

Consolidated Financial Statements of

AKELA PHARMA INC.

Years ended December 31, 2009 and 2008

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Akela Pharma Inc. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive loss, shareholders' deficiency and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



April 26, 2010, except as to note 18b), which is as of May 11, 2010

(1) Chartered accountant auditor permit, No. 13556

AKELA PHARMA INC.

Consolidated Financial Statements

Years ended December 31, 2009 and 2008
(in thousands of US dollars)

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AKELA PHARMA INC.

Consolidated Balance Sheets

As at December 31st
(in thousands of US dollars)

Going Concern Uncertainty (note 1)

	2009	2008
Assets		
Current assets:		
Cash (note 1)	\$ 107	\$ 2,345
Restricted cash (note 14)	938	600
Accounts receivable (note 10)	1,679	6,070
Prepaid expenses and other current assets	417	346
	<u>3,141</u>	<u>9,361</u>
Restricted cash and deposits (note 14)	-	1,258
Property and equipment	4,217	5,229
Intangible assets (note 8)	-	4,755
Goodwill (note 8)	-	6,457
Other assets (note 13)	598	1,397
	<u>\$ 7,956</u>	<u>\$ 28,457</u>
Liabilities and Shareholders' Deficiency		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 7,801	\$ 7,307
Deferred revenue (note 3)	2,795	4,515
Current portion of long-term debt (note 15)	1,015	1,311
	<u>11,611</u>	<u>13,133</u>
Deferred revenue (note 3)	14,630	16,266
Long-term debt (note 15)	6,615	4,894
Income taxes (note 16)	799	610
Shareholders' deficiency:		
Common shares (unlimited authorized, 30,890,338 and 21,655,577 common shares issued and outstanding with no par value at December 31, 2009 and December 31, 2008, respectively) (note 17)	67,544	66,346
Warrants (note 17)	2,954	2,814
Additional paid-in capital	8,511	8,105
Accumulated other comprehensive income	3,110	3,110
Deficit	(107,818)	(86,821)
Total shareholders' deficiency	<u>(25,699)</u>	<u>(6,446)</u>
Commitments, contingencies and guarantees (note 18)		
	<u>\$ 7,956</u>	<u>\$ 28,457</u>

See accompanying notes to audited consolidated financial statements.

Approved on behalf of the Board of Directors:

(Signed) Robert Rieder, Chairman of the Board

(Signed) Gordon Busenbark, Chairman of the Audit Committee

AKELA PHARMA INC.

Consolidated Statements of Operations and Comprehensive Loss

Years ended December 31st

(in thousands of US dollars, except share and per share data)

Going Concern Uncertainty (note 1)

	2009	2008
Revenues	\$ 13,893	\$ 14,774
Expenses:		
Direct costs	8,158	7,730
Selling, general and administrative	6,183	7,103
Research and development	3,711	11,563
Stock-based compensation (note 10)	238	477
Depreciation of property and equipment	1,464	1,866
Amortization of intangible assets	1,693	2,875
Interest on long-term debt	268	158
Unrealized loss on securities held for trading (note 7)	23	-
Foreign exchange loss	600	471
	<u>22,338</u>	<u>32,243</u>
Loss before under noted items	(8,445)	(17,469)
Other (expenses) income:		
Settlement with LRI (note 7)	1,664	-
Impairment of goodwill, intangible and other assets (note 8)	(9,601)	(9,635)
Lease termination (note 5)	(1,936)	-
Provision for repayment of government grants (note 6)	(1,544)	-
Restructuring (note 9)	(1,071)	-
Loss before income taxes	<u>(20,933)</u>	<u>(27,104)</u>
(Provision for) recovery of income taxes (note 16):		
Current	(64)	-
Future	-	1,115
	<u>(64)</u>	<u>1,115</u>
Net loss and comprehensive loss	<u>\$ (20,997)</u>	<u>\$ (25,989)</u>
Basic and diluted net loss per share (note 17(f))	<u>\$ (0.77)</u>	<u>\$ (1.35)</u>
Basic and diluted weighted average number of shares outstanding	<u>27,283,487</u>	<u>19,276,943</u>

See accompanying notes to audited consolidated financial statements.

AKELA PHARMA INC.

Consolidated Statements of Shareholders' Deficiency

Years ended December 31st
(in thousands of US dollars)

Going Concern Uncertainty (note 1)

	Common Shares		Warrants	Additional Paid-in Capital	Accumulated other comprehensive		Total
	Number	Dollars			income	Deficit	
Balance, December 31, 2007	11,768,294	\$ 54,227	\$ 364	\$ 11,702	\$ 3,110	\$ (59,355)	10,048
Issuance of units (note 17(b))	8,625,000	8,045	2,450	-	-	(1,477)	9,018
Purchase of PharmaForm (note 4)	1,222,283	4,074	-	(4,074)	-	-	-
Stock-based compensation (note 17(e))	-	-	-	477	-	-	477
Net loss	-	-	-	-	-	(25,989)	(25,989)
Balance, December 31, 2008	21,615,577	\$ 66,346	\$ 2,814	\$ 8,105	\$ 3,110	\$ (86,821)	(6,446)
Purchase of Nventa (note 4)	9,274,761	1,198	141	7	-	-	1,346
Stock-based compensation (note 17(e))	-	-	-	238	-	-	238
Lease termination (note 5)	-	-	-	160	-	-	160
Expiration of warrants (note 17(d))	-	-	(1)	1	-	-	-
Net loss	-	-	-	-	-	(20,997)	(20,997)
Balance, December 31, 2009	30,890,338	\$ 67,544	\$ 2,954	\$ 8,511	\$ 3,110	\$ (107,818)	(25,699)

See accompanying notes to audited consolidated financial statements.

AKELA PHARMA INC.

Consolidated Statements of Cash Flows

Years ended December 31st
(in thousands of US dollars)

Going Concern Uncertainty (note 1)

	Year ended December 31,	
	2009	2008
Cash flows from operating activities:		
Net loss	(20,997)	\$ (25,989)
Adjustments for:		
Depreciation of property and equipment	1,464	1,866
Amortization of intangible assets	1,693	2,875
Impairment of intangible and other assets (note 8)	9,601	9,635
Lease termination (note 5)	1,936	-
Provision for repayment of government grants (note 6)	1,544	-
Restructuring (note 9)	471	-
Settlement with LRI (note 7)	(101)	-
Stock-based compensation (note 10)	238	477
Unrealized foreign exchange loss	649	54
Unrealized loss on securities held for trading (note 7)	23	-
Income taxes (note 16)	64	(1,115)
Net changes in working capital (note 19 (a))	1,653	5,375
	(1,762)	(6,822)
Cash flows from financing activities:		
Repayments of long-term debt	(1,517)	(626)
Proceeds from issuance of units (note 17(b))	-	10,200
Unit issue costs (note 17(b))	-	(1,182)
	(1,517)	8,392
Cash flows from investing activities:		
Acquisition of property and equipment	(1,036)	(4,315)
Acquisition of Nventa (note 4)	1,157	-
Restricted cash (note 14)	920	(1,258)
Addition to intangible assets	-	(340)
	1,041	(5,913)
Net decrease in cash	(2,238)	(4,343)
Cash, beginning of year	2,345	6,688
Cash, end of year (note 1)	107	\$ 2,345

See accompanying notes to audited consolidated financial statements.

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1. Nature of operations, basis of presentation and going concern uncertainty

Akela Pharma Inc. (“Akela” or “the Company”) is an integrated drug development company focused on developing therapies for the inhalation and pain markets. In addition to our own product portfolio, the Company provides contract services comprised of pharmaceutical formulation research and development including specialty drug manufacturing, product development, quality control testing, analytical method development and patent litigation support.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) on a going concern basis which contemplates that Akela will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. The Company has and continues to incur significant net losses and negative cash flows from operations. The Company has funded such losses with external debt, share issuances, exclusive licensing and development agreements, government grants and working capital. As of December 31, 2009, the Company has a cash balance of \$107, net current liabilities of \$8,470, a shareholders’ deficit of \$25,699 and no operating line of credit.

An acute shortage of investor capital available for pharmaceutical development has adversely impacted the ability of the Company to obtain financing as well as the financial stability of its customer base, the credit quality of its receivables and the certainty of its revenue projections. Moreover, Akela will continue to encounter difficulty in raising additional financing from either new or existing investors until the Company significantly reduces its outstanding debt. The Company could and may also receive claims from creditors, as a number of Akela’s liability obligations are in default as at the audit report date (see notes 9, 15 and 18). As such, the realization of assets and discharge of liabilities in the ordinary course of business are subject to significant uncertainty.

These financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amount and classification of liabilities and the reported revenue and expenses that would be necessary should the Company be unable to continue as a going concern.

Akela’s ability to continue as a going concern is dependent upon, amongst other things, the successful development and marketing of its technologies, securing financing for its drug development program, the continued support and cooperation of shareholders, lenders, suppliers and the achievement of profitable operations. These endeavours are dependent on a number of circumstances outside the Company’s control, especially as it relates to financing for small biotech and specialty pharmaceutical companies. Management’s actions and plans with respect to addressing the going concern uncertainty include the following:

- a) On April 16, 2010, Akela and its wholly owned subsidiary, PharmaForm, announced that it had reached agreement with HEP Davis Spring, L.P. to terminate its lease for a planned new laboratory facility located at 9825 Spectrum Drive, Austin, Texas, eliminating \$14,481 in future lease payments to the Company. As part of the agreement, which took effect April 2, 2010, Akela released \$938 of funds from an associated cash secured letter-of-credit (see note 7), undertook to issue 1,250,000 common shares and assumed an obligation to pay the landlord in monthly installments of \$10 through March 2020 (see notes 5, 14, 15 and 17).
- b) On February 11, 2010, Akela achieved a near term development milestone in the pharmaceutical development of the Fentanyl TAIFUN® inhaler (the “Product”). The milestone achievement was related to Akela’s Fentanyl TAIFUN® license and co-development agreement with Teikoku Seiyaku Co. Ltd which was amended in June 2009 in order to advance certain milestone payments to support the continued development of the Product. Although the Company

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- achieved the milestone during the first quarter of 2010, it remains uncertain as to the timing or ability of the Company to collect the funds related to the \$1,800 development milestone. In the future should the Company receive the milestone payment, all funds will be committed to the Fentanyl TAIFUN® program.
- c) The Company, in 2010, began negotiating the sale of its contract service operations, PharmaForm. Proceeds from this disposition will be dedicated to the reduction of the Company's outstanding liabilities. Savings resulting from the reduction of overhead associated with the sale, combined with cost restructuring initiatives undertaken during 2009, will be dedicated to the continuance of operations. Any remaining funds will be utilized in the further advancement of Fentanyl TAIFUN®.
 - d) During January and May of 2010, in order to facilitate the continuance of operations until additional sources of cash are realized, certain shareholders agreed to extend a \$750 short-term, fully secured line of credit, bearing interest at 15%.
 - e) The Company has and is continuing to implement plans to reduce operational costs. In order to ensure the availability of current capital resources, the Company will attempt to issue new equity securities, issue new debt or pursue various other funding alternatives (see note 23).

Management believes that the above actions, together with the continued support and cooperation of shareholders, lenders and suppliers, the securing of additional milestone payments and other financing, and the successful sale of PharmaForm, will enable Akela to continue as a going concern. There can, however, be no assurance that the actions taken to date will result in sufficient funds being generated to enable the Company to continue as a going concern for the next twelve months. The financing environment within which the Company operates remains very challenging. Until such time as Akela's research and development efforts are commercialized or fully funded by third parties, for which no assurance can be given, the Company will continue to incur significant operating losses. Should the Company be unsuccessful in raising additional financing, it may have no choice but to seek protection from its creditors.

2. Significant accounting policies

a) *New accounting policies:*

- i) Effective January 1, 2009, the Company adopted Section 3064, *Goodwill and Intangible Assets*, replacing Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*. Various changes have been made to other sections of the CICA Handbook for consistency purposes. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The adoption of this standard did not have any impact on the Company's financial results or financial position.
- ii) On January 20, 2009 the Emerging Issues Committee ("EIC") of the Canadian Accounting Standard Board ("AcSB") issued EIC Abstract 173, *Credit Risk and Fair Value of Financial Assets and Financial Liabilities*, which establishes that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments.

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EIC 173 should be applied retrospectively without restatement of prior years to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of EIC 173 did not have any impact on the consolidated financial statements of the Company.

iii) In June 2009, the CICA amended Section 3862, *Financial Instruments – Disclosures*, to enhance disclosures about fair value measurements and liquidity risk of financial instruments. The amendment is to be applied to annual financial statements with fiscal years ending after September 30, 2009. The purpose of this amendment is to provide further convergence with International Financial Reporting Standards. Financial instruments recognized at fair value on the balance sheet must be classified in fair value hierarchy levels as follows:

- Level 1: This level includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.
- Level 2: This level includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. The instruments in this category are valued using models or other industry standard valuation techniques derived from observable market inputs.
- Level 3: This level includes valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value.

The amended Section relates to disclosure only and the Company reflected such additional disclosures under Note 19.

(b) Principles of consolidation

The consolidated financial statements include the consolidated accounts of the Company and its subsidiaries, all of which are wholly-owned. All significant intercompany balances and transactions have been eliminated on consolidation.

(c) Cash and cash equivalents

All highly liquid investments with an original maturity of three months or less are accounted for as cash equivalents. At December 31, 2009 and 2008, the Company had no cash equivalents.

(d) Property and equipment

Property and equipment are recorded at cost. Assets under capital leases are recorded at the present value of future minimum lease payments. Amortization is computed over the estimated useful lives using the straight-line method over the following periods:

Laboratory equipment	5 to 10 years
Computer equipment and software	3 to 5 years
Furniture and office equipment	3 to 7 years

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Leasehold improvements	Term of lease
Automotive equipment	5 to 7 years

(e) *Intangible assets*

The capitalized amount with respect to patents relates to direct costs incurred in connection with securing the patents. Patents are stated at cost and amortized using the straight-line method over the estimated useful lives ranging from ten to twenty years. Licenses, trademarks and intellectual property rights acquired are stated at cost and are amortized over their estimated useful lives of ten years using the straight-line method. Other intangible assets are amortized using the straight-line method over the following periods:

Customer contracts and relationships	3 years
Non competition agreement	3 years
FDA/DEA Certification	5 years

(f) *Impairment of long-lived assets and goodwill*

Long-lived assets, consisting of property and equipment and intangible assets with finite useful lives are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for long-lived assets, when the carrying amount of an asset to be held and used exceeds the sum of the undiscounted cash flows expected from its use and disposal; the impairment recognized is measured as the amount by which the carrying amount of the net asset exceeds its fair value. Fair value is the estimated value at which the asset would be bought or sold in a transaction between willing parties. The fair value against which the asset is measured may be established based on comparable information or transactions, or any other acceptable method of assessment.

Goodwill represents the excess of the cost of an acquired enterprise over the fair value of the assets acquired and liabilities assumed less any subsequent write downs for impairment. Goodwill is subject to an annual impairment test. Goodwill impairment is evaluated between annual tests upon the occurrence of certain events or circumstances. Goodwill impairment is assessed based on a comparison of the fair value of a reporting unit to the underlying carrying value of the reporting unit's net assets, including goodwill. When the carrying amount of the reporting unit exceeds its fair value, the fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of impairment, if any.

(g) *Financial instruments*

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are measured initially at fair value. Loans and receivables, investments held-to-maturity and other financial liabilities are subsequently measured at amortized cost. Held-for-trading financial investments are measured at fair value and all gains and losses are

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included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet or the losses are other than temporarily impaired..

Cash is classified as held for trading. Restricted cash and deposits are classified as held to maturity. Accounts receivable are classified as loans and receivables and accounts payable and accrued liabilities and long-term debt are classified as other financial liabilities.

The Company categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs used in their measurement:

- Level 1: This level includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.
- Level 2: This level includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. The instruments in this category are valued using models or other industry standard valuation techniques derived from observable market inputs.
- Level 3: This level includes valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value.

(h) Transaction costs

Transaction costs related to held-for-trading financial assets are expensed as incurred. Transaction costs related to other liabilities and loans and receivables are added to the carrying value of the asset or netted against the carrying value of the liability and are then recognized over the expected life of the instrument using the effective interest method.

(i) Income taxes

The Company applies the asset and liability method to account for income taxes. Under this method, future income tax assets and liabilities are determined based on the differences between the financial reporting and the tax basis of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets or liabilities are expected to be realized or settled. The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

(j) Comprehensive income

Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with GAAP.

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(k) Revenue recognition

The Company derives its revenues from licensing and co-development agreements and through providing contract services such as drug formulation, drug development and limited run drug manufacturing for pharmaceutical and biotech companies. Deferred revenues associated with co-development represent deferred license fees and payments received in advance of services being performed, milestones being reached or from final deliverables being provided. Upfront and milestone payments which require the Company's ongoing involvement are deferred and amortized into income over the estimated development period, which is reviewed periodically and adjusted on a prospective basis.

Revenue for contract services is recognized as work is performed, and amounts are earned. The timing of cash received from contract services agreements can differ from when revenue is recognized. The Company considers amounts to be earned once evidence of an arrangement has been obtained, services are delivered, fees are fixed or determinable, and collectability is reasonably assured. For contracts with fees based on time and materials, revenue is recognized over the period of performance.

For fixed price contracts, depending on the specific contractual provisions and the nature of the deliverables, revenue may be recognized as milestones are achieved or when final deliverables have been provided. At times, arrangements with customers involve multiple elements. The deliverables in each arrangement are evaluated at contract inception to determine whether they represent separate units of accounting. The total fee for the arrangement is allocated to each unit of accounting based on its relative fair value, taking into consideration any performance, cancellation or termination provisions. Fair value for each element is generally established based on the sales price charged when the same or similar services are sold separately to customers. Revenue is recognized when revenue recognition criteria for each unit of accounting is met.

Arrangements that include multiple elements are considered to be revenue arrangements with multiple deliverables. Under these arrangements, the identification of separate units of accounting is required and revenue is allocated among the separate units based on their relative fair values. Revenues for each unit of accounting are then recorded as described above.

Sales taxes collected from customers are presented on a net basis.

(l) Research and development expenses

Research and development costs (development costs did not meet the criteria for capitalization pursuant to GAAP) are expensed as incurred and include salaries, benefits and other operating costs such as outside services, supplies and allocated overhead costs. The Company performs research and development for its proprietary products and technology development and for others pursuant to collaboration agreements. For proprietary products and internal technology development programs, the Company invests its own funds without reimbursement from a third party. Costs associated with the treatment phase of clinical trials are accrued based on the total estimated cost of the clinical trials and are expensed ratably based on patient enrolment in the trials. Costs associated with the start-up and reporting phases of the clinical trials are expensed as incurred.

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Collaboration agreements typically include the development and licensing of the Company's technology. Under these agreements, the Company may be reimbursed for development costs, entitled to milestone payments when and if certain development or regulatory milestones are achieved, compensated for the manufacture and supply of clinical and commercial product and entitled to royalties on sales of commercial product. All of the Company's collaboration agreements are generally cancellable by the partner without significant financial penalty.

(m) Government assistance

Amounts received resulting from government assistance programs, including grants and investment tax credits for research and development, are reflected as a reduction of the cost of the asset or expense to which they relate at the time the eligible expenditures are incurred. Tax credits are recorded in the accounts when reasonable assurance exists that they will be realized.

(n) Foreign currency transactions

The Company adopted the US dollar as its functional and reporting currency effective January 1, 2007, as a significant portion of its revenues, expenses, assets and liabilities were as of that date denominated in US dollars. Prior to that date, the Company's operations were measured in Canadian dollars and the consolidated financial statements were expressed in Canadian dollars. All opening assets and liabilities were translated into US dollars using the exchange rate in effect on January 1, 2007. The change in the functional currency resulted in a currency translation adjustment of \$3,110 as of December 31, 2006, which is reflected in accumulated other comprehensive income, a separate component of shareholders' deficiency.

Transactions denominated in currencies other than the functional currency are measured and recorded in the functional currency using the exchange rate in effect at the date of the transaction or the average rate for the period in the case of revenue and expense transactions. Monetary assets and liabilities are revalued into the functional currency at each balance sheet date using the exchange rate in effect at that date, with any resulting exchange gains or losses being credited or charged to the consolidated statements of operations.

The foreign subsidiaries of the Company are considered to be integrated. As a result, the subsidiary accounts are translated into US dollars using the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rates in effect as the balance sheet date and any resulting foreign exchange gain or loss is reflected in the consolidated statement of operations. Non-monetary assets and liabilities are translated at historic rates. Revenue and expenses are translated at the average exchange rate during the period. Foreign exchange gains or losses are included in the consolidated statement of operations.

(o) Stock-based compensation

Employee stock options are accounted for using the fair value based method. Under this method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period using the straight line method.

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(p) *Earnings per share*

Basic earnings per share are computed by dividing net earnings by the weighted average number of common shares outstanding during the year. Diluted earnings per share are computed in a manner consistent with basic earnings per share except that the weighted average number of shares outstanding is increased to include additional shares from the assumed exercise of options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding options and warrants were exercised and that the proceeds from such exercises are used to repurchase common shares at the average share price for the reporting period.

(q) *Leases*

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risks of ownership to the lessee. Obligations under capital leases are reduced by the principle portion of lease payments. The imputed interest portion of lease payments is charged to expense. Payments required under operating leases are recorded as an expense.

(r) *Use of estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and revenue and expenses for the period reported.

Items requiring the use of significant management estimates include estimating the future cash flows for purposes of assessing the going concern assumption, the advancement of work on certain contracts for revenue recognition purposes, estimating the useful lives of long-lived assets, including property and equipment and intangible assets, estimating the fair value of assets and liabilities in connection with business acquisitions and impairments, as well as estimating stock-based compensation and the recoverability of research tax credits receivable and long-lived asset impairment assessments, future tax assets and the fair value of financial instruments. The reported amounts and note disclosures are determined to reflect the most probable set of economic conditions and planned courses of action. Actual results could differ from those estimates.

(s) *Comparative figures*

Certain comparative figures have been reclassified in order to conform with the current year's presentation.

(t) *Future accounting changes*

- i) *International Financial Reporting Standards*: The Accounting Standards Board of Canada ("AcSB") will converge Canadian GAAP for publicly accountable enterprises with International Financial Reporting Standards ("IFRS") over a transition period that will end effective January 1, 2011 for publicly accountable

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profit oriented enterprises. The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian generally accepted accounting principles, but there are significant differences in recognition, measurement and disclosure requirements. The Company will implement this standard in its first quarter of fiscal year ending December 31, 2011. The Company has not yet developed an IFRS transition plan in preparation for the changeover to IFRS.

- ii) Section 1582, *Business Combinations*: This new Section will be applicable to business combinations for which the acquisition date is on or after the Company's interim and fiscal year beginning January 1, 2011. Early adoption is permitted. The section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The Company has not yet determined the impact of the adoption of this new Section on its consolidated financial statements.
- iii) Section 1601, *Consolidated Financial Statements*: This new Section will be applicable to financial statements related to the Company's interim and fiscal year beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for the preparation of the consolidated financial statements. The Company has not yet determined the impact of the adoption of this new Section on its consolidated financial statements.
- iv) Section 1602, *Non-controlling interest*: This new Section will be applicable to financial statements related to the Company's interim and fiscal year beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company has not yet determined the impact of the adoption of this new Section on its consolidated financial statements.
- v) In December 2009, the EIC of the Accounting Standards Board issued EIC-175, *Multiple Deliverable Revenue Arrangements*, which addresses certain aspects of accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities, amending the previous guidance under EIC-142, *Revenue Arrangements with Multiple Deliverables*. The amendments require a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables using the relative selling price method, thus prohibiting the use of the residual method. EIC-175 also changes the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available.

EIC-175 may be applied prospectively and must be applied to revenue arrangements with multiple deliverables entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011. Early adoption is permitted.

The Company is currently evaluating the impact and effective date of EIC-175.

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3. Development and license agreements

In June 2007, the Company signed a licensing and development agreement with Janssen Pharmaceutical N.V. (“Janssen”), a Belgium subsidiary of Johnson & Johnson, for its lead product candidate Fentanyl TAIFUN®.

The licensing agreement covers the European Union, Eastern Europe, Russia, the Middle East and Africa. The Company and Janssen collaborate to develop the product for the initial indication of break-through cancer pain. The Company will manufacture and Janssen will market and distribute the product. Under the terms of the agreement, the Company received a signing fee of \$10,700 (€ 8,000) which has been deferred and is being recognized ratably over the estimated development period. The Company can receive up to an additional \$63,000 (€ 44,000) for meeting development, regulatory and commercial sales milestones. The Company could also receive royalty revenues and revenues from the sales of the product to Janssen. In December 2007, the Company extended the territory coverage of the initial license and development agreement to include Canada for a consideration of \$1,100 which has been deferred and is being recognized ratably over the estimated development period. In May 2008, the original agreement was amended in support of the development effort and to secure timely advancement of the Phase III clinical trials. Under the terms of the amended agreement, advanced milestone payments of \$3,700 (€ 2,500) were payable on the first local regulatory approval of the Phase III protocol and \$2,900 (€ 2,000) on the first clinical site readiness. An additional milestone of \$3,600 (€ 2,500) was due as of the inclusion of the 7th patient in the Phase III clinical study. The Company triggered the advance milestones in August, September and December of 2008. The resulting proceeds, \$10,200, have been deferred and are being recognized ratably over the estimated development period.

The Company has entered into licensing and development agreements with SK Chemicals Co. Ltd. in Korea in 2004 and Teikoku Seiyaku Co. Ltd. in Japan in 2005 for the development and registration of Fentanyl TAIFUN® in the South Korean/Chinese (excluding Taiwan and Hong Kong) and Japanese markets, respectively. Under these agreements, the Company has received signing fee of \$600 (€ 500) and is entitled to development milestone payments and reimbursements for development activities. In addition, the licensees will pay the Company royalties on sales and manufacturing revenues, if any, for supplying the finished product.

On June 17, 2009, Akela announced that it signed an amendment to its Fentanyl TAIFUN® license and co-development agreement with Teikoku Seiyaku Co. Ltd., in order to advance certain milestone payments to support the continued development of the Fentanyl TAIFUN® inhaler (the “Product”). According to the amendment to the original agreement announced in January 2006, milestone payments of up to \$2,000 would be advanced to be payable earlier than originally intended. Akela received \$200 upon signing of the amendment, and will receive \$1,800 subject to meeting a near term development milestone related to the pharmaceutical development of the Product. On February 11, 2010, this milestone was achieved. Use of the funds once and if received must be committed to the Fentanyl TAIFUN® program.

As part of the Company’s cost reduction effort in the first quarter of 2009, Akela suspended enrollment of new patients in the Fentanyl TAIFUN® program, and effective October 1, 2009, amortization of deferred license fees and milestones associated with Fentanyl TAIFUN® was revised in order to delay revenue recognition based on management’s re-assessment of projected commercialization, from May 2012 to June 30, 2016 (see note 3). Preparations for phase III efficacy trials in EU for the Fentanyl TAIFUN® program are continuing in parallel with preparations for chronic toxicology studies. Once complete, these studies will be followed by phase III safety studies prior to marketing authorization submissions. In order to sustain the continuance of the program through commercialization, the Company will need to secure additional funding (see note 1).

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4. Business acquisitions

- a) On May 21, 2009, the Company acquired all of the issued and outstanding securities of Nventa Biopharmaceuticals Corporation (“Nventa”) by way of plan of arrangement (the “Arrangement”) under the Business Corporations Act (British Columbia). The results of Nventa are consolidated from the date of acquisition.

Nventa, formerly listed on the TSX, was a biopharmaceutical company with a history of developing (i) innovative therapeutics incorporating its proprietary CoVal™ fusion technology for the treatment of viral infections and cancers, with a focus on diseases caused by the human papillomavirus (HPV) and (ii) a Toll-like Receptor 3 (TLR3) agonist for use as a vaccine adjuvant (a substance used to improve immune responses against target antigens) and as an immunotherapeutic for viral infections and cancer.

In accordance with the terms and conditions of the Arrangement, the Company issued 0.0355 Akela common shares (the “Ratio”) in exchange for every one common share of Nventa. In addition, Akela common shares are issuable pursuant to share purchase warrants and stock options of Nventa, with the number of shares and exercise prices adjusted based on the Ratio.

The acquisition was accounted for using the purchase method of accounting, and the purchase price allocation was based upon management’s best estimate of the fair values of the identifiable assets acquired and liabilities assumed at the date of acquisition as follows:

Net assets acquired:	
Cash and cash equivalents	1,369
Accounts Receivable	106
Goodwill	83
	<u>\$ 1,558</u>
Consideration:	
9,274,761 common shares	1,198
533,565 Akela stock options	7
3,430,904 Akela common share purchase warrants	141
Transaction costs	212
	<u>\$ 1,558</u>

The fair value of Akela’s common stock, stock options and share purchase warrants were determined based on the closing share price, the Black-Scholes option pricing model and exchange rates in effect on March 27, 2009, the announcement date of the Arrangement. (See also note 17 (b)).

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- b) On January 25, 2007, the Company completed the acquisition of all of the outstanding membership interests of Formulation Technologies, L.L.C. (doing business as "PharmaForm").

Under the terms of the share purchase agreement additional consideration was payable to the previous owners of PharmaForm if its gross revenues exceed \$10,000 for the 2007 calendar year. On December 31, 2007, this milestone had been achieved and shares having a value of \$4,074 were issued on March 31, 2008 ("Phase II distribution").

Future payments may be required under the purchase agreement if certain milestones are achieved ("contingent consideration"), as follows:

- (a) A payment (the Phase I Share Payment) is required to be made on when an IND application dossier is filed with the FDA for the first proprietary non-inhalation product developed by PharmaForm.
- (b) A final payment (the Phase III Share Payment) is required to be made on either (i) the date any proprietary non-inhalation product developed by PharmaForm completes the first Phase III clinical study or for which PharmaForm enters into a binding contractual arrangement with a third party, or (ii) the date of issuance to PharmaForm by the U.S. PTO of a notice that would allow PharmaForm to develop, produce and market an EDACS product candidate.

As of December 31, 2009, the maximum remaining contingent consideration payable by the Company is approximately \$9,000, most of which is payable in common shares of the Company. Any further purchase price consideration paid by the Company will be accounted for as additional goodwill. All obligations to make future payments will terminate on January 25, 2012. Each of the Phase I and III contingent payments will be made in common shares in an amount of \$4,375 plus \$100 per Phase, payable either in cash or in common shares at the option of the selling shareholders. As of December 31, 2009, the requisite product development milestones described under the terms the Phase I and III contingent payments had not been achieved.

As part of the purchase agreement, the selling shareholders have the right to sell back to the Company the common shares issued in connection with the acquisition transaction as well as any common shares issued as part of the contingent consideration in the future, should the Company fail to either have its common shares listed on the Toronto Stock Exchange ("TSX"), the NASDAQ Global Market or another US exchange within a reasonable period of time after the close date of the acquisition transaction ("put option"). Since the Company is already listed on the TSX, the Company believes that the probability of the selling shareholders obtaining the right is remote.

If Phase I or III contingent payments are made, and the Company fails to maintain its listing requirements and the put option is exercised by the holder, the contingent shares would be sold back at a price equal to the average closing price of the common shares on the primary market for the common shares for the ten trading day period ending on the last trading day immediately preceding the triggering event but subject to a minimum price equal to 70% of the closing value at date of acquisition and a maximum of 130% of the closing value at date of acquisition for the Phase I share Payment and 30% and 170% for the Phase III Share Payment.

On December 31, 2009 management determined that the carrying value of goodwill and intangibles associated with PharmaForm and Nventa would not be recoverable (see notes 8 and 12).

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5. Lease termination

On April 16, 2010, Akela and its wholly owned subsidiary, PharmaForm, announced that it had reached agreement with the landlord HEP Davis Spring, L.P. (HEP Davis Spring) to terminate our lease for a planned new laboratory facility located at 9825 Spectrum Drive, Austin, Texas, eliminating \$14,481 in future lease payment obligations to the Company. As part of the agreement, Akela released \$938 of funds from an associated cash secured letter-of-credit (see note 14), undertook to issue 1,250,000 shares of common shares, bearing a fair value of \$160, and assumed an obligation to pay HEP Davis Spring \$10 in monthly installments through March 2020, bearing a fair value of \$620 (see notes 5, 14, 15 and 17).

In addition to the consideration tendered by Akela as part of the lease termination, the Company also recorded an impairment charge of \$1,211 to deposits for tenant improvements abandoned and the reversal of \$993 of Akela's deferred rent for the lease.

The lease termination costs are summarized as follows:

	Total
Consideration tendered as part of lease termination agreement:	
Common shares to be issued (i)	160
Restricted cash on deposit (secured letter of credit)	938
Present value of obligation payable in monthly installments of \$10 through March 2020	620
	1,718
Other:	
Impairment loss on tenant improvements	1,211
Deferred rent	(993)
	218
	\$ 1,936

(i) 1,250,000 common shares, with issuance anticipated to occur during the third quarter of 2010.

The fair value of the common shares to be issued, \$160, was determined based on the closing market price as of March 31, 2010 and the Canadian, US dollar exchange rate on the effective date of the agreement, April 2, 2010.

The fair value of Akela's 10 year obligation to HEP Davis Spring was determined based on the Company's estimated current effective rate of interest, 15% (see note 15).

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6. Provision for repayment of government grants

In 2004 and 2005, the Company's Finnish subsidiary entered into certain funding arrangements with Tekes, the Finnish Funding Agency for Technology and Innovation. These arrangements provided for funding grants and loans, payable to the Company in installments, with respect to inhalation technology development. Following the Company's decision to down-size its Finnish operations in the summer of 2007, the Company was notified that this agency was reviewing loans and subsidies previously granted totaling €3,150 and €956, respectively. The agency concluded that the loans would not be collected prematurely but made a demand for repayment of the grants, together with interest. In April 2009 the Company's appeal against this decision was rejected by the Administrative Court of Turku, which concluded that Tekes had the right, by virtue of its lawful discretion, to order repayment of financing received through the grants. As a result, a charge of \$1,544, the US dollar equivalent of the grants received \$1,269 (€956), together with interest from July 2007 through March 31, 2009. On June 30, 2009 Akela announced that it had reached an agreement with Tekes to settle their demand for immediate repayment of the grants. According to the terms of the agreement, Akela will pay back the grants received plus interest, in equal quarterly installments, during a period of four years, starting in September 2010 with the last payment to occur in September 2014. As a result of this settlement, the Company's \$1,544 provision associated with Tekes' claim has been classified as long-term debt (see note 7). Upon the advice of legal counsel, the Company's estimated obligation, \$1,786 (€1,248), has been calculated as the principle amount of the original grants, €956, together with interest payable at rate of 11.5% from July 1, 2007 through December 31, 2008 and at a rate of 9.5% from January 1, 2009 thereafter. The Company continues to accrue interest on the Tekes' claim at a provisional rate of 9.5% until a formal amortization schedule is received.

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7. Settlement with LRI

On March 10, 2009, the Company agreed to accept a payment of \$2,000 Cdn (\$1,563 US) and 500,000 common share purchase warrants with an exercise price of \$0.50 Cdn (\$0.39 US) from LAB Research Inc. (LRI) as full and final settlement of its lawsuit relating to a failed Fentanyl TAIFUN® toxicology study. The fair value of the warrants together with the cash proceeds received as part of this settlement resulted in a gain of \$1,664.

The fair value of the warrants as of March 10, 2009, \$130 Cdn (\$101 US), was determined using the Black-Scholes pricing model and the following assumptions:

Warrants	
Risk-free interest rate	0.98%
Expected volatility	103.85%
Expected life in years	1.8
Expected dividend yield	-

A decline in the fair value of the warrants subsequent to the settlement resulted in an unrealized loss of \$23 on securities held for trading for the year ended December 31, 2009.

The fair value of the warrants as of December 31, 2009, \$78, has been included in prepaid and other current assets and was determined using the following Black-Scholes pricing model assumptions:

Warrants	
Risk-free interest rate	0.69%
Expected volatility	130.66%
Expected life in years	1
Expected dividend yield	-

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8. Impairment of property and equipment, goodwill, intangible and other assets

In light of the Akela's continuing significant net losses and liquidity issues, management tested the Company's long-lived assets, including goodwill, for recoverability. After determining the disposition value of the Akela's long-lived assets, management concluded that the carrying value of goodwill and intangibles associated with PharmaForm and Nventa would not be recoverable. (See note 1). An impairment of goodwill and intangibles resulted in a charge of \$9,601 for the year ended December 31, 2009 as follows:

	2009			
	Cost	Accumulated amortization	Impairment	Net carrying amount
Goodwill	\$ 6,540	\$ -	6,540	-
Intellectual property rights acquired	3,600	1,050	2,550	-
Customer contracts and relationships	2,000	1,945	55	-
Non-competition agreement	1,400	1,361	39	-
FDA/DEA certifications	1,000	583	417	-
	\$ 14,540	\$ 4,939	\$ 9,601	\$ -

In 2008, given the Company's cost of capital, limited availability of liquid resources and the continued and additional financing required, the availability of which was uncertain, to sustain Akela's development programs, management determined that the carrying value of certain assets would not be recoverable as of December 31, 2008. An impairment of intangible and other long-term assets associated with Fentanyl TAIFUN® and Akela's phase II product candidates, principally CGRP, resulted in charges of \$5,947 and \$3,688, respectively. As part of the Company's cost reduction effort announced in February 2009, management decided to continue the Fentanyl TAIFUN® program with focused scope by limiting the size and the number of clinical trial sites. The Company gave notice of its intent to terminate its licensing agreement to CGRP, and the GHRH program has been placed on hold until an out-licensing agreement or program specific financing is secured. (See notes 1, 11 and 12).

	2008			
	Cost	Accumulated amortization	Impairment	Net carrying amount
Intellectual property rights acquired	\$ 9,591	\$ 3,327	\$ 3,354	2,910
Licenses	3,484	1,507	1,977	-
Patents	2,136	347	1,789	-
Trademarks	18	14	4	-
Other assets (1)	3,908	-	2,511	1,397
	\$ 19,137	\$ 5,195	\$ 9,635	\$ 4,307

(1) Deposits for the development of commercial Fentanyl Taifun® injection moulds. (See note 13).

The Company's 2008 impairment charge triggered the recovery of \$935 in deferred tax liabilities associated with the carrying value of intellectual property (see note 16).

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9. Restructuring

In February and September of 2009, the Company undertook measures to reduce costs in order to preserve cash for operations. During 2009, the Company recorded a net charge of \$1,071 as part of this initiative. In addition to a provision of \$849 for employee severance and various non-recoverable costs associated with product development and an abandoned enterprise resource planning (ERP) system, restructuring also includes the following items:

- \$456 in gains resulting from Akela's negotiation of settlement plans to repay current liabilities associated with the Company's product development program during the 2nd and 3rd quarter of 2009, which were subsequently reversed during the 4th quarter of 2009 when the Company failed to respect its payment obligations under these arrangements¹,
- and a \$222 impairment loss on property and equipment associated with the Company's international subsidiaries, which were closed as part of the restructuring effort during the fourth quarter of 2009. (See also note 23).

At December 31, 2009, \$249 of accrued restructuring charges remained unpaid and are included in "Accounts payable and accrued liabilities" on the consolidated balance sheet.

	Total
Balance, December 31, 2008	\$ -
Provision for cost reduction plan:	
Employee severance	390
Impairment of property and equipment (P&E) associated with the Company's international subsidia	222
Termination of license agreement to CGRP, a former non-pain product candidate	79
Legal costs associated with dissolution of international subsidiaries	21
Costs associated with the development of ERP and business software	200
Costs associated with the development of commercial Taifun® injection moulds	159
Gains on settlement plans to repay current obligations for product development	(456)
Reversal of gains, failure to respect settlement plans with vendors (1)	456
	1,071
Noncash Items:	
Impairment loss on P&E	(222)
Utilized in 2009:	
Cash	(600)
Balance, December 31, 2009	\$ 249

¹ A number of the Company's payment obligations are in default as at the audit report date (see notes 1, 15 and 18).

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10. Accounts receivable

	2009	2008
Trade	\$ 1,576	\$ 5,875
Sales taxes	79	62
Other	24	133
	\$ 1,679	\$ 6,070

11. Property and equipment

	2009		
	Cost	Accumulated amortization	Net carrying amount
Laboratory equipment	\$ 5,023	\$ 1,774	\$ 3,249
Computer equipment and software	407	215	192
Furniture and office equipment	452	169	283
Leasehold improvements	2,312	1,819	493
	\$ 8,194	\$ 3,977	\$ 4,217

	2008		
	Cost	Accumulated amortization	Net carrying amount
Laboratory equipment	\$ 4,552	\$ 998	\$ 3,554
Computer equipment and software	935	625	310
Furniture and office equipment	477	137	340
Leasehold improvements	2,321	1,365	956
Automotive equipment	152	83	69
	\$ 8,437	\$ 3,208	\$ 5,229

Depreciation expense related to assets under capital leases was \$228 (2008-\$127). During 2008, \$3,808 of fully depreciated manufacturing equipment associated with the Company's Finnish subsidiary was written off.

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As of December 31, 2009 and 2008, the cost, accumulated amortization and net carrying value of laboratory equipment under capital leases was as follows:

	2009		2008	
Cost	\$	1,681	\$	1,209
Accumulated amortization		(342)		(148)
	\$	1,339	\$	1,061

12. Intangible assets

	2009			
	Cost	Accumulated amortization	Impairment (i)	Net carrying amount
Intellectual property rights acquired	\$ 3,600	\$ 1,050	\$ 2,550	-
Customer contracts and relationships	2,000	1,945	55	-
Non-competition agreement	1,400	1,361	39	-
FDA/DEA certifications	1,000	583	417	-
	\$ 8,000	\$ 4,939	\$ 3,061	\$ -

	2008			
	Cost	Accumulated amortization	Impairment (i)	Net carrying amount
Intellectual property rights acquired	\$ 9,591	\$ 3,327	\$ 3,354	2,910
Licenses	3,484	1,507	1,977	-
Customer contracts and relationships	2,000	1,278	-	722
Patents	2,136	347	1,789	-
Non-competition agreement	1,400	894	-	506
FDA/DEA certifications	1,000	383	-	617
Trademarks	18	14	4	-
	\$ 19,629	\$ 7,750	\$ 7,124	\$ 4,755

(i) See note 8.

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13. Other assets

	2009	2008
Deposits for leases, laboratory equipment and tenant improvements	\$ 598	\$ 1,397
	\$ 598	\$ 1,397

At December 31, 2009 management determined that the carrying value of deposits for tenant improvements associated with the expansion of a new laboratory facility in Austin, Texas would not be recoverable, as the lease for the site was being abandoned. (See note 5).

During 2008 management determined that the carrying value of certain deposits for the development of commercial TAIFUN® injection moulds would not be recoverable, and the Company recorded an impairment charge of \$2,511 to write down these deposits. (See note 8).

14. Restricted cash and deposits

Restricted cash as of December 31, 2009 consists of a \$938 cash deposit required as security for a 15 year office lease commencing on November 1, 2008 for the Company's new laboratory facility in Austin, Texas. On April 2, 2010 Akela surrendered this cash to the landlord, HEP Davis Spring, L.P. (HEP Davis Spring), as part of an agreement to terminate this lease (see note 5).

Restricted cash and deposits as of December 31, 2008 consists of a \$600 certificate of deposit pledged as collateral on a \$1,200 term loan which the Company repaid in December 2009 (see note 15) and a \$1,258 cash deposit required as security for the HEP Davis Spring office lease in Austin, Texas which the Company terminated on April 2, 2010. During 2009, \$320 of the amounts on deposit as security for the HEP Davis Spring lease was drawn to satisfy current lease payments.

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15. Long-term debt

	2009	2008
Repayment of grants by the Company's Finnish subsidiary in Euros (€1,190) bearing a current estimated provisional interest of 9.5%. According to the terms of the Company's settlement agreement with the lender, Akela will pay back the grants received plus interest, in equal quarterly installments during a period of four years, starting in September 2010 with the last payment to occur in September 2014. (See note 6).	\$ 1,786	\$ -
Capital loans of the Company's Finnish subsidiary in Euros (2009 - €2,539 ; 2008 - €2,539) bearing interest at the basic rate of interest of the Bank of Finland less 1%, with a minimum interest rate of 3%. The term of the loans are eight years to February 2013 with no capital repayments in the first five years; interest or other remuneration are conditional on specified equity requirements in the Company's Finnish subsidiary. For the years ended December 31, 2009 and 2008 no interest was payable on this unsecured debt.	3,632	3,542
Capital loans of the Company's Finnish subsidiary in Euros (2009 - €188; 2008 - €188) bearing interest at 5%; interest or other remuneration are conditional on specified equity requirements in the Company's Finnish subsidiary. For the years ended December 31, 2009 and 2008 no interest was payable on this unsecured debt.	270	263
Note payable of the Company's Finnish subsidiary in Euros (2009 - €464; 2008 - €494) bearing interest at the basic rate of interest of the Bank of Finland less 3%, with a minimum interest rate of 1%. The term of the loan is eight years to December 2013. The Company agreed to repay \$210 (€147) of the loan balance during the third quarter of 2009 with capital repayments beginning in 2011. During the fourth quarter of 2009, the Company failed to fulfill its commitment to repay the \$210 (€147) loan balance of this note. At December 31, 2009, the effective interest rate on this unsecured debt was 1.75%.	664	689
Balance carried forward	6,352	4,494

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Balance carried forward	6,352	4,494
	2009	2008
Balance brought forward	6,352	4,494
Note payable, bearing 8.75% interest, repayable over 60 months to May 2012, secured by a 1 st lien on accounts receivable and property and equipment and by \$600 of restricted cash (see note 14). At December 31, 2008 the current and debt coverage ratios required as part of Akela's covenant with the lender were not achieved. In December 2009 this note was repaid in full.	-	874
Present value of \$1,200 payable in monthly installments of \$10 through March 2020 pursuant to lease termination agreement. See note 5.	620	-
Capital lease obligations of Akela's subsidiary, PharmaForm, bearing interest from 6% to 10.11%, secured by related laboratory equipment.	649	819
Auto loan of the Company's Indian subsidiary bearing 8.5% interest	9	18
	7,630	6,205
Current portion of long-term debt	1,015	1,311
	\$ 6,615	\$ 4,894

Long-term debt repayments for the next five years are as follows:

	Capital leases			Other Long-term	Total
	Gross payments	Imputed interest	Present value		
2010	\$ 537	\$ (32)	\$ 505	\$ 510	\$ 1,015
2011	146	(2)	144	729	873
2012	-	-	-	697	697
2013	-	-	-	623	623
2014	-	-	-	330	330
Thereafter	-	-	-	4,092	4,092
	\$ 683	\$ (34)	\$ 649	\$ 6,981	\$ 7,630

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16. Income taxes

The income tax provision (recovery) differs from the amount computed by applying the combined Canadian federal and Quebec tax rates to earnings before income taxes. The reasons for the difference and the related tax effects are as follows:

	2009	2008
Loss before income taxes	(20,933)	(27,103)
Combined Canadian federal and Quebec provincial income taxes at 30.9% (2008 - 30.9%)	(6,468)	(8,375)
Adjustments for:		
Difference with foreign tax rates	192	772
Foreign exchange	(2,651)	1,834
Tax rates variation	433	1,455
Adjustment to opening timing difference	(303)	-
Change in valuation allowance and benefit of losses not recorded	8,719	3,752
Stock-based compensation	70	156
Permanent differences and other	72	(709)
Income tax (recovery) provision	\$ 64	\$ (1,115)

The provision (recovery of) for income taxes comprised of the following:

	2009	2008
Current income taxes	\$ 64	\$ -
Future income taxes	-	(1,115)
	\$ 64	\$ (1,115)

Beginning in 2008 and continuing through 2010, the Company has been undergoing a normal course audit by the Canadian Revenue Agency (the CRA) for the years 2005 and 2006. As a result of the audit, which is not yet complete, and based on management's best estimate of the outcome, a provision for the potential refund of investments tax credits received in prior years from the Québec taxation authorities has been recorded. The provision has been recorded as part of the accounts payable with a corresponding charge to research and development. In addition, the current year's income tax expense is composed of additional uncertain tax positions identified as part of the audit and which may result in income tax payable.

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The income taxes payable is comprised of managements best estimate of provision required for uncertain tax positions taken in prior years.

During 2008, the Company's impairment of intangibles and other assets triggered the recovery of \$935 in deferred tax liabilities associated with the carrying value of intellectual property (see notes 8 and 12).

The future income tax balances are summarized as follows:

	2009	2008
Future income tax assets:		
Non-capital losses	\$ 29,156	\$ 22,621
Share issue costs	329	478
Research and development expenses	5,630	4,858
Property and equipment	47	-
Provision bad debts	45	-
Intangible assets	489	519
Deferred revenues	5,363	5,436
Other	800	639
	41,859	34,551
Future income tax liabilities:		
Unrealized foreign exchange gain	(1,502)	(2,554)
	(1,502)	(2,554)
Less valuation allowance	(40,357)	(31,997)
Net future income tax liabilities	\$ -	\$ -

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The Company has accumulated scientific research and experimental expenditures and non-capital losses which are available to reduce future years' taxable income. Details of the available deductions, before valuation allowance, are as follows:

	Federal	Provincial	Foreign
Scientific research and experimental expenditures:			
Available indefinitely	\$ 20,930	\$ -	\$ -
Non-capital losses expiring:			
2012	-	-	2,614
2013	-	-	6,912
2014	1,528	1,531	5,145
2015	5,119	5,118	9,085
2016	-	-	16,517
2017	-	-	9,251
2018	-	-	5,124
2019	-	-	3,344
2026	-	-	420
2027	2,740	2,726	7,732
2028	3,715	3,715	13,658
2029	10,826	10,826	8,611

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17. Shareholders' deficiency

(a) Capital stock consists of an unlimited number of preference and common shares:

(i) Preference shares

The preference shares may be issued in one or more series, each series to consist of such number of shares as may, before the issue thereof, be fixed by resolution of our board of directors. The directors shall determine before the issue thereof the designations, rights, privileges, restrictions and conditions attaching to the preference shares of each series including the rate or amount of dividends or the method of calculating dividends, the dates of payment thereof, the redemption and/or purchase prices and terms and conditions of redemption and/or purchase, any voting rights, any conversion rights and any sinking fund or other provisions.

The preference shares of each series will, with respect to payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up, rank on a parity with the preference shares of every other series and be entitled to preference over our Common Shares and over any other shares ranking junior to the preference shares. The preference shares of any series may also be given such other preferences over our common shares and over any other shares ranking junior to the preference shares as may be fixed by our directors.

(ii) Common shares

The holders of Common Shares are entitled: (a) to vote at all meetings of shareholders except meetings at which only holders of a specified class of shares are entitled to vote; (b) to receive dividends as and when declared by our board of directors out of moneys properly applicable thereto subject to the rights of the holders of the preference shares; and (c) to receive our remaining property upon our dissolution, subject to the rights of the holders of the preference shares.

(b) Issuance of common shares, warrants and options:

(i) 2009 issuances

On May 21, 2009, the Company issued 3,430,904 purchase warrants, 9,274,761 common shares and 533,565 stock options as consideration for all of the issued and outstanding shares of Nventa Biopharmaceuticals Corporation ("Nventa"). (See note 4). The fair value of Akela's common stock, stock options and share purchase warrants was determined based on the closing share price, foreign exchange rates and the following weighted average Black-Scholes pricing model assumptions in effect on March 27, 2009, the announcement date of the Arrangement.

	Purchase Warrants	Stock Options
	(Weighted Average)	
Strike price (Cdn)	\$ 7.11	\$ 5.21
Risk-free interest rate	1.10%	0.66%
Expected volatility	190.36%	191.77%
Expected life in years	1.96	1.16

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The warrants and options issued as a result of the Nventa acquisition have been included in the tables below.

(ii) 2008 issuances

On March 27, 2008, the Company concluded a public offering of 8,625,000 units, each unit consisting of one common share and one-half of one common share purchase warrant, for aggregate proceeds of \$10,200 (Cdn \$10,350). The proceeds of the units offering were allocated based on the relative fair value of the common shares, \$8,045 (Cdn \$8,164), and common share purchase warrants, \$2,155 (Cdn \$2,186), using the Black-Scholes pricing model at the date of grant. Each whole warrant is exercisable to purchase one common share at a price of Cdn \$1.50 per share and expires three years from the closing date subject to the Company's right to accelerate the expiry date of the warrants in certain events.

As compensation for the offering, the Company granted the underwriters common share purchase warrants (Compensation Options) bearing a fair value of \$295 (Cdn \$299). Each Compensation Option is exercisable to purchase 603,750 common shares at a price of Cdn \$1.20 per share that expires two years from the closing date.

Expenses in connection with the offering were approximately \$1,477 (Cdn \$1,499), which includes the fair value of the Compensation Options, \$295, and \$1,182 for underwriters' fees (\$714), legal and other offering costs (\$468).

The fair value of the common share purchase warrants and compensation options was determined using the following Black-Scholes pricing model assumptions:

	Purchase Warrants	Compensation Options
Strike price (Cdn)	\$ 1.50	\$ 1.20
Risk-free interest rate	2.64%	2.57%
Expected volatility	71.03%	73.76%
Expected life in years	3	2

On March 31, 2008, the Company issued 1,222,283 shares of common stock to the former owners of PharmaForm as consideration for meeting a gross revenue milestone as of December 31, 2007. This \$4,074 Phase II distribution of common shares was recorded as a reclassification from additional paid in capital. (See note 4).

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(c) Stock option plans

The Company's stock option plans (the "Plans") are designed to attract, retain and motivate directors, officers, employees and consultants of the Company and to advance the interests of the Company by providing such persons with the opportunity to participate in the long-term growth of the Company. The Plans are administered by the Company's board of directors and, subject to the provisions of the Plan, the number of shares subject to each option, the option price, the expiration date of each option, the extent to which options are exercisable from time to time and the terms and conditions relating to each such option shall be determined by the board of directors.

Under the Company's 2002 Stock Incentive Plan, the aggregate number of common shares available for issuance is 10% of the common shares outstanding. The number of common shares, which may be issued to any one person, shall not exceed 5% of the Company's common shares on a non-diluted basis. The exercise price of the stock options granted must not be less than the most recent quoted closing market price per share. Options are granted for a term not exceeding ten years. In general, options vest over periods of up to three years. Effective June 2007, no further options can be granted under the 2002 Stock Option Plan.

In June 2007, the shareholders approved the 2007 Stock Incentive Plan. Under the 2007 Stock Incentive Plan, the aggregate number of common shares available for issuance is 714,285. The maximum number of common shares that may be awarded to any one grantee during any calendar year cannot exceed 71,428. In addition, the number of common shares issuable to insiders, at any time or in any given year, under all security based compensation arrangements, cannot exceed 10% of the issued and outstanding common shares.

The Company may also issue restricted and unrestricted stock awards at a price that may be less than fair market value, subject to restrictions and conditions, if applicable, as the administrator may determine at the time of the grant. No such stock awards have been issued by the Company.

As of December 31, 2009, 524,585 options remained available for issuance under the Company's stock option plans.

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Changes in outstanding options issued under the Company's stock option plans for the years ended December 31, 2009 and 2008, were as follows:

	Number	Weighted Average Exercise Price (CDN \$'s)
Balance, December 31, 2007	1,126,393	7.43
Granted	478,000	1.19
Balance, December 31, 2008	1,604,393	5.57
Granted	713,565	3.88
Cancelled	(1,589,393)	5.49
Expired	(170,510)	6.04
Balance, December 31, 2009	558,055	\$ 3.49
Options exercisable, December 31, 2009	396,113	\$ 4.27

Range of exercise prices (CDN)	Options outstanding	Weighted average exercise price (CDN)	Options exercisable	Weighted average exercise price (CDN)	Weighted average remaining contractual life (years)
\$22.26 - 73.24	6,212	\$ 73.24	6,212	\$ 73.24	0.39
\$12.01 - 22.25	8,875	\$ 22.25	8,875	\$ 22.25	0.39
\$6.51 - 12.00	5,000	\$ 6.86	5,000	\$ 6.86	7.33
\$3.76 - 6.50	17,750	\$ 3.94	17,750	\$ 3.94	0.39
\$3.01 - 3.75	243,776	\$ 3.24	231,417	\$ 3.24	0.78
\$2.26 - 3.00	79,342	\$ 2.39	49,759	\$ 2.39	0.58
\$1.51 - 2.25	7,100	\$ 2.25	7,100	\$ 2.25	0.39
\$1.01 - 1.50	120,000	\$ 1.38	30,000	\$ 1.38	8.28
\$0.61 - 1.00	40,000	\$ 0.61	10,000	\$ 0.61	8.84
\$0.15 - 0.60	30,000	\$ 0.15	30,000	\$ 0.15	3.09
\$0.15 - 73.24	558,055	\$ 3.49	396,113	\$ 4.27	1.74

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(d) Warrants and broker units

As of December 31, 2009, the following warrants were outstanding:

Warrants		Common share equivalents	Exercise price (CDN)	Expiration Date
Number	Fair value at issuance (USD)			
1,223,124	8	1,223,124	\$ 7.04	February 22, 2010 (1)
603,750	295	603,750	\$ 1.20	March 28, 2010
1	364	252,898	\$ 8.96	April 22, 2010
111,410	4	111,410	\$ 14.08	November 1, 2010 (1)
4,312,500	2,155	4,312,500	\$ 1.50	March 28, 2011
941,725	49	941,725	\$ 7.04	January 4, 2012 (1)
974,533	79	974,533	\$ 7.04	January 24, 2012 (1)
8,167,043	\$ 2,954	8,419,940		

(1) Issued in connection with the acquisition of Nventa. See note 4.

In August 2009, 180,112 stock purchase warrants originally issued as part of the Nventa acquisition expired, and the fair value of these expirations, \$1, was reclassified to additional paid in capital.

(e) Stock-based compensation

For the year ended December 31, 2009, the Company granted 713,565 (2008 – 478,000) options. The Company recognized total stock-based compensation of \$238 (2008 – \$477).

The weighed average fair value of each option granted is estimated on the date of grant using the Black-Scholes pricing model with the following weighted average assumptions:

	2009	2008
Risk-free interest rate	0.97%	3.02%
Expected volatility	188.45%	79.17%
Expected life in years	1.81	6.00
Expected dividend yield	-	-

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The following table summarizes the weighted average grant-date fair value per share for options granted during the years ended December 31, 2009 and 2008:

	Number of options	Weighted average grant-date fair value (CDN \$'s)
2009	713,565	0.05
2008	478,000	0.81

Dividend yield was excluded from the calculation since it is the present policy of the Company to retain all earnings to finance operations.

(f) Earnings per share

Because the Company incurred losses in 2009 and 2008, the earnings per share impact of stock options, warrants and convertible debentures is considered anti-dilutive and have therefore been excluded.

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18. Commitments, contingencies and guarantees

(a) Commitments:

The annualized aggregate maturities of the Company's contractual obligations are as follows:

	2010	2011	2012	2013	2014	2015+	Total
Operating leases	757	623	-	-	-		\$ 1,380
Capital leases *	537	146	-	-	-	-	683
Service contracts	560	560	47	-	-	-	1,167
Long-term debt *	704	910	852	746	404	4,508	8,124
	2,558	2,239	899	746	404	4,508	\$ 11,354

* Long-term debt and capital leases include principal and related interest.

The Company is party to license agreements with Auxilium Pharmaceutical, Inc. ("Auxilium") granting Auxilium an exclusive, worldwide royalty-bearing license to develop, make and sell products that contain oral transmucosal film technology for which there is an issued patent in the United States. The terms of these license agreements are for the life of the licensed patents.

To increase the speed of the development of products using the licensed technology, Auxilium entered into a research and development agreement with PharmaForm, on a fee-for-service basis. Auxilium will be the sole owner of any intellectual property rights developed in connection with this agreement.

The intellectual rights associated with this agreement are based on sublicense agreements with the University of Mississippi and the University of Texas. In the event that the University of Mississippi or the University of Texas license agreements are terminated during the term of the Auxilium agreement, PharmaForm shall pay to Auxilium one-half of all direct expenses and costs Auxilium has incurred relating to the research and development of the compounds, technology, or products pursued under the Agreement which exceed the cumulative gross profit earned by Auxilium on such products, as of the date of the termination of such agreement. With respect to each of the University of Mississippi sublicense agreement, the right to terminate for convenience may only be exercised by all inventors as a group. One of the Company's board members is an inventor. The University of Texas license agreement may only be terminated for convenience by mutual agreement of the parties thereto. As of December 31, 2009, the minimum amount of this contingency is \$2.3 million, representing one-half of amounts received by the Company from Auxilium, and is subject to upward adjustment for any additional amounts incurred by Auxilium on this project. The Company has not recorded a liability with respect to this guarantee as the Company does not expect to make any payments for this item and the standby liability is nominal.

The Company is party to a royalty bearing license for a drug delivery system in which it is required to pay 75% of any sublicense fees received by the Company to the licensors. The Company's sublicense to Auxilium is subject to these agreements.

In May 2008, Akela's original license and development agreement with Janssen for Fentanyl TAIFUN® was amended to secure advanced milestones of €2.5 million on the first local regulatory approval of the Phase III protocol and €2.0 million on clinical site readiness. As part of this agreement, Akela agreed to use the funds to prepare and conduct the Phase III clinical and long-term toxicology studies and finance other project critical expenses. Failure to comply with these conditions would result in an obligation to refund all of the funds to

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Janssen. The Company triggered the advance milestones in August and September 2008 and the resulting proceeds were dedicated to the Fentanyl program under the supervision of the Joint Development Team (JDT) which is comprised of six members; three representatives of Akela and three representatives of Janssen. As the advanced milestones were invested to sustain the clinical program and timely progress toward the development of Fentanyl TAIFUN® from the date of the amendment (May 23, 2008) through December 31, 2009, the Company believes it has complied with the terms of the advance milestones.

In June 2009, Akela's license and co-development agreement with Teikoku Seiyaku Co. Ltd for Fentanyl TAIFUN® was amended to secure advanced milestones of up to \$2,000 to support the continued development of the Fentanyl TAIFUN® inhaler (the "Product"). As part of this agreement, Akela agreed to use the funds to prepare and conduct the Phase III clinical and long-term toxicology studies, set up commercial manufacturing operations for the Product including investments in manufacturing equipment, conduct necessary pharmaceutical development activities, including the development of the inhaler and stability studies, and finance other project critical expenses, exclusively for the Product. Akela received \$200 upon signing of the amendment and will receive \$1,800 subject to meeting a near term development milestones related to the development of the Product. On February 11, 2010, this milestone was achieved. Although the Company achieved the milestone during the first quarter of 2010, it remains uncertain as to the timing or ability of the Company to collect the funds related to the \$1,800 development milestone. In the future should the Company receive the milestone payment, all funds will be committed to the Fentanyl TAIFUN® program. As use of the \$200 received to date has been dedicated to the development of the Product in accordance with the terms of the amended agreement, the Company has not recorded a liability with respect to this guarantee.

(b) Contingencies:

In February 2010, Akela and its wholly owned subsidiary, PharmaForm, announced the outcomes of two legal cases involving former employees, Michael Crowley and Stephen Lerner. In Michael Crowley vs. Formulation Technologies, LLC doing business as ("d/b/a/") PharmaForm, the arbitrator found in favor of Mr. Crowley. As a result, Mr. Crowley has been awarded \$325 for payment under Mr. Crowley's employment agreement, commissions and vacation accruals earned over his employment period, partial payment of Mr. Crowley's legal fees and Mr. Crowley's out-of-pocket expenses. In the separate matter of Lerner vs. Akela Pharma Inc. and Formulation Technologies, LLC d/b/a/ PharmaForm, a jury sided with Mr. Lerner and awarded him \$189 in severance pay and approximately \$47 in vacation pay earned during the period which he was employed by the company in addition to out of pocket legal expenses. The judgment was solely against Akela Pharma. After reviewing the evidence and hearing the arguments of counsel, the District Court of Travis County, Texas denied the jury's award of severance in the Lerner suit, and on May 11, 2010, the court issued a final verdict awarding Mr. Lerner unused vacation pay and out of pocket legal expenses. Akela's provisions for losses on these legal actions, totaling \$485, have been recorded in accounts payable and accrued liabilities as of December 31, 2009.

The Company and certain board members have also been named as defendants in actions filed in the District Court of Travis County, Texas by two former employees; Andrew Reiter and Robert Clayborough. The actions claim actual and compensatory damages in an unspecified amount, costs and other relief in connection with the termination of employment. While the results of litigation cannot be predicted with certainty, the Company does not expect the ultimate conclusion of these matters will have a material adverse effect on the Company's

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consolidated financial statements. Provisions have been recorded for the amounts the Company may be required to pay to settle these litigation matters.

In addition to executive employment termination litigation resulting from recent organizational changes at Akela, the Company also faces claims from creditors for unpaid services and supplies, as a number of Akela's liability obligations are in default as at the audit report date (see notes 9 and 15). One of the Company's creditors, Blaschko Computers has asserted a breach of contract claim against PharmaForm related to the termination of a business software system during the fourth quarter of 2009 (see note 9). While the outcome of these claims cannot be predicted with certainty the Company does not anticipate that these pending legal matters will have a material adverse effect on the Company's financial condition. The amounts payable under such claims have been recorded in accounts payable and accrued liabilities as of December 31, 2009.

(c) Guarantees:

The Company has entered into a number of standard indemnification agreements in the ordinary course of its business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, who are generally the Company's business partners or customers. The Company agrees to indemnify for claims, demands or judgments that arise out of negligence or misconduct of the Company, or act of alleged infringement of intellectual property by any third-party with respect to the Company's activities under the agreement. At December 31, 2009 and 2008, the Company has not recorded a liability with respect to these guarantees as the Company is not aware of any such claim and does not expect to make any payments for the aforementioned items and the standby liability is nominal.

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19. Supplemental cash flow disclosure and other information

(a) Net changes in operating assets and liabilities:

	2009	2008
Accounts receivable	\$ 4,497	\$ (1,264)
Prepaid expenses	7	116
Accounts payable and accrued liabilities	505	(1,404)
Deferred revenue	(3,356)	8,038
	\$ 1,653	\$ 5,486

(b) Cash paid for:

	2009	2008
Interest	\$ 126	\$ 135

(c) Non-cash transactions:

	2009	2008
Issuance of common shares, options and warrants in connection with the acquisition of Nventa (note 4(a))	\$ 1,346	\$ -
Issuance of warrants to underwriters as compensation for March 27, 2008 public offering (note 17(b))	-	295
Property and equipment financed through capital leases	423	712

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20. Related party transactions

During 2009 and 2008, the Company incurred legal and tax consulting fees totaling \$73 and \$201, respectively, for legal services provided by Knorr Rechtsanwälte, a firm associated with Dr. Günter Knorr, the Company's former Chairman of the Board. This related party relationship was terminated in 2009.

During 2009 and 2008, the Company also incurred nil and \$71 in expenses for IT consulting services provided by Guardus Corporation, firm a owned by Dr. Halvor Jaeger, the Company's former Chief Executive Officer (CEO). This related party relationship was terminated in 2009.

In addition, during 2009 and 2008, the Company incurred expenses of \$114 and \$307, respectively, for management services provided by PRI International Consulting Inc., a company directly controlled by Dr. Jaeger. This related party relationship was terminated in 2009.

During 2009 and 2008, the Company incurred expenses totaling \$560 and \$632 for consulting services paid to three current shareholders and the former principal owners and founders of PharmaForm. One of these shareholders is Robert O. Williams III, Ph.D., a member of the Board of Directors. As of December 31, 2009, accounts payable includes a \$93 outstanding liability to these shareholders for previously rendered consulting services.

In addition, during 2009 the Company incurred \$53 in expenses for financial consulting services performed by Charlestown Capital Advisors, LLC, a private investment company founded and managed by Raj Maheshwari, a former board member of the Company. This related party relationship was terminated in 2009.

With the exception of the previously mentioned consulting services provided by Dr. Williams, all related party transactions with board members of the Company ceased with the appointment of a new Board of Directors which took effect in June 2009.

These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by the related parties.

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21. Financial instruments

(a) *Classification:*

The classification of financial instruments as of December 31, 2009 and 2008 and their respective carrying values and fair values are as follows:

December 31, 2009	Held-for-trading	Loans and receivables	Held-to-maturity	Other financial liabilities	Carrying value	Fair value
Cash	\$ 107				\$ 107	\$ 107
Accounts receivable		1,679			1,679	1,679
Restricted cash and deposits			938		938	938
Accounts payable and accrued liabilities				7,801	7,801	7,801
Long-term debt				7,630	7,630	3,358

December 31, 2008	Held-for-trading	Loans and receivables	Held-to-maturity	Other financial liabilities	Carrying value	Fair value
Cash	\$ 2,345				\$ 2,345	\$ 2,345
Accounts receivable		6,070			6,070	6,070
Restricted cash and deposits			1,858		1,858	1,858
Accounts payable and accrued liabilities				7,307	7,307	7,307
Long-term debt				6,205	6,205	2,110

(b) *Fair value:*

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. In the absence of quoted prices in active markets, considerable judgment is required in estimating fair value. Estimates are not necessarily indicative of the amounts the Company could be realized in a current market transaction. The following methods and assumptions were used to estimate fair values:

(i) *Held-for-trading*

Cash – Cash is classified as “held for trading” due to its short-term nature and the fact that it must be readily available to finance the Company’s operations. The carrying value is therefore considered a reasonable approximation of fair value.

(ii) *Loans and receivables*

Accounts receivable– Due to their short-term nature, the carrying values of accounts receivable and restricted cash is considered a reasonable approximation of fair value.

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(iii) Held to maturity

Restricted cash and deposits – Restricted cash and deposits are classified as “held to maturity” as these are cash deposits which have been pledged as collateral and security on certain debt and leases which have fixed maturities. Due to its inherent liquidity and the fact that it must be available to finance the Company’s operations, the carrying value is considered a reasonable approximation fair value.

(vi) Other financial liabilities

Accounts payable, accrued liabilities and long-term debt – Accounts payable and accrued liabilities are measured at amortized cost which approximates fair value due to their short-term nature. The fair value of long-term debt is estimated based on discounted cash flows using year-end market yields or the market value of similar instruments with the same maturity, or quoted market prices when available. Due to the judgment used in applying a wide range of acceptable techniques and estimates in calculating fair value amounts, fair values are not necessarily comparable among financial institutions or other market participants and may not be realized in an actual sale or the immediate settlement of the instrument.

As of December 31, 2009 and 2008, the carrying amount of financial assets that the Company has pledged as collateral for long-term debt facilities was approximately nil and \$9.5 million, respectively.

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22. Financial risk management

The following is a discussion of the Company's exposure to and management of risks arising from financial instruments, including credit risk, foreign currency risk, interest rate risk, and liquidity risk.

(a) Credit risk

Credit risk results from the possibility that a loss may occur from the failure of another party to perform according to the terms of the contract. Financial instruments that potentially subject the Company to credit risk consist primarily of cash, restricted cash, deposits and accounts receivable. Cash and restricted cash are maintained with a high credit quality financial institution. For accounts receivable, the Company performs periodic credit evaluations and typically does not require collateral. Provisions are recognized, if necessary, in order to reflect risks related to bad debts. During the years ended December 31, 2009 and 2008, the Company wrote off nil and \$100 of receivables and recorded a provision of \$470 and \$150 was recorded as a result of this evaluation. The carrying amount of cash, restricted cash and trade accounts receivable represents the Company's maximum credit exposure.

For the year ended December 31, 2009 and 2008, one customer accounted for approximately 22% and 14%, respectively, of the Company's revenues. As of December 31, 2009, two customers accounted for approximately 24% of the Company's receivables (2008 – 57%).

The following table sets forth details of the age of receivables:

	As of December 31, 2009
Total accounts receivable	\$ 1,679
Of which:	
Not overdue	1,418
Past due for more than one day but for not more than three months	114
Past due more for than three months but for not more than six months	77
Total accounts receivable, gross	\$ 2,299
Allowance for doubtful accounts	(620)
Total accounts receivable, net	\$ 1,679

(b) Foreign currency risk

The functional currency of the Company and its subsidiaries is the US dollar. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than US dollars and by the translation of assets and liabilities denominated in currencies other than the US dollar at each balance sheet date. Revenues are primarily received in US dollars and other currencies while a portion of expenses are paid in other currencies, primarily the Canadian dollar and the Euro. The Company's consolidated loss could therefore be affected by the Canadian and Euro/US dollar exchange rate and other exchange rates relative to the US dollar, which exchange rates may fluctuate over time. From time to time, the Company engages in the use of derivative

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financial instruments to manage its currency exposure. During 2009 and 2008, the Company has not engaged in the use of any derivative financial instruments.

The following is a breakdown of financial instruments by foreign currency as of December 31, 2009 and 2008:

(in thousands of US dollars)	December 31,			
	2009			
	\$Cdn	Euro	\$Bds	INR
Cash	\$ 5	\$ 49	\$ 24	\$ -
Accounts receivable	73	7	-	-
Accounts payable and accrued liabilities	1,597	989	143	160
Long-term debt	-	6,352	-	-

(in thousands of US dollars)	December 31,			
	2008			
	\$Cdn	Euro	\$Bds	INR
Cash	\$ 461	\$ 717	\$ 24	\$ 151
Accounts receivable	64	3,665	4	-
Accounts payable and accrued liabilities	819	1,978	210	13
Long-term debt	-	4,494	-	18

The following exchange rates applied during the reporting period and for the year ended December 31, 2009:

Currency	Exchange	Average	Closing
Canadian dollar	US/Cdn	0.8798	0.9515
Euro	US/Euro	1.3931	1.4306
Barbadian	US/Bds	0.5076	0.5017
Indian Rupee	US/INR	0.0207	0.0214

Based on the Company's foreign currency exposure, varying the above exchange rates to reflect a 5% strengthening of the U.S. dollar would have decreased the net loss by \$781, assuming all other variables remained constant with an equal and opposite effective if the U.S. dollar weakened by 5%.

(c) *Interest rate risk*

The Company's exposure to interest rate risk primarily arises from a loan in Euros from a Finnish governmental body, which bears interest at floating rates. As of December 31, 2009, \$0.7 million of the Company's total debt portfolio was subject to movement in floating interest rates. A 1% change in interest rates would have an effect on the loss from continuing operations before income taxes of approximately \$7 for the year ended December 31, 2009. The Company currently does not have any outstanding credit facilities, other than those described in note 15.

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(d) Liquidity risk

Liquidity risk, which is considered high by the Company (see note 1), is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages its liquidity risk by continuously monitoring forecasts and actual cash flows and through regular distribution of this information to the Board of Directors and the Audit Committee.

The following are the contractual maturities of financial liabilities as of December 31, 2009:

	Amounts Payable	Less than 1 year	1 to 3 years	3 to 5 years	Thereafter
Accounts Payable and accrued liabilities	\$ 7,801	\$ 7,801	\$ -	\$ -	\$ -
Capital leases *	683	537	146	-	-
Long-term debt *	8,124	704	1,762	1,150	4,508
	\$ 16,608	9,042	1,908	1,150	4,508

Long-term debt and capital leases include principal and related interest .

23. Capital Management

The Company's objectives when managing capital are:

- To sustain the continuance of the Fentanyl TAIFUN® program,
- To maintain a flexible capital structure which optimizes the cost of capital at acceptable risk,
- To sustain our ability to continue as a going concern in order to provide returns for shareholders.

In the management of capital, the Company includes cash, long-term debt and shareholders' deficiency (excluding comprehensive income) in the definition of capital.

Our ability to raise funding from the capital markets is challenging and is expected to remain so for the foreseeable future. The Company's strategy therefore is sustain the continuance of the Fentanyl TAIFUN® program through the sale of PharmaForm and other non-strategic assets and seek funding for our proprietary compounds from our current and new commercial partners. Until we succeed in raising additional capital through partner funding, equity or debt financing we are not recruiting any further patients into clinical studies.

The Company is not subject to any externally imposed capital requirements.

AKELA PHARMA INC.

Notes to Consolidated Financial Statements

Years ended December 31, 2009 and 2008
(in thousands of US dollars)

24. Segment Reporting

The Company operates in one reportable segment being pharmaceutical development, or “Pharma.”

Revenues were derived from customers located in the following geographic areas:

	2009	2008
United States	\$ 10,285	\$ 11,985
Belgium	3,080	2,088
Other	528	701
	\$ 13,893	\$ 14,774

Property and equipment and intangible assets by geographic areas are as follows:

	2009			2008		
	United States	Other	Total	United States	Other	Total
Property and equipment	\$ 4,217	\$ -	\$ 4,217	\$ 5,036	193	\$ 5,229
Intangibles	-	-	-	4,755	-	4,755
Goodwill	-	-	-	6,457	-	6,457
	\$ 4,217	\$ -	\$ 4,217	\$ 16,248	\$ 193	\$ 16,441