions of 11,637 units as of December 31, 2009 (2008 - 7,872). During 2008 the partnership repurchased, at a discount, 3,200 units from the former general partner. The units consist of cash and assumption of a portion of the notes payable to EWS. The individual limited partners of EWILP personally assumed a total of \$9,737,177 of the limited partnership debt.

The above arrangement between EWS and EWILP includes a Management Services Agreement that engages EWS to provide management, personnel, facilities and equipment for the continued operations of EWILP's business interests.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
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13 ENVIRONMENTAL WASTE INTERNATIONAL LIMITED PARTNERSHIP (Continued)

EWS has the right, but not the obligation, to re-acquire all assigned rights to the patents, proprietary software and system design portfolio through the purchase of all outstanding LP Units. This option can be exercised from January 10, 2010 through to December 1, 2014 by issuing up to \$9,900,000 in EWS stock at its then fair market value, as long as EWS stock is trading at a minimum of \$0.50 a share. EWILP has been accounted for as variable interest entity (note 3(b)).

14 CAPITAL STOCK

(a) The Company is authorized to issue an unlimited number of common shares.

(b) The following details the changes in the issued shares for the periods ended June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
	Number	\$	Number	\$
Issued and Outstanding:				
Balance, beginning of period	77,448,324	\$ 36,178,267	71,398,324	\$ 35,839,145
Issued for Cash:				
Private placements (i)	-	-	6,000,000	900,000
Employee stock options	870,000	126,200	-	-
Cost of equity financing	-	-	-	(567,378)
Stock based compensation related to exercise of options	-	-	50,000	6,500
Balance, end of period	78,318,324	\$ 36,304,467	77,448,324	\$ 36,178,267

(i) Private placement: 6,000,000 common shares at \$0.15 per share

During 2004, the Company issued a non-brokered private placement for 1,000,000 units consisting of one common share at \$0.40 and one half warrant. Each warrant entitles the holder to acquire one additional common share at \$0.60 per share before April 27, 2006. None of these warrants were exercised in 2006.

The Company has placed a stop-trade order on 1,000,000 of the issued and outstanding shares.

The non-brokered private placement on March 14, 2006 totaling 4,000,000 units consisted of one common share at \$0.12 and one half warrant. Each warrant entitles the holder to acquire one additional common share at \$0.16 per share before March 13, 2008. None of these warrants were exercised in 2008 and expired on March 13, 2008.

The non-brokered private placement for 2,500,000 units on November 7, 2006 consisted of one common share at \$0.10 and one warrant. Each warrant entitles the holder to acquire one additional common share at \$0.20 per share before October 31, 2008. None of these warrants were exercised in 2008 and expired on October 31, 2008.

Pursuant to non-brokered private placement on May 8, 2007, the Company issued 2,000,000 units, consisting of one common share at \$0.15 and one warrant. Each warrant entitles the holder to acquire one additional common share at \$0.20 per share before May 7, 2009. None of these warrants were exercised in 2008.

ENVIRONMENTAL WASTE INTERNATIONAL INC.
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14 CAPITAL STOCK (14(b) Continued)

Pursuant to non-brokered private placement on July 23, 2009, the Company issued 6,000,000 units, consisting of one common share at \$0.15 and one warrant. Each warrant entitles the holder to acquire one additional common share at \$0.20 per share before July 23, 2011. None of these warrants were exercised in 2009.

(c) Stock Options:

The Board of Directors have established a stock option plan under which options to purchase shares are granted to directors, employees, officers and consultants of the Company. The number of options and exercise price thereof is set by the Board of Directors at the time of grant, provided that the exercise price shall not be less than the market price of the common shares on the day immediately preceding the grant of the options, on the stock exchange on which such shares are then traded. All the options issued to date vest immediately and generally expire from one (1) to five (5) years from the date of Grant.

On June 16, 2010, at the Annual General and Special Shareholders' meeting, the shareholders approved the resolution to increase the number of common shares available for issue from 7,100,000 to 7,500,000 under the plan, representing less than 10% of the total number of shares in issue. All new options issued after June 27, 2007 are subject to a six-month vesting period.

The following options to purchase shares are held by directors, employees, officers and consultants of the Company. In all cases, one option entitles the holder to purchase 1 common share at the designated exercise price.

Stock option activity for the six months ended June 30, 2010 and year ended December 31, 2009 is presented below:

	Weighted average exercise price		Weighted average exercise price	
	Six Months ended June 30, 2010		Year-ended December 31 2009	
	#	\$	#	\$
Balance, beginning of year	6,430,000	0.19	5,320,000	0.19
Granted	1,685,000	0.27	1,795,000	0.24
Expired	(515,000)	(0.22)	(635,000)	(0.38)
Exercised	(870,000)	(0.15)	(50,000)	(0.13)
Outstanding at end of period	6,730,000	0.21	6,430,000	0.19

The following table summarizes information about the outstanding exercisable options expiring up to June 16, 2015

Range of Prices	#	Weighted Average Remaining Life in Years	Weighted Average Exercise Price
Less than .25	4,870,000	3.04	0.17
.25 to .30	1,460,000	2.96	0.30
Greater than .30	400,000	4.71	0.35
	6,730,000	3.13	0.21

The fair value of these options were estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: expected dividend yield 0%; expected volatility of 100%; risk free interest rates of 1.36% - 3%; and an expected life of 2 - 5 years. This generated an expense to stock-based compensation of \$265,151 in 2009 (2008 - \$78,679).

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14 CAPITAL STOCK (Continued)

(d) Warrants:

On April 17, 2009, the Company issued 515,000 warrants; each warrant entitles the holder to acquire an additional common share at \$0.20 and expires on April 16, 2011.

On July 23, 2009, the Company issued 6,000,000 warrants, each warrant entitles the holder to acquire an additional common share at \$0.20 and expires on July 22, 2011.

Warrant activity for the six months ended June 30, 2010 and year ended December 31, 2009 is presented below:

	Weighted average exercise price		Weighted average exercise price	
	Six Months ended June 30, 2010		Year-ended December 31 2009	
	#	\$	#	\$
Balance, beginning of year	6,515,000	0.20	6,515,000	0.20
Issued during the year				
Exercised during the year				
Expired during the year				
Outstanding at end of period	6,515,000	0.20	6,515,000	0.20

(i) The fair value of these warrants was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: expected dividend yield 0%; expected volatility of 100%; risk free interest rate of 1.36% and an average expected life of 2 years.

A summary of warrants outstanding at December 31, 2009 is set out below:

	Number of Warrants	Amount \$
Balance - December 31, 2005	500,000	-
Warrants expired in 2006	(500,000)	-
Warrants granted in 2006	4,500,000	217,784
Balance - December 31, 2006	4,500,000	217,784
Warrants granted in 2007	2,000,000	140,979
Balance - December 31, 2007	6,500,000	358,763
Warrants expired in 2008	(4,500,000)	-
Balance - December 31, 2008	2,000,000	358,763
Warrants expired in 2009	(2,000,000)	-
Warrants granted in 2009	6,515,000	567,378
Balance - December 31, 2009	6,515,000	\$ 926,141

(e) Per Share Amounts:

For the year ended December 31, 2009, the weighted average number of shares were 74,074,077 (2008 - 71,313,666). Diluted earnings per share reflect the exercise of options, warrants and convertible debt as if issued at the later of the date of grant or beginning of the year.

(f) Contributed Surplus:

	June 30, 2010	December 31, 2009
Balance, beginning of period	\$ 1,802,868	\$ 1,529,671
Stock options granted and/or vested during the period:		
Net options issued and expired	-	273,197
Balance, end of period	\$ 1,802,868	\$ 1,802,868

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15 RELATED PARTY TRANSACTIONS

During 2009, the Company engaged in transactions in the normal course of operations with the following related parties, the total of these expenses included in the consolidated statement of operations and deficit are as follows:

Interest and distributions paid to the directors - \$27,376 (2008 - \$28,527) and to a relative of the President - \$36,000 (2008 - \$36,000) and \$6,496 (2008 - \$8,096) to a relative of a director.

During 2009 the Company recovered \$6,300 for use of office space and paid rent of \$4,000 from/to a Company in which the President and the CFO of EWS are shareholders.

During 2009 the Company incurred \$47,012 legal expenses with a law firm, which has a partner, who is also a member of the Board of Directors (2008 - \$0).

Consulting fee income in 2009 was earned from Ellsin.

A limited partner of the partnership is also a shareholder of the Company. Operating, labour and manufacturing expenses include marketing fees of \$316,727 in 2009 paid to a company owned by one of the general partners in EWILP and \$13,570 to two limited partners.

Two of the directors of Ellsin (see note 12) are also directors and shareholders of EWS.

16 SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT TAX CREDITS

The Company has outstanding claims for federal scientific research and experimental development tax credits (SR&ED tax credits) for the fiscal years 2004, 2005, 2006, 2007, 2008 and 2009, the value of which is approximately \$541,600. Since these claims have not been formally approved, the benefit thereof has not been reflected in these financial statements. The tax credits will be recorded in the year when reasonable assurance of their realization exists.

During fiscal 2009, the company recognized SR&ED tax credits of \$33,454 related to fiscal year 2008 (2008 - \$42,527 related to fiscal year 2007), for which no accounting benefit was previously recognized. These SR&ED tax credits have been recorded as a reduction of expenses in the year of receipt.

17 PRIOR PERIOD ADJUSTMENT

As explained in notes 3(b) and 13, during fiscal 2008, the Company has corrected its method of accounting for its variable interest in EWILP in accordance with Accounting Guideline 15. Accordingly, the following items on the comparative (December 31, 2007) income statement have been revised; revenues have decreased by \$1,634,000, expenses have increased by \$29,167 and other income items (gain on sale of technology rights, interest income and gain on sale of partnership units) have decreased by \$9,022,580 for a total adjustment of \$10,685,747.

18 SEGMENTED INFORMATION

The Company has determined that it has two geographic operating segments.

	<u>2010 Revenues</u>	<u>2009 Revenues</u>
	\$	\$
Canada	740,115	727,073
United States	14,525	76,082
Total	<u>\$ 754,640</u>	<u>\$ 803,155</u>

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19 CAPITAL DISCLOSURES

Capital management:

The Company's objectives when managing its capital are:

- (a) to maintain a flexible capital structure which optimizes the cost of capital at acceptable risk while providing an appropriate return to its shareholders;
- (b) to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business;
- (c) to safeguard the Company's ability to obtain financing should the need arise; and
- (d) to maintain financial flexibility in order to have access to capital in the event of future acquisitions and to improve current and new research and development for new technologies.

The Company manages its capital structure and makes adjustments to it in accordance with the objectives stated above, as well as responds to changes in economic conditions and the risk characteristics of the underlying assets. The Company monitors the return on capital, which is defined as total shareholders' equity. There were no changes in the Company's approach to capital management during the fiscal year ended December 31, 2009. The Company is not subject to externally imposed capital requirements.

20 ACCOUNTING FOR FINANCIAL INSTRUMENTS

Financial instruments are defined under Canadian generally accepted accounting principles as contracts that give rise to both financial assets and financial liabilities. In the balance sheet, this includes cash and cash equivalents, accounts receivable, loans payable and accounts payable and accrued liabilities.

The fair values of cash and cash equivalents approximate their carrying value due to their short-term nature. The Company's accounts receivable, are classified as loans and receivables, loans payable are classified as loans payable. Accounts payable and accrued liabilities are classified as other financial liabilities, the fair values of which approximate their carrying values due to the short-term nature of these instruments. The carrying values of financial instruments approximate fair values unless otherwise indicated.

The carrying amount of the Company's long-term investments is dependant on the underlying operations and accordingly a fair value is based on management's best estimate using inputs that are not based on directly observable markets.

Fair value estimates are made at a specific point in time, using available information about the financial instrument. These estimates are subjective in nature and often cannot be determined with precision. The Company has determined that the carrying value of its short-term financial assets and liabilities approximates fair value at December 31, 2009 and 2008 due to the short term maturity of these instruments.

Risk Management

In the normal course of business, the Company is exposed to financial risks that potentially impact its operating results. The Company employs risk management strategies with a view to mitigating these risks to the extent possible on a cost effective basis. The Company does not enter into derivative financial agreements for speculative purposes.

This note provides disclosures relating to the nature and extent of the Company's exposure to risks arising from financial instruments, including credit risk, liquidity risk, foreign currency risk and interest rate risk, and how the Company manages those risks.

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20 ACCOUNTING FOR FINANCIAL INSTRUMENTS (Continued)

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's financial instruments that are exposed to concentrations of credit risk are primarily cash and term deposits. The Company limits its exposure to credit risk with respect to cash and term deposits by ensuring available cash is deposited with reputed banks in Canada all of which have a credit rating of A or better

The Company's exposure to credit risk for these financial Instruments is as follows:

	June 30	Dec 31
	2010	2009
	\$	\$
Cash and term deposits	2,604,798	1,189,585
Accounts receivable	364,399	318,505
	<u>\$ 2,969,197</u>	<u>\$ 1,508,090</u>

The Company's credit risk is primarily attributable to uncertainties relating to timing and collectability of its long term notes receivables from the Limited Partnership (EWILP) and its individual partners. Company management believes its credit risk is low as it expects EWILP units will be fully subscribed and that EWILP will commercially exploit the Company's product lines and expand market penetration during the course of the agreement. The Company expects EWILP will generate enough revenue and cash to fulfill its debt obligations owing to the Company. Amounts related to notes receivable have been eliminated on consolidation. In addition the Company takes into account the debtor's payment history, credit worthiness and the economic environment in which it operates to assess impairment. Based on the above management believes that the credit risk concentration with respect to this financial instrument is low.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, to the extent possible, that it will always have sufficient liquidity to meet liabilities when due. As at June 30, 2010, in addition to cash on hand of \$2,104,798 the Company had \$500,000 in term deposits, available to be drawn on to pay its liabilities. A large portion of the cash was subsequently invested in short term deposits.

The Company manages liquidity risk through the management of its capital structure and financial leverage as outlined below.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares and acquire or dispose of rights to certain intellectual property assets. In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors. In order to maximize ongoing development efforts, the Company does not pay out dividends.

Accounts payable and accrued liabilities are current financial instruments expected to be settled in the normal course of operations.

Foreign Currency Risk

As at December 31, 2009, the Company determined change in the U.S. dollar exchange rate would not impact net earnings and is not exposed to significant foreign currency risk.

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20 ACCOUNTING FOR FINANCIAL INSTRUMENTS (Continued)

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates.

The Company is exposed to interest rate fluctuations related to interest earned on term deposits. The Company has performed sensitivity analysis on interest rate risk at December 31, 2009 to determine how a change in interest rates would impact equity and net earnings. Since this balance carries a fixed rate of interest and management does not expect change in the current rate of interest and accordingly not exposed to any interest rate risk.

The risk that the Company will realize a loss as a result of a decline in the fair value of the notes receivable or pay more interest on loans payable is limited because the majority of these instruments bear a fixed rate of interest and are generally held to maturity.

21 OTHER ITEMS

(a) Sale of Real Property

During the fourth quarter of 2006, the Company disposed of land and building under the terms of a sale-leaseback transaction. Of the pre-tax gain of \$625,552, as calculated below, \$216,533 has been deferred and is being amortized to income over the term of the lease.

Sale Price	\$ 1,765,000
Less: net book value	(1,075,728)
Less: selling expenses	<u>(63,720)</u>
Gain before the undernoted	625,552
Less amount of gain deferred as a result of sale-leaseback transaction (note 8)	<u>(216,533)</u>
Net gain	<u><u>\$ 409,019</u></u>

The Company leased back approximately 18% of the building. In accordance with the Canadian Institute of Chartered Accountants ("CICA") emerging issue number 25, the net present value of the minimum lease payments over the lease term is deferred and amortized to income over the lease term. The remaining balance \$215,229 at the beginning of fiscal 2007 is being amortized to income over the remaining term of the lease income (note 9).

(b) Settlement of Law Suit

In 2005, a former officer commenced a wrongful dismissal action against the Company for approximately \$400,000 plus costs. During the year this action was settled by the Company for \$70,000 including taxes, to the maximum of \$100,000 pending any default in payments required under the settlement.

Cost of settlement of law suit - net of taxes \$833	<u><u>\$ 69,167</u></u>
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22 COMMITMENTS

Future approximate minimum lease payments for the ensuing five years, including estimated tenant's share of operating expenses and realty taxes, required under lease contract are as follows:

	\$
2010	61,600
2011	105,600
2012	96,000
2013	96,000
2014 and after	140,000

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23 INCOME TAXES

(a) Provision of Income Taxes

The provision for income taxes differs from that calculated by applying statutory rates for the following reasons:

	2009 \$	2008 \$
Net income (loss) before income taxes	<u>(851,998)</u>	<u>(494,453)</u>
Expected income tax expense (recovery) based upon the combined Canadian federal and provincial expected tax rates of 33.30% and (2008 - 33.50%)	(281,159)	(165,642)
Adjustments to tax benefit resulting from:		
Permanent differences (items not deductible or taxable for tax purposes)	230,605	24,092
Timing differences	1,544,755	816,058
Unrecorded tax benefit of losses	(1,494,201)	(674,508)
Provision for income taxes	<u>\$ -</u>	<u>\$ -</u>

(b) Future Income Tax Balances

The tax effect of temporary differences that gives rise to future income tax assets and liabilities at December 31, 2009 and 2008 are as follows:

	2009 \$	2008 \$
Non-capital losses	1,483,510	2,875,534
SR&ED tax credits available	528,775	510,704
SR&ED expenditures applicable to future years	681,344	671,421
Timing differences resulting in potential future income taxes	858,358	872,014
Total net future tax assets	3,551,987	4,929,673
Valuation allowances	(3,551,987)	(4,929,673)
Total net future tax assets	<u>\$ -</u>	<u>\$ -</u>

(c) Tax Benefits Available

The Company has incurred the undernoted non-capital losses and has \$1,348,087 of scientific research expenses for tax purposes, which are available to reduce future taxable incomes. The potential benefit of amounts from these non-capital losses, if any, are expected to approximate to 33%. Given the uncertainty of realization, no future asset or benefit has been recognized in these financial statements.

The estimated losses and expiry dates are as follows:

	\$
2015	501,000
2026	536,500
2029	310,587
	<u>\$ 1,348,087</u>

24 CONTINGENT LIABILITIES

In 2000, a former officer commenced a wrongful dismissal action against the Company for \$1,000,000 plus costs. In 2001, the former officer commenced a second claim against the Company relating to unpaid loans. The Company denies liability in either action, and has made no provision in the financial statements.

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24 CONTINGENT LIABILITIES (Continued)

Warranties and Guarantees

In 2005, the Company sold a limited warranty which expired on December 7, 2009 on an installed system. In 2009, \$23,176 was amortized to income. As at December 31, 2009, accounts payable includes a liability of \$0 (2008 - \$19,080) for future warranty costs. Management's best estimate is that this amount is an adequate provision against future potential liabilities.

Director/Officer Indemnification

Under its by-laws, the Company indemnifies its directors / officers, former directors / officers and individuals who have acted at the Company's request to be a director / officer of an entity in which the Company is a shareholder, to the extent permitted by law, against any and all charges, costs, expenses, amounts paid in settlement and damages incurred by the directors and officers as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors and officers are sued as a result of their service. Indemnification claims will be subject to any statutory or other legal limitation period. There are no indemnification claims known to the Company at this time. The Company has purchased directors' and officers' liability insurance. No amount has been accrued in these financial statements with respect to any indemnifications.

25 COMPARATIVE FIGURES

Certain 2009 comparative figures have been reclassified to conform to the current year's financial statement presentation.

26 SUBSEQUENT EVENTS

No significant subsequent events occurred after period end.

Prepared by Management - without audit