

ID WATCHDOG, INC.
CONSOLIDATED FINANCIAL STATEMENTS
QUARTERS ENDED MARCH 31, 2009 AND 2008

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

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

ID WATCHDOG, INC.

CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,437,113	\$ 5,117,596
Accounts receivable	116,368	71,665
Prepaid expenses and other	341,939	245,180
Total current assets	2,895,420	5,434,441
Furniture and equipment, net (Note 3)	561,228	581,026
Debt offering costs, net (Note 5)	78,387	160,072
Total assets	\$ 3,535,035	\$ 6,175,539
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 651,395	\$ 306,430
Accrued liabilities	616,250	552,049
Convertible debentures, net of unamortized discount of \$41,759 at March 31, 2009 and \$84,523 at December 31, 2008 (Note 5) ...	3,499,441	3,481,677
Current portion of capital lease obligation (Note 5)	2,290	2,290
Derivative contract liabilities	888,600	21,983
Total current liabilities	5,657,976	4,364,429
Capital lease obligation, net of current portion (Note 5)	7,136	7,854
Total liabilities	5,665,112	4,372,283
Commitments and Contingencies		
SHAREHOLDERS' EQUITY (DEFICIT)		
Share capital: (Note 6)		
Preferred shares; 450,000,000 shares authorized:		
Series A redeemable convertible preferred shares; \$2.00 stated value; 1,750,000 shares authorized; 1,750,000 shares issued; no shares outstanding at March 31, 2009 and December 31, 2008; liquidation preference of \$3,500,000 at December 31, 2008	—	—
Series B redeemable convertible preferred shares; \$2.00 stated value; 500,000 shares authorized; 497,500 shares issued; no shares outstanding at March 31, 2009 and December 31, 2008; liquidation preference of \$995,000 at December 31, 2008	—	—
Ordinary shares; no par value; 450,000,000 shares authorized, 50,088,375 and 20,027,918 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	17,490,918	17,441,578
Accumulated deficit	(19,620,995)	(15,638,322)
Total shareholders' (deficit) equity	(2,130,077)	1,803,256
Total liabilities and shareholders' equity or deficit	\$ 3,535,035	\$ 6,175,539

See notes to unaudited consolidated financial statements

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

	Quarter Ended March 31,	
	2009	2008
Revenue	\$ 1,214,021	\$ 891,326
Cost of revenue	263,904	226,975
Gross profit	950,117	664,351
Operating expense:		
Marketing expense	2,493,981	1,821,413
General and administrative expense	1,377,822	562,286
	3,871,803	2,383,699
Operating loss	(2,921,686)	(1,719,348)
Other income (expense):		
Loss on derivative contract liabilities	(866,617)	—
Interest income	9,133	18,343
Interest expense	(203,503)	(210,497)
Loss on sale of equipment	—	(502)
	(1,060,987)	(192,656)
Net loss	(3,982,673)	(1,912,004)
Dividends on redeemable convertible preferred shares	—	(72,493)
Deemed dividends on redeemable convertible preferred shares ..	—	(508,176)
Accretion of discount related to redeemable convertible preferred shares	—	(146,880)
Net loss applicable to ordinary shares	<u>\$ (3,982,673)</u>	<u>\$ (2,639,553)</u>
Basic and diluted net loss per share applicable to ordinary shares	<u>\$ (0.08)</u>	<u>\$ (0.13)</u>
Weighted average number of shares outstanding - basic and diluted	<u>50,017,938</u>	<u>20,010,614</u>

See notes to unaudited consolidated financial statements

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

	<u>Ordinary Shares</u> (#)	<u>Amount</u>	<u>Accumulated Deficit</u>	<u>Total Shareholders' Equity</u>
Balances, December 31, 2008	49,999,089	\$17,441,578	\$(15,638,322)	\$ 1,803,256
Net loss	—	—	(3,982,673)	(3,982,673)
Ordinary shares issued upon conversion of convertible debentures	89,286	24,691	—	24,691
Share-based compensation expense and stock options issued for services	—	24,649	—	24,649
Balances, March 31, 2009	<u>50,088,375</u>	<u>\$17,490,918</u>	<u>\$(19,620,995)</u>	<u>\$ (2,130,077)</u>

See notes to unaudited consolidated financial statements

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

	Quarter Ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net loss	\$ (3,982,673)	\$ (1,912,004)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	64,678	25,028
Amortization of debt offering costs and convertible debenture discount	124,140	126,625
Share-based compensation expense to employees, directors and consultants	24,649	7,938
Ordinary shares issued in payment of interest	—	16,787
Compensation paid by officer/shareholder	—	96,850
Loss on derivative contracts	866,617	—
Loss on sale of equipment	—	502
Changes in assets and liabilities:		
Increase (decrease) in accounts receivable	(44,703)	81
Increase in prepaid expenses and other	(96,759)	(82,160)
Increase in accounts payable and accrued liabilities	409,166	140,860
Net cash used in operating activities	(2,634,885)	(1,676,343)
Cash flows from investing activities:		
Capital expenditures	(44,880)	(113,121)
Net cash used in investing activities	(44,880)	(113,121)
Cash flows from financing activities:		
Proceeds from issuance of redeemable convertible preferred shares and warrants	—	3,500,000
Proceeds from exercise of warrants and stock options, net	—	8,333
Repayment of capital lease obligation	(718)	(588)
Net cash provided by financing activities	(718)	3,507,745
Net (decrease) increase in cash	\$ (2,680,483)	\$ 1,718,281
Cash and cash equivalents, beginning of period	\$ 5,117,596	\$ 631,665
Cash and cash equivalents, end of period	\$ 2,437,113	\$ 2,349,946
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 79,953	\$ 67,381
Supplemental disclosure of non-cash investing and financing activities:		
Ordinary shares issued upon conversion of debt	\$ 25,000	\$ —

See notes to unaudited consolidated financial statements

ID WATCHDOG, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2009
(Unaudited)
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1. Organization, Basis of Presentation, Liquidity and Management's Plans:

Organization:

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

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

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

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

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

Interim reporting:

The accompanying consolidated financial statements of the Company are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial statements. Accordingly, they do not necessarily include all the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements include all adjustments, which are normal and recurring in nature, considered necessary to present fairly the Company's financial position as of March 31, 2009, the results of operations for the three months ended March 31, 2009 and 2008, and cash flows for the three months ended March 31, 2009 and 2008. The results of operations for the three months ended March 31, 2009, are not necessarily indicative of those to be expected for the entire year. For a more complete understanding of the Company's operations, financial position and accounting policies, these consolidated financial statements and the notes thereto should be read in conjunction with the audited financial statements of ID Watchdog, Inc. for the year ended December 31, 2008.

Liquidity:

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

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

The Company has incurred significant losses from operations, and has funded its operations primarily through its IPO and private placements of debt and equity including loans from related parties. The Company also has a limited operating history and has only recently had significant revenue producing operations beginning in the fourth quarter of 2007.

The Company has \$3.5 million of convertible debentures outstanding at March 31, 2009 and these debentures mature in June and July 2009. Management believes that one large shareholder and another entity, Bolder Venture Partners, which is controlled by the Company's CEO, will convert their outstanding debentures totaling \$2.0 million into ordinary shares. Management also believes that other debenture holders will convert their debentures into ordinary shares as the recent market price of the Company's ordinary shares has been significantly higher than the \$0.28 per share conversion price of the convertible debentures.

IDW's marketing expenditures are largely discretionary. Aside from the convertible debentures, IDW does not have any other significant commitments including non-cancelable purchase commitments.

Our business plan implemented during the second quarter of 2009, calls for maintaining the current level of customers during the year until we obtain additional financing in order to fund customer growth. We plan to hold gross margins steady in 2009 and plan to decrease general and administrative expenses and marketing expenses to achieve a positive cash flow.

Management believes that the \$2.4 million of cash and cash equivalents on hand at March 31, 2009 combined with 2009 gross profits will provide adequate working capital for use in connection with the Company's 2009 business plan and programs during the short and long term.

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

2. Summary of Significant Accounting Policies:

Basis of presentation:

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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Principles of consolidation:

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

Use of estimates:

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

Fair value of financial instruments:

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

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

Derivative financial instruments:

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

Cash equivalents:

Cash equivalents are highly liquid investments that consist primarily of short-term money market instruments with original maturities of three months or less at the time of purchase. We utilize and invest with financial institutions that are sound and of high credit quality. Our investments are in low-risk instruments and we limit our credit risk exposure in any one institution or type of investment instrument in accordance with the Company's investment policy criteria which includes consideration of the credit worthiness of the institution.

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Accounts receivable:

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

Furniture and equipment:

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

The Company capitalizes costs related to internally developed software in accordance with Statement of Position ("SOP") 98-1, "*Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*". Only costs incurred during the development stages, including design, coding, installation and testing are capitalized. These capitalized costs primarily represent costs for consultants directly associated with the software development. Upgrades or modifications that result in additional functionality are capitalized.

Debt offering costs:

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

Long-lived assets:

Management assesses the carrying values of long-lived assets for impairment when circumstances indicate that such amounts may not be recoverable from future operations. Generally, long-lived assets are considered impaired if the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. At March 31, 2009, management believes that no impairment exists.

Convertible securities:

Beneficial Conversion Feature

Pursuant to Emerging Issues Task Force ("EITF") Issue No. 98-5 ("EITF 98-5"), "*Accounting For Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratio*" and EITF Issue No. 00-27, "*Application of EITF Issue No. 98-5 to Certain Convertible Instruments*," the Company records, as a discount to convertible securities, the intrinsic value of such beneficial conversion features based upon the differences between the fair value of the underlying ordinary shares at the commitment date of the security transaction and the effective conversion price embedded in the instrument. Discounts under these arrangements are amortized over the expected term to the redemption date of the related security.

Derivative Financial Instruments

Pursuant to SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," as amended, the Company reviews all convertible debt instruments for the existence of an embedded conversion option, which may require bifurcation, fair value accounting and a related mark to market adjustment at each reporting period end date. In addition, under the provisions of EITF Issue No. 00-19, "*Accounting for Derivative Financial*

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Instruments Indexed to, and Potentially Settled in a Company's Own Stock," and related guidance, the Company may be required to classify certain stock equivalents issued in connection with the underlying debt instrument as derivative liabilities.

In determining the appropriate fair value, the Company uses the Black-Scholes option-pricing model. In assessing convertible debt instruments, management first reviews the guidance of EITF No.'s 98-5, 00-27 and 05-2 as well as SFAS No. 150 to determine if the convertible debt host instrument is conventional convertible debt and further if there is a beneficial conversion feature requiring a fair value measurement. If the instrument is not considered conventional convertible debt, the Company will continue its evaluation process of these instruments as potential derivative financial instruments.

Once determined, the Company assesses these instruments as derivative liabilities. The fair value of these instruments are adjusted to reflect fair value at each reporting period end, with any increase or decrease in the fair value being recorded in results of operations as an adjustment to fair value of derivatives. In addition, the fair value of freestanding derivative instruments such as warrants, are also valued using the Black-Scholes option-pricing model. In assessing the nature of a financial instrument as freestanding, the Company has applied the guidance pursuant to EITF No.'s 00-19.

Finally, if necessary, the Company will apply the related guidance in EITF No.'s 00-19-2 and 05-4 as well as SFAS No. 5 when determining the existence of liquidated damage provisions. Liquidated damage provisions are not marked to market, but evaluated based upon the probability that a related liability should be recorded.

Pursuant to SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement No. 133" ("SFAS 161"), the Company discloses required information about derivatives and hedging activities. SFAS 161 requires additional narrative disclosure about how and why an entity uses derivative instruments, how they are accounted for under SFAS 133, and what impact they have on financial position, results of operations and cash flows.

Warrants:

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

Revenue recognition:

The Company's services are offered to consumers primarily on a monthly subscription basis. Subscription fees are generally billed directly to the subscriber's credit card or demand deposit account. At times, as a means of allowing customers to become familiar with the Company's services, the Company offers free trial periods. No revenue is recognized until these applicable periods are completed.

Revenue for annual and multi-year subscription fees is deferred and recognized on a straight-line basis over the related subscription period. Deferred revenue was \$125,263 and \$110,868 at March 31, 2009 and December 31, 2008, respectively, and is included in accrued liabilities on the consolidated balance sheets.

In addition, the Company has established a reserve for charge-backs and discretionary refunds based on actual experience. This reserve was \$24,043 and \$21,628 at March 31, 2009 and December 31, 2008, respectively, and is included in accrued liabilities on the consolidated balance sheets.

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Advertising:

Advertising costs are expensed as incurred. For the three months ended March 31, 2009 and March 31, 2008, advertising costs were \$382,448 and \$491,783, respectively. Advertising costs are included in marketing expense in the consolidated statements of operations.

Share-based compensation:

The Company has one share-based compensation plan which is described in Note 6. The Company accounts for share-based awards that are settled through the issuance of equity using a fair value based method, whereby the fair value of the share-based award is determined at the date of grant using a market-based option valuation model. The fair value of the award is recorded as share-based compensation expense on a straight-line basis over the vesting period of the award, with a corresponding increase to ordinary shares in the consolidated balance sheets. Share-based compensation expense is included in general and administrative expense in the consolidated statements of operations.

Research and development:

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

Income taxes:

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

The Company recognizes the impact of uncertain tax positions if that position is more likely than not of being sustained on audit, based upon the technical merits of the position. The Company also recognizes interest and penalties accrued on any uncertain tax positions as a component of income tax expense. The Company did not have any accrued interest or accrued penalties associated with any uncertain tax positions at March 31, 2009 and December 31, 2008; nor were any income tax expenses recognized during the three months ended March 31, 2009 and 2008, associated with uncertain tax positions.

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Loss per share:

Basic net loss per ordinary share (“EPS”) is computed by dividing net loss applicable to ordinary shares by the weighted-average number of ordinary shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. Currently, all potentially dilutive securities have an anti-dilutive effect on EPS and accordingly, basic and dilutive weighted average shares are the same. As of March 31, 2009, a total of 52,394,705 shares of potentially dilutive securities have been excluded from the calculation of EPS, as the effect of including these securities would be anti-dilutive, as follows:

Potentially Dilutive Securities as of March 31, 2009	
	(shares)
Convertible debentures	12,647,143
Warrants	35,081,812
Stock options	4,665,750
Total	52,394,705

Reclassifications:

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

Recently adopted accounting pronouncements:

Effective January 1, 2008, the Company adopted SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis. SFAS 157 provides a definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Company’s valuation methods used in 2008 were consistent with those used in prior years and, therefore, the adoption of SFAS 157 did not have an impact on the Company’s consolidated financial statements.

SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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

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

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

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

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The following table presents information about the Company's liabilities measured at fair value on a recurring basis as of March 31, 2009 and December 31, 2008, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
At March 31, 2009:				
Derivative contract liabilities – warrants ..	\$ 888,600	—	\$ 888,600	—
At December 31, 2008:				
Derivative contract liabilities – warrants..	\$ 21,983	\$ —	\$ 21,983	\$ —

Effective January 1, 2008, the Company adopted SFAS No. 159, "Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). Under SFAS 159, entities may choose to measure at fair value certain financial instruments and other items at fair value that are not currently required to be measured at fair value. The adoption of this pronouncement did not have any effect on the Company's consolidated financial statements, because the Company did not elect the fair value methodology permitted under SFAS 159 for any financial instruments or other items that are not currently required to be measured at fair value.

Effective January 1, 2009 the Company adopted EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock" ("EITF 07-5") and establishes a two-step process for making such determination. The adoption of EITF 07-5 did not have an impact on the Company's consolidated financial statements.

Effective January 1, 2009 the Company adopted SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement No. 133" ("SFAS 161") which enhances the disclosure requirements about derivatives and hedging activities. SFAS 161 requires additional narrative disclosure about how and why an entity uses derivative instruments, how they are accounted for under SFAS 133, and what impact they have on financial position, results of operations and cash flows.

3. Furniture and Equipment:

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

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Office equipment	\$ 190,454	\$ 158,539
Furniture and fixtures	44,203	44,203
Computer software	629,150	616,185
Total furniture and equipment.....	863,807	818,927
Less: accumulated depreciation and amortization	(302,579)	(237,901)
Furniture and equipment, net	<u>\$ 561,228</u>	<u>\$ 581,026</u>

Office equipment at March 31, 2009 and December 31, 2008 includes \$14,470 of assets under a capital lease. Accumulated depreciation at March 31, 2009 and December 31, 2008 includes \$723 in each period, respectively, of accumulated depreciation applicable to office equipment assets under capital lease.

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Depreciation and amortization expense for the three months ended March 31, 2009 and March 31, 2008 was \$64,678, and \$25,028, respectively, and is included in general and administrative expense in the consolidated statements of operations.

4. Related Party Transactions:

Consulting services expense – related parties:

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

	Three Months Ended March 31,	
	2009	2008
Chief executive officer, cash compensation	\$ 49,797	\$ 25,417
Director, cash compensation	18,000	15,000
Veracity Credit Consultants, LLC, cash compensation	14,993	—
Total consulting services expense – related parties	\$ 82,780	\$ 40,417

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

Marketing expense – related party:

In January 2008, the Company entered into a month-to-month services agreement with Veracity Credit Consultants, LLC (“VCC”) an entity controlled by the Company’s President, to provide call center facilities and call center services at prevailing market rates. The Company incurred \$47,676 and \$75,000 of call center marketing expense to this related party during the three months ended March 31, 2009 and 2008, respectively. Marketing expense – related party is included in marketing expense in the consolidated statements of operations.

Prepaid expenses – related party:

In September 2008, the Company entered into a one year non-cancellable agreement with VCC to provide call center facilities and services during the period October 1, 2008, through September 30, 2009, at prevailing market rates. The agreement provided for discounted fees in exchange for prepayment of approximately one year’s services and in September 2008, the Company prepaid \$252,336 of the estimated cost of these services. In February 2009, the Company renegotiated the agreement with VCC and extended the term of the agreement through January 2010. The Company advanced VCC \$100,360 with the extended term. Prepaid expense of \$255,781 and \$207,123 to this related party is included in prepaid expenses and other assets on the March 31, 2009 and December 31, 2008 consolidated balance sheet.

Accounts payable – related parties:

At March 31, 2009 and December 31, 2008, accounts payable to related parties was \$21,917 and \$7,497, respectively.

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5. Borrowings:

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

	March 31, 2009	December 31, 2008
Current borrowings:		
Current portion of capital lease obligation.....	\$ 2,290	\$ 2,290
Convertible debentures	3,541,200	3,566,200
Unamortized discount	(41,759)	(84,523)
Total current borrowings.....	\$ 3,501,731	\$ 3,483,967
Long-term borrowings:		
Capital lease obligation, net of current portion.....	\$ 7,136	\$ 7,854
Total long-term borrowings	\$ 7,136	\$ 7,854

During the three months ended March 31, 2009 and 2008, the Company recognized \$42,456 and \$44,940, respectively, of debt discount amortization applicable to the convertible debentures.

During the three months ended March 31, 2009 and 2008, the Company recognized \$81,685 and \$81,685 respectively, of debt offering costs amortization applicable to the convertible debentures.

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

Convertible debentures and warrants:

In July 2007, ID Rehab completed a private placement of two-year, 9% unsecured convertible debentures with detachable warrants to purchase up to 13,304,610 ordinary shares of the Company with gross proceeds of \$3,725,291. The 9% convertible debentures may be converted into ordinary shares of the Company on or prior to their maturity dates in June and July 2009 at a conversion price of \$0.28 per ordinary share at the election of the holder. In addition, the 9% convertible debentures will automatically convert into ordinary shares upon the occurrence of all of the following events:

- (i) the passage of ninety days following the effective date of a registration statement registering for resale the shares issuable upon conversion of the convertible debentures,
- (ii) the shares of ID Rehab's common stock have become listed or eligible for trading on a specified U.S. national securities exchange or the OTC Bulletin Board,
- (iii) the closing price for ID Rehab's common stock on such market exceeds 125% of the conversion price for 30 consecutive trading days, and
- (iv) the average trading volume for the same period exceeds 60,000 shares per day.

Each of the detachable warrants entitles the holder to acquire one ordinary share of the Company for each \$0.28 of the face amount of the holder's convertible debenture. One-half of each warrant has an exercise price of \$0.35 per share and the other one-half has an exercise price of \$0.40 per share. The warrants may be exercised at any

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

ID Rehab may be required to immediately redeem the debentures for an amount equal to 130% of the principal balance upon the occurrence of certain events, including a change in control of ID Rehab, ID Rehab's failure to comply with SEC reporting requirements, after ID Rehab becomes subject to such requirements, and de-listing of ID Rehab's common stock, as defined.

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

Based on the Company's evaluation of the provisions of the FASB's Staff Position ("FSP") No. EITF 00-19-2, "Accounting for Registration Payment Arrangements" no accrual for liquidated damages was determined to be necessary at December 31, 2008 and 2007 as ID Rehab received the aforementioned comment letter from the SEC pertaining to Rule 415 and there have been no events or circumstances since the receipt of that comment letter that would require ID Rehab to recognize a liability relating to the convertible debenture registration rights.

The terms of the convertible debentures prohibit ID Rehab from paying dividends without the consent of the debenture holders.

ID Rehab engaged a firm to assist the Company in completing the private placement of Securities. This firm was paid a success fee based on gross proceeds received; 5% on proceeds received from officers, directors and acquaintances of ID Rehab, and 10% on proceeds received from all other investors, except for investors introduced to the investment firm by ID Rehab, in which case the fee was 5%. ID Rehab also agreed to pay the investment firm an expense allowance equal to 2% of aggregate gross offering proceeds and to reimburse the investment firm for certain costs incurred up to a maximum of \$15,000. ID Rehab paid the firm \$456,279 in fees, allowances and reimbursable expenses in 2007. Total costs related to the issuance of the convertible debentures (\$627,754) were capitalized as debt offering costs on the consolidated balance sheets and are being

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charged to interest expense using the straight-line method which approximates the effective interest method over the life of the convertible debentures.

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

6. Shareholders' Equity:

Ordinary shares:

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

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

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

Concurrent with the completion of the IPO, the Company's issued and outstanding preferred shares, consisting of 1,750,000 Series A Preferred shares and 497,500 Series B Preferred shares, together with accrued dividends payable totaling \$285,388, were automatically converted in accordance with the special rights and restrictions of such shares and dividends payable into a total of 10,597,068 ordinary shares and 5,298,528 warrants, each warrant having the same terms as the IPO Warrants. The Company also issued to the Agents, as consideration applicable to the conversion transaction, warrants to purchase an aggregate of 486,848 ordinary shares at a price of \$0.48 per share for a period of five years (the "Agents' Conversion Warrants").

The Company incurred IPO equity issuance costs totaling \$2,267,898 (including the aforementioned Agents' commissions and fees). IPO equity issuance costs include noncash costs of \$303,648 representing the fair market value of the Agents Warrants, the Agents' Conversion Warrants, the Corporate Finance Units and stock options issued for consulting services.

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The fair values of the IPO Warrants, Agents Warrants and Agents' Conversion Warrants were calculated using the Black-Scholes valuation model with the following assumptions as of September 5, 2008:

<u>Assumptions</u>	
Expected term	2.0 – 5.0 years
Estimated volatility	38%
Risk-free interest rate	2.23% – 2.91%
Dividend yield	0%

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

The fair values of the warrants were calculated using the Black-Scholes valuation model with the following assumptions on June 24, 2008:

<u>Assumptions</u>	
Expected term	2.2 – 5.0 years
Estimated volatility	38%
Risk-free interest rate	2.87% - 3.52%
Dividend yield	0%

Stock options:

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

Employee options generally vest over 18 to 36 months as long as the optionee remains in the Company's employ. Share-based compensation expense is recognized over the period that the stock options vest. Consultant options generally vest over 18 months and share-based compensation expense is recognized during periods that the services are rendered.

The Company uses the Black-Scholes option pricing model to value stock options. The Black-Scholes model requires the use of a number of assumptions, including expected share price volatility, risk-free interest rates,

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

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

	Three Months Ended March 31,	
	2009	2008
Expected term	2.9 – 5.0 years	2.8 - 3.3 years
Estimated volatility	38%	45%
Risk-free interest rate	1.8% - 3.7%	4.5% – 4.9%
Dividend yield	0%	0%

During the three months ended March 31, 2009, the Company granted 795,000 options to employees and consultants at an exercise price of CDN\$0.60. During the three months ended March 31, 2008, the Company granted 75,000 options to an employee at an exercise price of \$0.35 per share.

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A summary of stock option activity for the three months ended March 31, 2009 and 2008 follows:

	Stock Options Denominated in U.S. Dollars			
	Three Months Ended March 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	3,375,000	\$ 0.43	1,655,556	\$ 0.20
Granted	—	—	75,000	0.35
Exercised	—	—	(55,556)	0.15
Forfeited	(151,250)	0.40	—	—
Expired	—	—	—	—
Outstanding, end of period	<u>3,223,750</u>	<u>\$ 0.43</u>	<u>1,675,000</u>	<u>\$ 0.21</u>
Exercisable, end of period	<u>1,894,167</u>	<u>\$ 0.33</u>	<u>1,112,500</u>	<u>\$ 0.17</u>
Exercisable and expected to vest as of March 31, 2009	<u>3,223,750</u>	<u>\$ 0.43</u>		

	Stock Options Denominated in Canadian Dollars			
	Three Months Ended March 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	647,000	\$ 0.60	—	\$ —
Granted	795,000	0.60	—	—
Outstanding, end of period	<u>1,442,000</u>	<u>\$ 0.60</u>	<u>—</u>	<u>\$ —</u>
Exercisable, end of period	<u>335,250</u>	<u>\$ 0.60</u>	<u>—</u>	<u>\$ —</u>
Exercisable and expected to vest as of March 31, 2009	<u>1,442,000</u>	<u>\$ 0.60</u>		

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

Stock Options Denominated in U.S. Dollars			
<u>Exercise Prices</u>	<u>Stock Options Outstanding</u>		<u>Stock Options Exercisable</u>
	<u>Shares</u>	<u>Weighted Average Remaining Contractual Term (years)</u>	<u>Shares</u>
\$0.15	900,000	2.18	900,000
\$0.28	400,000	3.18	279,167
\$0.35	22,917	3.82	22,917
\$0.48	150,000	4.15	75,000
\$0.60	1,750,833	4.21	617,083
	<u>3,223,750</u>	<u>3.51</u>	<u>1,894,167</u>

Stock Options Denominated in Canadian Dollars			
<u>Exercise Prices</u>	<u>Stock Options Outstanding</u>		<u>Stock Options Exercisable</u>
	<u>Shares</u>	<u>Weighted Average Remaining Contractual Term (years)</u>	<u>Shares</u>
\$0.60	1,442,000	4.76	335,250
	<u>1,442,000</u>	<u>4.76</u>	<u>335,250</u>

Share-based compensation expense:

A summary of share-based compensation expense follows:

	Three Months Ended March 31,	
	<u>2009</u>	<u>2008</u>
Share-based compensation expense – employees and directors	\$ 21,949	\$ 7,938
Share-based compensation expense – consultants	2,700	—
Total share-based compensation expense	<u>\$ 24,649</u>	<u>\$ 7,938</u>

As of March 31, 2009, there were 1,961,333 nonvested employee stock options outstanding and the total unrecognized share-based compensation expense relating to these options was \$144,946. This expense is expected to be recognized over a weighted average period of 1.96 years.

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Warrants:

A summary of warrant activity for the three months ended March 31, 2009 and 2008 follows:

Warrants Denominated in U.S. Dollars				
	Three Months Ended March 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	19,898,284	\$ 0.40	15,965,486	\$ 0.38
Issued	—	—	3,000,000	0.35
Exercised	—	—	—	—
Outstanding, end of period	<u>19,898,284</u>	<u>\$ 0.40</u>	<u>18,965,486</u>	<u>\$ 0.37</u>

Warrants Denominated in Canadian Dollars				
	Three Months Ended March 31,			
	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	15,183,528	\$ 0.87	—	\$ —
Issued	—	—	—	—
Exercised	—	—	—	—
Outstanding, end of period	<u>15,183,528</u>	<u>\$ 0.87</u>	<u>—</u>	<u>\$ —</u>

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

Warrants Denominated in U.S. Dollars		
Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.35	10,625,601	3.42
\$0.40	7,625,601	3.25
\$0.48	486,848	4.44
\$0.60	639,401	4.20
\$0.90	520,833	1.47
Outstanding as of March 31, 2009	19,898,284	3.35

Warrants Denominated in Canadian Dollars		
Exercise Prices	Shares	Weighted Average Remaining Contractual Term (years)
\$0.60	1,360,000	1.47
\$0.90	13,823,528	1.47
Outstanding as of March 31, 2009	15,183,528	1.47

Ordinary shares reserved for future issuance:

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

	Shares
Stock option plan	7,200,000
Warrants	35,081,812
Convertible debentures	12,647,143
Total	54,928,955

7. Generally Accepted Accounting Principles in Canada:

The consolidated financial statements have been prepared in accordance with U.S. GAAP which differs in certain respects from those principles that the Company would have followed had its consolidated financial statements been prepared in accordance with Canadian GAAP. There were no significant measurement differences that materially affect the consolidated financial statements at March 31, 2008 or the three months then ended. Significant measurement differences that materially affect the consolidated financial statements at March 31, 2009 and the three months then ended and December 31, 2008 are as follows:

The Company has issued warrants to purchase ordinary shares that are denominated in Canadian dollars, which results in the Company having warrants outstanding that are denominated outside its U.S. dollar functional

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currency. Under U.S. GAAP warrants with exercise prices denominate in a currency other than its functional currency cannot be classified as equity. As a result, these instruments are treated as derivatives and are recorded as liabilities which are carried at fair value with changes in the fair value recorded in the consolidated statement of operations.

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

Consolidated Balance Sheet	<u>March 31, 2009</u>	<u>March 31, 2009</u>
	Canadian GAAP	U.S. GAAP
Derivative contract liabilities	\$ —	\$ 888,600
Total current liabilities	\$ 4,769,376	\$ 5,657,976
Ordinary shares	\$ 18,292,606	\$ 17,490,918
Accumulated deficit	\$ (19,512,099)	\$ (19,620,995)
Total shareholders' equity	\$ (1,219,494)	\$ (2,130,077)
	<u>Three Months Ended</u>	<u>Three Months Ended</u>
	<u>March 31,</u>	<u>March 31,</u>
	<u>2009</u>	<u>2008</u>
Consolidated Statement of Operations		
Net loss under U.S. GAAP	\$ (3,982,673)	\$ (1,912,004)
Loss on derivative contract liabilities recognized	866,617	—
Additional interest expense under Canadian GAAP	—	(727,549)
Net loss under Canadian GAAP	<u>\$ (3,116,056)</u>	<u>\$ (2,639,553)</u>

Had the Company followed Canadian GAAP, certain items in the December 31, 2008 consolidated balance sheet and consolidated statement of shareholders' equity would have been reported as follows:

Consolidated Balance Sheet	<u>December 31, 2008</u>	<u>December 31, 2008</u>
	Canadian GAAP	U.S. GAAP
Derivative contract liabilities	\$ —	\$ 21,983
Total current liabilities	\$ 4,342,446	\$ 4,364,429
Ordinary shares	\$ 18,221,283	\$ 17,441,578
Accumulated deficit	\$ (16,396,043)	\$ (15,638,321)
Total shareholders' equity	\$ 1,825,239	\$ 1,803,256
	<u>December 31, 2008</u>	<u>December 31, 2008</u>
	Canadian GAAP	U.S. GAAP
Warrants issued in connection with IPO, sale of Series A and Series B redeemable convertible preferred shares and private placement of ordinary shares.....	\$ 1,357,948	\$ 578,243