

Consolidated Financial Statements of

AKELA PHARMA INC.

Years ended December 31, 2010 and 2009



Tel: 514 931 0841
Fax: 514 931 9491
www.bdo.ca

BDO Canada s.r.l./S.E.N.C.R.L./LLP
1000, rue De La Gauchetière O.
Bureau 200
Montréal QC H3B 4W5 Canada

Independent Auditor's Report

To the shareholders of Akela Pharma Inc.

We have audited the accompanying financial statements of Akela Pharma Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of income (loss) and comprehensive income (loss), shareholders' deficiency and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independent Auditor's Report

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Akela Pharma Inc. and its subsidiaries as at December 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the entity has a deficit amounting to \$24,369,000 for the year ended December 31, 2010 and, as of that date, the entity's current liabilities exceeded its current assets by \$8,173,000. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

Other Matter

The consolidated financial statements of the Company as at December 31, 2009 and for the year then ended December 31, 2009 were audited by another auditor who expressed an unmodified opinion on those statements on April 26, 2010, except as to Note 18(b), which is as of May 11, 2010.

BDO Canada LLP/s.r.l./S.E.N.C.R.L.¹

Chartered Accountants

Montréal, Québec
March 31, 2011

¹ CA auditor permit No. 14518

AKELA PHARMA INC.

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AKELA PHARMA INC.

Consolidated Balance Sheets

As at December 31st
(in thousands of US dollars, except share and per share data)

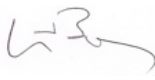
	2010	2009
Assets		
Current assets:		
Cash	\$ 474	\$ 107
Restricted cash (Note 14)	-	938
Accounts receivable (Note 10)	1,590	1,679
Prepaid expenses and other current assets	302	417
	<u>2,366</u>	<u>3,141</u>
Property and equipment (Note 11)	3,085	4,165
Intangible assets (Note 12)	74	52
Other assets (Note 13)	67	598
	<u>\$ 5,592</u>	<u>\$ 7,956</u>
Liabilities and Shareholders' Deficiency		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 5,709	\$ 7,801
Deferred revenue (Note 3)	3,527	2,795
Income taxes payable (Note 16)	266	-
Current portion of long-term debt (Note 15)	1,037	1,015
	<u>10,539</u>	<u>11,611</u>
Deferred revenue (Note 3)	12,979	14,630
Income taxes payable (Note 16)	-	799
Long-term debt (Note 15)	6,443	6,615
	<u>\$ 29,961</u>	<u>\$ 33,655</u>
Shareholders' deficiency: (Note 17)		
Common shares (unlimited authorized, 32,390,338 and 30,890,338 common shares issued and outstanding with no par value at December 31, 2010 and December 31, 2009, respectively)	67,739	67,544
Warrants	2,287	2,954
Additional paid-in capital	9,082	8,511
Accumulated other comprehensive income	3,110	3,110
Deficit	(106,587)	(107,818)
Total shareholders' deficiency	<u>(24,369)</u>	<u>(25,699)</u>
Commitments, contingencies and guarantees (Note 18)		
	<u>\$ 5,592</u>	<u>\$ 7,956</u>

See accompanying notes to audited consolidated financial statements.

Going Concern Uncertainty (note 1)

Approved on behalf of the Board of Directors:


(Signed) Gordon Busenbark, Chairman of the Audit Committee


(Signed) Beng Lai, Member of the Audit Committee

AKELA PHARMA INC.

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

As at December 31st

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

	2010	2009
Revenues	\$ 13,302	\$ 13,893
Expenses:		
Direct Costs	5,446	8,158
Selling, general and administrative	4,953	6,183
Research and development	118	3,711
Stock-based compensation (Note 17(e))	64	238
Amortization of property and equipment (Note 11)	1,437	1,464
Amortization of intangible assets (Note 12)	58	1,693
Interest on long-term debt	1,090	268
Unrealized and realized loss on securities held for trading (Note 7)	78	23
Foreign exchange gain (loss)	(466)	600
	12,778	22,338
Income (loss) before under noted items	524	(8,445)
Other (expenses) income:		
Settlement with LRI (Note 7)	-	1,664
Impairment of goodwill, intangible and other assets	-	(9,601)
Lease termination	-	(1,936)
Provisions for repayment of government grants (Note 6)	-	(1,544)
Restructuring (Note 9)	-	(1,071)
Income (loss) before income taxes	524	(20,933)
(Provision for) recovery of income taxes (Note 16)		
Current	707	(64)
Future	-	-
	707	(64)
Net income (loss) and comprehensive income (loss)	\$ 1,231	\$ (20,997)
Basic and diluted net income (loss) per share (Note 17 (g))	\$ 0.04	\$ (0.77)
Basic and diluted weighted average number of shares outstanding (Note 17 (f) and (g))	31,535,338	27,283,487

See accompanying notes to the audited consolidated financial statements.

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Consolidated Statements of Shareholders' Deficiency

Years ended December 31st

(in thousands of US dollars except for share data)

	Common Shares			Additional Paid-in Capital	Accumulated other comprehensive income	Deficit	Total
	Number	Dollars	Warrants				
Balance, December 31, 2008	21,615,577	\$ 66,346	\$2,814	\$8,105	\$3,110	\$ (86,821)	\$ (6,446)
Purchase of Nventa (Note 17(b))	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)
Line of Credit Indemnified Costs (Note 17 (b))	250,000	35	-	-	-	-	35
Stock-based compensation (Note 17 (e))	-	-	-	64	-	-	64
Lease Termination (Note 5)	1,250,000	160	-	(160)	-	-	-
Expiration of warrants (Note 17 (d))	-	-	(667)	667	-	-	-
Net Income	-	-	-	-	-	1,231	1,231
Balance, December 31, 2010	32,390,338	\$ 67,739	\$2,287	\$9,082	\$3,110	\$ (106,587)	\$ (24,369)

Total Accumulated Other Comprehensive Income and Deficit amounts to \$(103,477) (2009- \$(104,708))

See accompanying notes to the audited consolidated financial statements

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Notes to Consolidated Financial Statements

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

	Year ended December 31,	
	2010	2009
Cash flow from operating activities:		
Net Income (loss) and comprehensive income (loss)	\$ 1,231	\$ (20,997)
Adjustments for:		
Amortization of property and equipment	1,437	1,412
Amortization of intangible assets	58	1,745
Impairment of intangible and other assets (note 8)	-	9,601
Loss on disposal of equipment under capital lease	76	-
Lease Termination	-	1,936
Provision for repayment of government grants (note 6)	-	1,544
Restructuring (note 9)	-	471
Settlement with LRI	-	(101)
Stock-based compensation (note 17)	64	238
Unrealized foreign exchange loss	(466)	649
Realized and unrealized loss on securities held for trading (note 7)	78	23
Income Taxes (note 16)	-	64
Capitalized interest	887	-
Net changes in working capital (note 19(a))	(3,498)	1,653
	(133)	(1,762)
Cash flows from financing activities:		
Repayment of long-term debt	(410)	(1,517)
	(410)	(1,517)
Cash flows from investing activities:		
Acquisition of property and equipment	(28)	(1,036)
Cash acquired of Nventa (note 4)	-	1,157
Restricted Cash (note 14)	938	920
	910	1,041
Net increase (decrease) in cash	367	(2,238)
Cash, beginning of year	107	2,345
Cash, end of year (note 1)	\$ 474	\$ 107

Additional information (Note 19)

See accompanying notes to the audited consolidated financial statements

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Notes to Consolidated Financial Statements

Years ended December 31, 2010 and 2009

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

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 the Company’s own product portfolio, the Company through its wholly-owned subsidiary, PharmaForm LLC, 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 incurred significant net losses and negative cash flows from operations in prior years. 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, 2010, the Company has a cash balance of \$474, net current liabilities of \$8,173, a shareholders’ deficit of \$24,369 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 15, 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 endeavors 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) In 2009 the Company announced and undertook two corporate reorganizations to conserve cash. On February 9, 2009 the Company announced the implementation of measures to cut costs and preserve cash. The reduction in costs targeted the Pharmaceutical Development programs as well as, PharmaForm. On September 3, 2009, the Company announced a comprehensive corporate restructuring designed to achieve several operational objectives. As part of its efforts to preserve its ability to execute on its development strategy for Fentanyl TAIFUN® and to optimize the infrastructure required to support its PharmaForm clients, the Company reduced its head count by 32

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employees to a workforce of 65. Further, the Company also announced the closure of the Company's international operations and the centralization of the Company's operational headquarters in Austin, Texas.

- b) As part of the Company's cost reduction effort, the Fentanyl TAIFUN® program operates with a focused scope limiting the size and the number of clinical trial sites. The Company's strategy therefore is to sustain the continuance of the Fentanyl TAIFUN® program and seek funding for the Company's proprietary compounds from the Company's current and new commercial partners. Until the Company succeeds in raising additional capital through partner funding, equity or debt financing the Company is not recruiting any further patients into clinical studies.
- c) The Company is no longer funding the scientific development of GHRH, HspE7, AKL 0721 or Poly ICR. While the Company is actively seeking licensing arrangements as well as other external development strategies, the Company may not be able to obtain sufficient capital to continue to fund the maintenance and prosecution costs of the patents and intellectual property associated with these technologies. Because of the Company's significant liquidity issues, the Company may be forced to terminate these programs as the Company looks to strategically focus the Company's current remaining capital resources on Fentanyl TAIFUN®.
- d) On April 16, 2010, the Company announced that the Company had reached agreement with HEP Davis Spring, L.P. to terminate its leased 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 associated cash secured letter-of-credit, 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 note 5).
- e) On June 17, 2009, the Company announced that the Company had signed an amendment to the Company's Fentanyl TAIFUN® license and co-development agreement with Teikoku Seiyaku Co. Ltd. ("Teikoku"). According to the amendment to the original agreement announced in January 2006, milestone payments of up to \$2.0 million would be advanced to be payable earlier than originally intended. The Company received \$0.2 million upon signing of the amendment, and would receive \$1.8 million subject to meeting a near term development milestone related to the pharmaceutical development of the Product. On February 11, 2010, Akela achieved a near term development milestone in the pharmaceutical development of the Fentanyl TAIFUN® inhaler (the "Product"). The remaining \$1.8 million was received by Akela on August 6, 2010. All milestone funding is contractually committed to the ongoing development of Fentanyl TAIFUN®.
- f) On October 29, 2010, the Company was awarded through the United States Qualifying Therapeutic Discovery Grant Program federal grants of \$0.7 million to facilitate continued development of research programs.
- g) During 2010 as a result of the measures to cut costs, reduce liabilities and increase cash which was begun in 2009, the Company has minimized costs related to the development strategy for Fentanyl TAIFUN®. The Company has effectively reduced operating costs and increased margins within the PharmaForm subsidiary.

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- h) In order to ensure the availability of current capital resources, the Company may attempt to issue new equity securities, issue new debt or pursue various other funding alternatives.

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 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 may 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:*

There are no new accounting policies implemented in the year.

(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. These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

(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, 2010 and 2009, 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 7 years
Computer equipment	3 to 5 years
Furniture and office equipment	3 to 7 years
Leasehold improvements	Term of lease

(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

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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
Computer software	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 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 and is categorized as Level 1. Restricted cash and deposits are classified as held to maturity. Accounts receivable are classified as loans and receivables, and accounts payable, 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 ability to observe the inputs used in their measurement:

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- Level 1: This level includes assets including securities held for trading and liabilities measured at fair value based on unadjusted quoted price 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.

(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 clinical 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. Revenues from licensing and co-development agreements are recognized as follows, for 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

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determinable, and collectability is reasonably assured. For contracts with fees based on time and materials, revenue is recognized over the period of performance.

Revenue 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.

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 co-development 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.

(m) Government assistance

Amounts received resulting from government assistance programs, including grants and investment tax credits for research and development, are either reflected as a reduction of the cost of the asset or expense to which they relate at the time the eligible expenditures are incurred or are treated as other income for grants received in periods after the eligible expenditures occurred. Tax credits are recorded in the accounts when reasonable assurance exists that they will be realized. In 2010 the Company recorded revenue of \$727 in US Qualifying Therapeutic Discovery Grants. During 2010, \$238 was received and the balance is included in accounts receivable (2009 – nil). In 2009, the conditions relating to a Finnish grant were no longer respected and the grant was recorded as a long-term debt with a corresponding adjustment to net income being made (Note 15).

(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.

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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. The Company determines the fair value of stock options granted using the Black-Scholes option pricing model. Forfeitures are recorded as incurred.

(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

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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 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.

(ii) *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 has determined that EIC-175, will not have an impact on the Company's interim or annual financial statements beginning January 1, 2011.

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

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agreements, the Company 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 would 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 and on August 6, 2010, the Company received the funds. The \$2,000 has been deferred and is being recognized ratably over the estimated development period to June 30, 2016. Use of the funds must be committed to the ongoing development of Fentanyl TAIFUN®.

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. 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).

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:

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	2009
<hr/>	
Net assets acquired:	
Cash and cash equivalents	1,369
Accounts Receivable	106
Goodwill	83
	<hr/>
	\$ 1,558
	<hr/>
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
	<hr/>
	\$ 1,558
	<hr/>

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)).

- 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 the date which is the later of six months following the closing date or the date 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, 2010, 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

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option of the selling shareholders. As of December 31, 2010, 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 listed on the TSX, the Company believes that the probability of the selling shareholders obtaining the right is remote.

If in the event that Phase I or III milestones are achieved, and the Company fails to maintain its listing requirements resulting in the contingent payments being made, the put option would be exercised by the holder, and 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).

5. Lease termination

In April 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 a lease in 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 14, 15 and 17) at December 31, 2009.

In 2009, 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.

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The lease termination costs recorded in 2009 are summarized as follows:

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

The fair value of the common shares issued, \$160, was determined based on the closing market price 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 then effective rate of interest, 15% (see note 15).

6. Provision for repayment of government grants and loans

Between 2001 and 2006, 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 and other 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 a portion of the loans would not be collected prematurely but made a demand for repayment of a portion of one loan and the issued grants, together with interest. In April 2009, the Company's appeal against the decision to repay the grants 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, during 2009 a charge of \$1,544 was made for 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, in 2009 the Company's \$1,544 provision associated with Tekes' claim was classified as long-term debt. In 2009, upon the advice of legal counsel, the Company's estimated obligation, \$1,786 (€1,248), had 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. Prior to 2010 interest expense

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related to the loans issued to the Company by Tekes was not previously accrued. In March 2011, the Company was notified by Tekes of the actual interest rates applied. The Company no longer accrues interest on the Tekes' grants at a provisional rate of 9.5% as of December 31, 2010. Interest is calculated by Tekes under their amortization and payments schedule. As of December 31, 2010 the Company uses the actual rate of Tekes. The interest rates used by Tekes vary and are tied to the basic rate of interest of the Bank of Finland plus a potential 3% premium. The basic rate of interest of the Bank of Finland was 1% at December 31, 2010. As of December 31, 2010, the Company has not made two scheduled payments of principal and interest due on 9/30/10 and 12/31/10 representing (€159). In the fourth quarter of 2010, the Company recorded interest expense of \$1,059 based upon the revised interest calculation utilizing the reported Tekes rates of interest for the government grants and loans received (see note 15).

7. Settlement with Lab Research Inc (LRI:TSX)

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 that was recorded in 2009.

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 and realized loss of \$78 and \$23 on securities held for trading for the year ended December 31, 2010 and December 31, 2009.

Based on the remaining life of the warrants, which were to expire on December 30, 2010, together with the prevailing market price and expected volatility of LRI's common stock at nominal risk free interest rates, the Company concluded that the fair value of the warrants was nil.

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

In 2009, 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 all goodwill and all intangibles resulted in a charge in December of 2009 of \$9,601.

				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	\$ -

9. Restructuring

During 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, which includes costs for employee severance and other restructuring costs, costs also include 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 fulfill its payment arrangements,
- 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.

At December 31, 2010, there are no remaining unpaid restructuring charges.

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Restructuring Charges	Total
Balance, December 31, 2008	\$ -
Provision for cost reduction plan:	
Employee severance	390
Impairment of property and equipment associated the Company's international subsidiaries	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
	1,071
Noncash Items:	
Impairment loss on P&E	(222)
Paid in 2009	
Cash	(600)
Balance, December 31, 2009	249
Paid in 2010	
Cash	249
Balance, December 31, 2010	\$ -

10. Accounts receivable

	2010	2009
Trade	\$ 1,566	\$ 1,576
Sales taxes	-	79
Other	24	24
	\$ 1,590	\$ 1,679

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11. Property and equipment

	2010		
	Cost	Accumulated amortization	Net carrying amount
Laboratory equipment	\$ 5,310	\$ 2,531	\$ 2,779
Computer equipment	303	210	93
Furniture and office equipment	452	239	213
Leasehold improvements	-	-	-
	\$ 6,065	\$ 2,980	\$ 3,085

	2009		
	Cost	Accumulated amortization	Net carrying amount
Laboratory equipment	\$ 5,023	\$ 1,774	\$ 3,249
Computer equipment	297	157	140
Furniture and office equipment	452	169	283
Leasehold improvements	2,312	1,819	493
	\$ 8,084	\$ 3,919	\$ 4,165

Amortization expense related to assets under capital leases was \$101 (2009-\$228).

As of December 31, 2010 and 2009, the cost, accumulated amortization and net carrying value of laboratory equipment under capital leases was as follows:

	2010		2009	
Cost	\$ 914		\$ 1,681	
Accumulated amortization		(217)		(342)
	\$ 697		\$ 1,339	

12. Intangible assets

	2010			
	Cost	Accumulated amortization	2010 Impairment	Net Amount
Computer software	\$ 191	\$ 117	\$ -	\$ 74
	\$ 191	\$ 117	\$ -	\$ 74

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			2009	
	Cost	Accumulated amortization	2009 Impairment	Net Amount
Intellectual property rights acquired	\$ 3,600	\$ 1,050	\$ 2,550	\$ -
Customer contracts and relationships	2,000	1,945	55	-
Computer software	111	59	-	52
Non-competition agreement	1,400	1,361	39	-
FDA/DEA certifications	1,000	583	417	-
	\$ 8,111	\$ 4,998	\$ 3,061	\$ 52

(See Note 8)

13. Other assets

	2010	2009
Deposits for leases, laboratory equipment and tenant improvements	\$ 67	\$ 598
	\$ 67	\$ 598

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

14. Restricted cash and deposits

Restricted cash as of December 31, 2010 is nil. Restricted cash as of December 31, 2009 consisted of a \$938 cash deposit for a office lease commencing on November 1, 2008. In April 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).

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15. Long-term debt

	2010	2009
Repayment of grants by the Company in Euros (2010 - €1,226; 2009 - €1,248) grants bearing interest at the basic rate of interest of the Bank of Finland plus interest premium of 3% (€334). According to the terms of the Lender's Payment Decision of 6/17/2009, the Company's Finnish subsidiary will pay back the grants received plus interest, with principal in equal quarterly installments during a period of four years, starting in September 2010 and the last payment to occur in June 2014. As of the date of this report, the Company has not made the payments of principal and interest due at 9/30/10 nor 12/31/10 representing (€159). (See note 1).	\$ 1,642	\$ 1,786
Capital loans of the Company in Euros (2010 - €2,425; 2009 - €1,886) unsecured loans 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 and principal repayment are contingent upon specified successful financial performance of the Company's Finnish subsidiary. The Company's Finnish subsidiary currently does not meet the specified requirements of financial performance to cause repayment. Agreement 976/04.	3,247	2,698
Capital loans of the Company's in Euros (2010 - €129; 2009 - €189) unsecured loans 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 is eight years to February 2010 however interest and principal repayment are contingent upon specified successful financial performance of the Company's Finnish subsidiary. The Company's Finnish subsidiary currently does not meet the specified requirements of financial performance to cause repayment. Agreement 651/01.	173	270
Capital loans of the Company's in Euros (2010 - €476; 2009 - €464) unsecured loans 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 loan is eight years to February 2010 however interest and principal repayment are contingent upon specified successful financial performance of the Company's Finnish subsidiary. The Company's Finnish subsidiary currently does not meet the specified requirements of financial performance to cause repayment. Agreement 746/02	637	664
Balance carried forward	5,699	5,418

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	2010	2009
Balance brought forward	5,699	5,418
Capital loans of the Company in Euros (2010 - €338; 2009 - €315) unsecured loans 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's capital repayments were to begin in 2011 however interest and principal repayment are contingent upon specified successful financial performance of the Company's Finnish subsidiary. The Company's Finnish subsidiary currently does not meet the specified requirements of financial performance to cause repayment. Agreement 810/05.	452	450
Capital loans of the Company in Euros (2010 - €155; 2009 - €150) 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 (€147) of the loan balance during the third quarter of 2009. During the fourth quarter of 2009, the Company failed to fulfill its commitment to repay the (€147) loan balance of this note. At December 31, 2010, the effective interest rate on this unsecured debt was 1.00%. The current loan balance at 12/31/10 of (€147) of principal and (€20) has not been repaid. Agreement 810/05.	207	214
Capital loans of the Company in Euros (2010 - €268; 2009 - €189) bearing interest at 5%. The terms of the loans are for 7 years to January 2011. Interest and principal repayment are contingent upon specified successful financial performance of the Company's Finnish subsidiary. The Company's Finnish subsidiary currently does not meet the specified requirements of financial performance to cause repayment.	359	270
Present value of \$1,200 payable in monthly installments of \$10 through March 2020 pursuant to lease termination agreement. (Note 5)	599	620
Capital lease obligations of the Company bearing interest 6% to 10.11%, secured by related equipment with a carrying value at December 31, 2010 of \$453 and December 31, 2009 \$965. All lease obligations are current portion of long-term debt.	155	649
Auto loan bearing 8.5% interest	9	9
	7,480	7,630
Current portion of long-term debt	1,037	1,015
	\$ 6,443	\$ 6,615

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Capital Lease and long-term debt repayments for the next five years are as follows:

		Capital Leases and LTD				
	Gross payments	Imputed interest	Present Value	Other Long Term	Total	
2011	\$ 160	\$ (5)	\$ 155	\$ 882	\$ 1,042	
2012	-	-	-	447	447	
2013	-	-	-	445	445	
2014	-	-	-	249	249	
2015	-	-	-	59	59	
Thereafter	-	-	-	5,243	5,243	
	\$ 160	\$ (5)	\$ 155	\$ 7,325	\$ 7,485	

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:

	2010	2009
Loss before income taxes	524	(20,933)
Combined Canadian federal and Quebec provincial income taxes at 29.9% (2009 - 30.9%)	157	(6,468)
Adjustments for:		
Difference with foreign tax rates	(233)	192
Foreign exchange	(49)	(2,651)
Tax rates variation	41	433
Adjustment to opening timing difference	(38)	(303)
Change in valuation allowance	957	8,719
Stock-based compensation	19	70
Benefit of losses not recorded	(765)	-
Changes in previously recorded provisions and other	(796)	72
Income tax (recovery) provision	(707)	64

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

	2010	2009
Current income taxes	\$ (707)	\$ 64
Future income taxes	-	-
	\$ (707)	\$ 64

Beginning in 2008 and continuing through 2011, the Company has been undergoing an audit in the normal course of business by the Canadian Revenue Agency (the CRA) for the years 2005 and 2006. As a result of the audit management has reviewed their 2009 estimate of the potential liability related to the investment tax credits they received in prior years. This adjustment is based upon the ongoing negotiations with the government. The potential liability is recorded as part of income taxes payable and the corresponding adjustment to the estimate has been recorded as a decrease to research and development expenses.

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

The future income tax balances are summarized as follows:

	2010	2009
Future income tax assets:		
Non-capital losses	\$ 28,952	\$ 29,156
Share issue costs	329	329
Research and development expenses	4,161	5,630
Property and equipment	26	47
Provision bad debts	8	45
Intangible assets	-	489
Deferred revenues	5,934	5,363
Other	782	800
	40,192	41,859
Future income tax liabilities:		
Unrealized foreign exchange gain	(657)	(1,502)
Less valuation allowance	(39,535)	(40,357)
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	\$15,469	\$ -	\$ -
Non-capital losses expiring			
2013	-	-	6,690
2014	1,615	1,618	5,145
2015	1,645	1,645	9,085
2016	-	-	16,937
2017	-	-	16,697
2018	-	-	18,782
2019	-	-	11,955
2020	-	-	2,042
2027	2,895	2,881	-
2028	3,925	3,925	-
2029	9,324	9,324	-
2030	1,378	1,378	-

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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 the Company's 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 the Company's liquidation, dissolution or winding up, rank on a parity with the preference shares of every other series and be entitled to preference over the Company's 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 the Company's common shares and over any other shares ranking junior to the preference shares as may be fixed by the Company's 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 the Company's board of directors out of moneys properly applicable thereto subject to the rights of the holders of the preference shares; and (c) to receive the Company's remaining property upon the Company's dissolution, subject to the rights of the holders of the preference shares.

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

(i) 2010 issuances

On December 6, 2010, the Company issued 250,000 shares of common stock, bearing a fair value of \$35, to Ingalls & Snyder as part of an agreement to pay the indemnified costs related to a Line of Credit Agreement entered into as of June 3, 2010. The line of credit was for an amount not to exceed \$2,750 with a non-compounded interest rate of fifteen percent per annum with any outstanding principal and unpaid interest six months after the effective date. This agreement was mutually terminated on September 24, 2010. The fair value of the common shares was determined based on the closing market price of December 6, 2010.

On June 25, 2010, the Company issued 1,250,000 shares of common stock, bearing a fair value of \$160, to HEP Davis Spring, L.P. (HEP Davis Spring) as part of an agreement to terminate a lease in Austin, Texas. The fair value of the common shares was determined based on the closing market price as of the effective date of the agreement, April 2, 2010.

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(ii) 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

(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 was 714,285. The maximum number of common shares that were allowed to be awarded to any one grantee during any calendar year could not exceed 71,428.

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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.

In June 2010, the shareholders approved an Amendment of the 2007 Stock Incentive Plan. Under the Amended Stock Incentive Plan the number of shares that may be granted or sold as “Unrestricted Stock Awards” in any calendar year from and after June 30, 2010 shall not exceed 3,089,011 shares of Common Stock. The number of shares that may be granted or sold as Unrestricted Stock Awards is not subject to any separate limitation, other than the overall general limit on the maximum aggregate number of Common Shares that may be granted or sold as Unrestricted Stock Awards in any calendar year. The number of common shares issuable to insiders, at any time or in any given year, under all security based compensation arrangements of the issued and outstanding common share are subject to certain limitations contained in the 2007 Plan and modifications under the 2007 Amendment.

The Amended Stock Incentive Plan permits the grant or sale of Unrestricted Stock Awards to grantees, pursuant to which grantees may receive Common Shares free of any vesting restrictions, in respect of past services or other valid consideration, or in lieu of any cash compensation to such grantee.

As of December 31, 2010, 2,161,893 options remained available for issuance under the Company’s stock option plans.

Changes in outstanding options issued under the Company’s stock option plans for the years ended December 31, 2010 and 2009, were as follows:

	Number	Weighted Average Exercise Price (CDN \$'s)
Balance, December 31, 2008	1,604,393	5.57
Granted	713,565	3.88
Forfeited	(1,589,393)	5.49
Expired	(170,510)	6.04
Balance, December 31, 2009	558,055	3.49
Granted	1,671,403	0.11
Forfeited	(123,667)	1.33
Expired	(349,388)	4.79
Balance, December 31, 2010	1,756,403	\$ 0.17
Options Exercisable December 31, 2010	446,705	\$ 0.27

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Range of exercise prices (CDN)	Options outstanding	Weighted average exercise price (CDN)	Weighted average exercise price (USD Equivalent)	Options exercisable	Weighted average exercise price (CDN)	Weighted average exercise price (USD Equivalent)	Weighted average remaining contractual life (years)
\$1.39 - 6.86	5,000	\$6.86	\$6.90	5,000	\$6.86	\$6.90	6.33
\$0.16 - 1.38	50,000	\$1.38	\$1.39	25,000	\$1.38	\$1.39	7.28
\$0.11 - 0.15	1,671,403	\$0.11	\$0.11	416,705	\$0.11	\$0.11	9.85
\$0.11 - 6.86	1,726,403	\$0.17	\$0.17	446,705	\$0.27	\$0.27	

(d) Warrants and broker units

As of December 31, 2010, the following warrants were outstanding:

Warrants					
Number	Fair value at issuance (USD)	Common share equivalents	Exercise price (CDN)	Exercise price (USD) Equivalent	Expiration Date
4,312,500	2,155	4,312,500	\$1.50	\$1.51	March 28, 2011
941,725	49	941,725	\$7.04	\$7.08	January 4, 2012 (1)
974,533	79	974,533	\$7.04	\$7.08	January 24, 2012 (1)
6,228,758	2,283	6,228,758			

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

In 2010, 2,191,182 stock purchase warrants and broker units expired. The fair value of these expirations, \$667, was reclassified to additional paid in capital. In 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.

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(e) Stock-based compensation

For the year ended December 31, 2010, the Company granted 1,641,403 (2009 – 713,565) options. During 2010 the Company recognized total stock-based compensation of \$64 (2009 – \$238).

The weighted 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:

	2010	2009
Risk-free interest rate	1.87 %	0.97 %
Expected volatility	153.05 %	188.45 %
Expected life in years	3.00	1.81
Expected dividend yield	-	-

The following table summarizes the weighted average grant-date fair value per share for options granted during the years ended December 31, 2010 and 2009:

	Number of options	Weighted average grant-date fair value (CDN \$'s)
2010	1,641,403	0.11
2009	713,565	0.05

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

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(f) Weighted average number of shares (basic)

Weighted Average Shares	Shares Issued	Shares Outstanding	Period	Weighted Shares
January 1, 2010		30,890,338	0.50	15,445,169
June 25, 2010	1,250,000	32,140,338	0.42	13,498,942
December 6, 2010	250,000	32,390,338	0.08	2,591,227
December 31, 2010 Weighted Average Shares				31,535,338

Weighted Average Shares	Shares Issued	Shares Outstanding	Period	Weighted Shares
Balance January 1, 2009	-	21,615,577	0.39	8,406,057
Nventa	9,274,761	30,890,338	0.61	18,877,430
December 31, 2009 Weighted Average Shares				27,283,487

(g) Earnings per share

The total maximum shares outstanding shares if all dilutive and potentially dilutive instruments were exercised or converted at December 31, 2010 is 39,065,801 derived from 446,705 exercisable options, 6,228,758 exercisable warrants and 32,390,338 outstanding common shares at December 31, 2010. Of the potentially dilutive instruments only 386,705 exercisable options were “in the money” at December 31, 2010.

In 2010 the impact of earnings per share on a fully dilutive basis would have a decrease of \$0.006 per share based upon the 1,671,403 options (vested and non-vested) that were “in the money”. The denominator in the diluted earnings per share calculation amounted to 31,618,760. In 2009, the earnings per share impact of stock options, and warrants were considered anti-dilutive and were excluded in reporting.

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18. Commitments, contingencies and guarantees

(a) *Commitments:*

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

	2011	2012	2013	2014	2015	2016+	Total
Operating Leases	400	317	-	-	-	-	717
Service Contracts	149	13					162
	549	330	-	-	-	-	879

Since 2003, 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, 2010, 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 50-65% 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

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expenses. Failure to comply with these conditions would result in an obligation to refund all of the funds to 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, 2010, the Company believes it has complied with the terms of the advance milestones.

On June 17, 2009, the Company announced that the Company had signed an amendment to the Company's Fentanyl TAIFUN® license and co-development agreement with Teikoku Seiyaku Co. Ltd. ("Teikoku"), 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 \$2.0 million would be advanced to be payable earlier than originally intended. The Company received \$0.2 million upon signing of the amendment, and was entitled to the \$1.8 million on February 11, 2010 when the milestone was achieved relating to the pharmaceutical development of the Product. The \$1.8 million was received by Akela on August 6, 2010. All milestone funding is contractually committed to the ongoing development of Fentanyl TAIFUN®.

(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 February 2010, Mr. Crowley filed suit against Formulation Technologies, LLC ("d/b/a/") PharmaForm to confirm an arbitration award. On July, 2, 2010 the Court appointed receiver levied \$442 from PharmaForm's financial accounts. On October 25, 2010 the Court agreed to discharge the receiver and released \$92 plus interest as reimbursement to PharmaForm for the original levy.

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 provision for this unpaid liability at December 31, 2010 was \$118.

The Company and certain board members were named as defendants in actions filed in the District Court of Travis County, Texas by two former employees; Andrew Reiter and Robert Clayborough. The Company has reached settlement agreements with both Mr. Reiter and Mr. Clayborough with neither agreement having a material adverse effect on the Company's consolidated financial statements. Both legal matters before the Court have been dismissed.

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In 2010 the Company was notified of potential claims related to previous employees. Although no formal litigation has been entered into, the Company has entered a provisional accrual of \$450 related to these matters.

On December 31, 2010, the Company did not meet its obligation to pay Tekes, the Finnish Funding Agency for Technology and Innovation, an initial quarterly installment of approximately \$0.1 million as part of a litigation settlement arrangement between Tekes and Akela's Finnish subsidiary (see notes 5 and 8). While the Company intends to resolve Tekes' grievances as part of an action plan to address all outstanding claims associated with Akela's Finish subsidiary, which represent approximately \$6.2 million of the Company's consolidated long-term debt as of December 31, 2010, it is not possible to estimate the amount of additional losses or range of possible losses, if any, that might result from an adverse resolution of this matter.

The Company also faces claims from creditors for unpaid services and supplies, as a number of Akela's liability obligations are in default (see notes 1 and 8). While the outcome of these claims cannot be predicted with certainty the Company does not anticipate that these pending legal matters will have an additional 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, 2010.

(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, 2010 and 2009, 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.

19. Supplemental cash flow disclosure and other information

(a) Net changes in operating assets and liabilities:

	2010	2009
Accounts receivable	\$ 89	\$ 4,497
Prepaid expenses	115	7
Accounts payable and accrued liabilities	(2,250)	505
Income taxes payable	(533)	-
Deferred Revenue	(919)	(3,356)
	\$ (3,498)	\$ 1,653

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(b) Additional information:

	2010	2009
Interest paid	\$ 183	\$ 126

(c) Non-cash transactions:

	2010	2009
Issuance of common shares, options and warrants in connection to the acquisition of Nventa Corp. (note 4(a))	\$ -	\$ 1,346
Issuance of common shares in connection to the termination of a leased facility with HEP Davis Spring LP (note 5)	160	-
Issuance of common shares in connection to the settlement of a termination fee related to the Ingalls & Snyder line of credit (note 17(b)(i))	35	-
Use of deposits against acquisition of property and equipment	523	-
Cancellation of capital lease	177	-
Property and equipment financed through capital leases	93	423

20. Related party transactions

One of the Company's consultants, Robert O. Williams III, Ph.D., also served as a member of the Board of Directors until June 2010. For consulting services rendered to the Company, during 2010 the Company paid \$31 and at December 31, 2010 had a \$62 current liability and \$94 long term liability payable to Robert Williams related to an October 2010 negotiated settlement of outstanding payables and termination of a consulting agreement between the Company and Robert Williams. During 2009 the Company incurred expenses totaling \$280 related to Robert Williams consulting and the current liability in 2009 was \$187. This related party transaction ended in 2010 when Dr. Williams did not stand for re-election to the Akela Board of Directors and the Company and Robert Williams terminated the consulting agreement.

During 2009, the Company incurred legal and tax consulting fees totaling \$73, 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.

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

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.

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.

21. Financial instruments

(a) Classification:

The classification of financial instruments as of December 31, 2010 and 2009 and their respective carrying values and fair values are as follows:

31-Dec-10	Held for trading	Loans and receivables	Held-to- maturity	Other financial liabilities	Carrying value	Fair Value
Cash	\$474				\$474	\$474
Accounts receivable		1,590			1,590	1,590
Accounts payable & accrued liabilities				5,709	5,709	5,709
Long-term debt				7,325	7,325	2,693

31-Dec-09	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 & accrued liabilities				7,801	7,801	7,801
Long-term debt				6,981	6,981	3,358

(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:

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(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.

(ii) 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.

(iii) Other financial liabilities

Accounts payable, accrued liabilities and long-term debt. 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. Some short term portion of long-term debt related to capital lease obligations is secured by related equipment with a carrying value at December 31, 2010 of \$697.

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.

Management’s objectives and policies in managing financial risk for the year ending December 31, 2010 were based upon cash conservation, reduction of current payables and accrued liabilities through the use of internal funding from profitable operations. The use of short term lines of credit to mitigate cash flow needs and liquidity risk was utilized periodically to manage variations of revenue flow. Management has focused upon the retirement and extinguishing of capital leases and long term debt to decrease the overall debt-to-equity ratio. The Company carries long term debt with favorable repayment terms and has reduced the risk of default on repayment of this debt. The majority of foreign currency risk is based upon the Euro based long term debt of the Company. The Company is exposed to minimal operational foreign currency risk as the majority of revenues are currently derived from with the US. Management has focused upon the reduction of credit risk related to accounts receivable by focus the client base on credit worthy, established pharmaceutical and drug development companies. Management intends to continue to utilize these policies for the coming periods and there is no change in the management of financial risks compared to December 31, 2009.

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(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, 2010 and 2009, the recorded a provision of \$23 and \$470 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, 2010 and 2009, one customer accounted for approximately 29% and 22%, respectively, of the Company's revenues. As of December 31, 2010, two customers accounted for approximately 39% of the Company's total receivables (2009 – 24%).

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

	As of December 31, 2010
Total accounts receivable	\$ 1,566
Of which:	
Not overdue	658
Past due for more than one day but for not more than three months	825
Past due more for than three months but for not more than six months	106
Total accounts receivable, gross	\$ 1,589
Allowance for doubtful accounts	(23)
Total accounts receivable, net	\$ 1,566

	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

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(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 financial instruments to manage its currency exposure. During 2010 and 2009, 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, 2010 and 2009:

(in thousands of US dollars)	December 31, 2010			
	\$Cdn	Euro	\$Bds	INR
Cash	\$ 14	\$ 0	\$ 1	\$ -
Accounts receivable	561	7	-	-
Accounts payable and accrued liabilities	1,370	261	148	166
Long-term debt	-	6,726	-	-

(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	-	-

The following exchange rates applied during the reporting period and for the year ended December 31, 2010:

Currency	Exchange	Average	Closing
Canadian dollar	US/Cdn	0.9703	1.0054
Euro	US/Euro	1.3248	1.3391
Barbadian	US/Bds	0.5083	0.5128
Indian Rupee	US/INR	0.0219	0.0222

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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 \$455, 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, 2010, \$6,7 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 \$53 for the year ended December 31, 2010. The Company currently does not have any outstanding credit facilities.

(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, 2010:

	Amounts Payable	Less than 1 year	1 to 3 years	3 to 5 years	Thereafter
Accounts Payable & Accrued Liabilities	5,709	5,709	-	-	-
Operating Leases	717	400	317	-	-
Capital Leases *	155	155	-	-	-
Service Contracts	162	149	13	-	-
Long-term debt *	7,325	882	892	308	5,243
	14,068	7,295	1,222	308	5,243

*Long term debt includes capital leases in Note 15.

AKELA PHARMA INC.

Notes to Consolidated Financial Statements

Years ended December 31, 2010 and 2009

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23. Capital Management

The Company's objectives when managing capital are:

- To sustain the continuance of the Fentanyl TAIFUN® program,
- Generate increasing profitability and cash flow from contract research and pharmaceutical manufacturing.
- To maintain a flexible capital structure which optimizes the cost of capital at acceptable risk,
- To sustain the Company's 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.

	2010	2009
Shareholders' deficiency	\$ (24,369)	\$ (25,699)
Current and long-term debt	7,480	7,630
	(16,889)	(18,069)
Less: cash and cash equivalents	(474)	(107)
	\$ (17,363)	\$ (18,176)

The Company's 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 the Company's proprietary compounds from the Company's current and new commercial partners. Until the Company succeeds in raising additional capital through partner funding, equity or debt financing are not recruiting any further patients into clinical studies.

The Company is not subject to any externally imposed capital requirements and there was no change in the management of capital for the year ending December 31, 2010.

AKELA PHARMA INC.

Notes to Consolidated Financial Statements

Years ended December 31, 2010 and 2009

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

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:

	2010	2009
United States	\$ 10,449	\$ 10,285
Europe	2,853	3,080
Other	-	528
	\$ 13,302	\$ 13,893

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

	2010	2009
	United States	
Property and equipment	\$ 3,085	\$ 4,165
Intangibles	\$ 74	\$ 52
	\$ 3,159	\$ 4,217