

Condensed Consolidated Interim Financial Statements

**MEDIFOCUS INC.**

For the three months ended June 30, 2011 and 2010  
(Unaudited)

## **Responsibility for the Financial Statements and Notice of no Auditor Review**

The accompanying condensed consolidated interim financial statements for Medifocus Inc. ("Medifocus") are the first financial statements we have prepared since our transition to International Financial Reporting Standards ("IFRS"). They have been prepared by management in accordance with International Accounting Standard 34, "Interim Financial Reporting" ("IAS 34"), as issued by the International Accounting Standards Board ("IASB"). Previously, Medifocus reported under Canadian Generally Accepted Accounting Principles ("Canadian GAAP"), and the most significant accounting policies under Canadian GAAP were set out in the March 31, 2011 annual audited financial statements. Management has amended certain accounting policies and descriptions it previously applied in the Canadian GAAP financial statements to comply with IFRS; however, these changes have not had any material impact on the amounts previously recorded. These interim statements are presented on the accrual basis of accounting and accordingly, a precise determination of many assets and liabilities is dependent upon future events. Therefore, estimates and approximations have been made using careful judgment. Recognizing that the Company is responsible for both the integrity and objectivity of the financial statements, management is satisfied that these interim financial statements have been fairly presented.

These statements have not been reviewed by the Company's external auditor.

**Medifocus Inc.**

Incorporated under the laws of Ontario

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF  
FINANCIAL POSITION (unaudited)**

As at	June 30, 2011	March 31, 2011	April 1, 2010
	\$	\$	\$
<b>ASSETS</b>			<i>Note 15</i>
<b>Current</b>			
Cash and cash equivalents	364,448	522,008	60,181
Restricted cash	—	—	373,027
Harmonized sales tax recoverable	62,775	58,889	34,660
Prepaid expenses and sundry assets	8,207	8,207	8,603
<b>Total current assets</b>	<b>435,430</b>	<b>589,104</b>	<b>476,471</b>
Product development assets <i>[note 2]</i>	3,519,630	3,375,471	2,652,167
Plant and equipment, net <i>[note 5]</i>	14,640	15,994	22,754
	<b>3,969,700</b>	<b>3,980,569</b>	<b>3,151,392</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current</b>			
Accounts payable and accrued liabilities	1,053,080	1,157,084	740,091
Advance subscriptions	—	—	373,027
Due to employees and consultants <i>[note 14]</i>	421,762	441,963	463,329
Convertible promissory debt <i>[note 7]</i>	192,410	179,838	216,325
Convertible debenture <i>[note 8]</i>	281,335	267,915	—
<b>Total current liabilities</b>	<b>1,948,588</b>	<b>2,046,799</b>	<b>1,792,772</b>
<b>Equity</b>			
Capital stock <i>[note 6]</i>	4,094,818	3,797,443	3,385,892
Common shares to be issued <i>[note 6]</i>	1,207,815	1,207,815	615,316
Equity portion of convertible debenture <i>[note 8]</i>	11,670	11,670	—
Contributed surplus	1,219,944	1,202,147	—
Accumulated deficit	(4,513,134)	(4,285,305)	(2,642,588)
<b>Total equity</b>	<b>2,021,113</b>	<b>1,933,770</b>	<b>1,358,620</b>
	<b>3,969,700</b>	<b>3,980,569</b>	<b>3,151,392</b>

*The accompanying notes are an integral part of these condensed consolidated interim financial statements*

On behalf of the Board:

**“Joseph  
Chan”**

Director

**“Grant B.  
Walsh”**

Director

**Medifocus Inc.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF LOSS  
AND COMPREHENSIVE LOSS (unaudited)**

For the three months ended June 30

	2011	2010
	\$	\$
<b>Operating Expenses</b>		
Development and investor relations	15,159	123,810
Consulting and management fees	75,937	85,249
Accretion of discount <i>[note 8]</i>	2,920	—
General and office	45,708	35,034
Professional fees	18,918	28,687
Listing fees	29,434	9,250
Stock based compensation expense	17,797	—
Interest expense	24,788	9,579
Depreciation	6,760	29,213
	<u>227,421</u>	<u>320,822</u>
Net loss before foreign exchange	<u>(227,421)</u>	<u>(320,822)</u>
Foreign exchange loss	408	1,690
Net loss and comprehensive loss	<u>(227,829)</u>	<u>(322,512)</u>
Basic and fully diluted loss per share	<u>(0.0075)</u>	<u>(0.0124)</u>
Weighted average number of common shares outstanding 000's <i>[note 10]</i>	<u>30,534,182</u>	<u>26,002,635</u>

*The accompanying notes are an integral part of these condensed consolidated interim financial statements*

**Medifocus Inc.**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS  
(unaudited)**

For the three months ended June 30

	<b>2011</b>	<b>2010</b>
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net loss for the period	(227,829)	(322,512)
Items not involving cash		
Depreciation	408	1,690
Stock-based compensation	17,797	—
Shares to be issued in lieu of payment	6,760	29,213
Accretion of discount	2,920	—
Unrealized foreign exchange gain	(8,733)	—
Net change in non-cash working capital balances related to operations <i>[note 10]</i>	(115,518)	(59,352)
<b>Cash used in operating activities</b>	<b>(324,195)</b>	<b>(350,961)</b>
<b>INVESTING ACTIVITIES</b>		
Additions to product development charges	(144,159)	(158,350)
<b>Cash used in investing activities</b>	<b>(144,159)</b>	<b>(158,350)</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of common shares	297,374	527,499
Convertible debenture	13,420	—
<b>Cash provided by financing activities</b>	<b>310,794</b>	<b>527,499</b>
<b>Net increase in cash and cash equivalents during the period</b>	<b>(157,560)</b>	<b>18,188</b>
Cash and cash equivalents, beginning of period	522,008	60,181
<b>Cash and cash equivalents, end of period</b>	<b>364,448</b>	<b>78,369</b>
<b>Supplementary information:</b>		
<i>Interest paid</i>	24,788	9,579
<i>Income taxes paid</i>	—	—
<i>Shares to be issued in lieu of payment [note 9]</i>	6,760	29,213

*The accompanying notes are an integral part of these consolidated financial statements*

**Medifocus Inc.**
**UNAUDITED INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)**

	Common shares		Warrants		Subtotal Cad \$	Common shares to be issued		Equity	Other	Contributed	Deficit Cad \$	Total
	#	Cad \$	#	Cad \$		#	Cad \$	Portion of Promissory Notes Cad \$	Comprehensive Income	Surplus Cad \$		Shareholders Equity Cad \$
March 31, 2008	103	52,081	-	-	52,081	-	-	168,207	-	-	(2,383,716)	(2,163,428)
Shares issued upon exercise of warrants	429,410	85,882	-	-	85,882	-	-	-	-	-	-	85,882
Reversal of Celsion (Canada) Inc. Shares	(103)	-	-	-	-	-	-	-	-	-	-	-
Medifocus shares	6,650,000	1,125,000	-	-	1,125,000	-	-	-	-	-	-	1,125,000
Medifocus share issued in exchange of Celsion shares	11,200,000	(1,125,000)	-	-	(1,125,000)	-	-	-	-	-	-	(1,125,000)
Effect of reorganization	-	(165,000)	-	-	(165,000)	-	-	-	-	-	950,383	785,383
Shares issued for debt settlement	1,666,280	1,374,733	-	-	1,374,733	3,092,105	463,816	-	-	-	-	1,838,549
Shares issued for payment of professional fees	250,000	125,000	-	-	125,000	-	-	-	-	-	-	125,000
Shares issued in private placement	4,140,755	1,913,196	4,140,755	-	1,913,196	-	-	-	-	-	-	1,913,196
Equity portion of promissory note	-	-	-	-	-	-	-	(168,207)	-	-	-	(168,207)
Net loss for the period	-	-	-	-	-	-	-	-	-	-	(328,623)	(328,623)
March 31, 2009	24,336,445	3,385,892	4,140,755	-	3,385,892	3,092,105	463,816	-	-	-	(1,761,956)	2,087,752
Expiration of warrants	-	-	(50,000)	-	-	-	-	-	-	-	-	-
Shares issued for payment of professional fees	-	-	-	-	-	500,000	151,500	-	-	-	-	151,500
Net loss for the period	-	-	-	-	-	-	-	-	-	-	(880,632)	(880,632)
March 31, 2010	24,336,445	3,385,892	4,090,755	-	3,385,892	3,592,105	615,316	-	-	-	(2,642,588)	1,358,620
Net loss for the period	-	-	-	-	-	-	-	-	-	-	(322,512)	(322,512)
June 30, 2010	24,336,445	3,385,892	4,090,755	-	3,385,892	3,592,105	615,316	-	-	-	(2,965,100)	1,036,108
Issuance of common shares on private placement	2,449,997	337,830	2,449,997	319,180	657,010	-	-	-	-	319,180	-	657,010
Issuance of common shares on private placement	3,745,000	458,788	3,745,000	192,810	651,598	-	-	-	-	192,810	-	651,598
For settlement of accrued interest	-	-	-	-	-	275,510	52,499	-	-	-	-	52,499
Issued to officers	-	-	-	-	-	1,700,000	306,000	-	-	-	-	306,000
Issued to directors	-	-	-	-	-	1,300,000	234,000	-	-	-	-	234,000
Extension of warrants	-	(385,067)	-	385,067	-	-	-	-	-	385,067	-	-
Stock options granted	-	-	-	-	-	-	-	-	-	305,090	-	305,090
Net loss for the period	-	-	-	-	-	-	-	-	-	-	(1,320,205)	(1,320,205)
March 31, 2011	30,531,442	3,797,443	10,285,752	897,057	4,694,500	6,867,615	1,207,815	-	-	1,202,147	(4,285,305)	1,922,100
Issuance of common shares on private placement	1,000,000	297,375	-	-	297,375	-	-	-	-	-	-	297,375
Stock options granted	-	-	-	-	-	-	-	-	-	17,797	-	17,797
Equity portion of promissory note	-	-	-	-	-	-	-	11,670	-	-	-	11,670
Net loss for the period	-	-	-	-	-	-	-	-	-	-	(227,829)	(227,829)
June 30, 2011	31,531,442	4,094,818	10,285,752	897,057	4,991,875	6,867,615	1,207,815	11,670	-	1,219,944	(4,513,134)	2,021,113

The accompanying notes are an integral part of these condensed consolidated interim financial statements

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011 and 2010

### 1. Corporate Information and Going Concern Uncertainty

Medifocus Inc. (the "Company" or "Medifocus") was incorporated under the *Business Corporations Act* (Ontario) on April 25, 2005. The Company is in the business of development and commercialization of minimally invasive, focused heat tumor targeting cancer treatment devices and systems. Medifocus owns a patented microwave focusing technology platform, the Adaptive Phased Array ("APA") thermotherapy system, which can precisely target and concentrate microwave energy to destroy cancer tumors without damaging healthy tissue when used alone or in conjunction with chemotherapy or radiation. The core technology has been exclusively licensed from The Massachusetts Institute of Technology ["MIT"]. The address of the Company's registered office is 130 King Street West, Suite 1800, Toronto, Ontario M5X 1E3, Canada

The Company is in the development stage and is subject to the risks and challenges to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, dependence on key individuals, and the ability to secure adequate financing to meet obligations and continue as a going concern. The Company has yet to complete its Phase III clinical trials and there is no assurance that these trials will be successful.

The Company's continuing operations are dependent upon its ability to secure additional equity capital, divest assets or generate cash flow from operations in the future, none of which are assured. There can be no assurances that the Company's activities will be successful or that sufficient funds can be raised in a timely manner. As a result, there is significant doubt regarding the "going concern" assumption and accordingly, the use of accounting principles applicable to a going concern. These condensed consolidated interim financial statements do not include any adjustments related to the carrying values and classification of assets and liabilities that might be required should the Company be unable to continue as a going concern.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### *Statement of compliance*

The Company has historically prepared its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and required publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these condensed consolidated interim financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" ("IAS 34") and IFRS 1 "First Time Adoption of

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011 and 2010

International Financial Reporting Standards " (IFRS 1") using accounting policies consistent with IFRS as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). The disclosures concerning the transition from Canadian GAAP to IFRS are included in note 15. Management has amended certain accounting policies and descriptions it previously applied in the Canadian GAAP financial statements to comply with IFRS; however, these changes have not had any material impact on the amounts previously recorded.

The policies applied in these interim condensed consolidated financial statements are based on IFRS effective as of September 26, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending March 31, 2012 could result in restatement of these interim condensed consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The condensed consolidated interim financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended March 31, 2011, with consideration given to the IFRS transition disclosures included in Note 15 to these interim consolidated financial statements.

The Company has applied IFRS in its financial reporting with effect from its transition date of April 1, 2010 in accordance with the transitional provisions set out in IFRS 1. IFRS 1 requires that a first-time adopter retrospectively apply all IFRS standards effective at the end of its first IFRS reporting period. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters. The following items are relevant to the Company's reporting:

**Business Combinations** IFRS 1 provides the option of applying IFRS 3 "Business Combinations" retrospectively or prospectively from the transition date. The Company elected not to retrospectively apply IFRS 3 to business combinations that occurred prior to its transition date and therefore has not restated any aspect of these transactions.

**Estimates** As required by IFRS 1, the estimates used by the Company at the transition date are consistent in all respects with the estimates it previously made at the same date for purposes of its CGAAP reporting.

### (a) Principles of consolidation

The condensed consolidated financial statements reflect the financial position and results of operations of the Company and its wholly-owned subsidiary Celsion (Canada) Inc. All intercompany transactions and balances have been eliminated.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011 and 2010

### (b) Use of estimates

To prepare financial statements in conformity with IFRS, the Company must necessarily make estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the actual results. The estimates and assumptions most critical to determining the carrying values of assets and liabilities include those related to the allowance for doubtful accounts, the estimated useful lives of property, plant and equipment, amortization of intangibles, valuation of intangibles, and valuation of share based payments. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or the period of revision and future periods if the revision affects both current and future periods.

### (c) Plant and equipment

Plant and equipment are recorded at cost less specifically related tax credits and are amortized on a declining balance basis over the estimated useful lives of the assets, as follows:

Furniture and fixtures	20%
Equipment	30%

Leasehold improvements are amortized on a straight line basis over the lesser of the lease term.

The Company reviews the estimated useful lives, residual values and depreciation method at each yearend, accounting for the effect of any changes in estimate on a prospective basis.

The gain or loss arising on disposing of or retiring an item of property, plant and equipment is determined as the difference between the sales proceeds and the asset's carrying amount and is recognized in profit or loss.

### (d) Research costs and product development charges

Research costs are expensed as incurred. Expenditure on development activities is capitalized only if the product or process is technically and commercially feasible, if development costs can be measured reliability, if future economic benefits are probable, if the Company intends to use or sell the asset and the Company intends and has sufficient resources to complete development.

The Company capitalizes the cost of acquiring patents and licenses from third parties as well as the cost of preparing the Microfocus APA 1000 System to enter clinical trial, and the design of the trial, and will amortize that cost over the useful life of the APA System once the APA System is approved and placed in service. No amortization expense was recognized through June 30, 2011 because the APA System has not yet been approved. The Company has received approval from Health Canada and the US Food and Drug Administration ("FDA") to initiate clinical trials. Following the completion of the clinical trials, expected in fiscal 2013, the APA System will be placed into use.

## **NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

June 30, 2011 and 2010

The benefits of tax credits for SR&ED and Government Assistance are recorded in the year as reductions to the related expenses or capital costs and recognized only when there is reasonable assurance that the Company has complied with all the terms and conditions of the relevant tax credit program and the credits will be recovered.

### **(e) Impairment of long-lived assets**

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether any indication exists those assets have suffered an impairment loss. If any such indication exists, it estimates the asset's recoverable amount to determine the extent of the impairment loss, if any. Where it is not possible to estimate a specific asset's recoverable amount, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to specific cash-generating units, or otherwise they are allocated to the smallest group of cash generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the Company discounts estimated future cash flows to their present value using a pre-tax discount rate reflecting current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If an asset or cash-generating unit's recoverable amount is estimated to be less than its carrying amount, the carrying amount is reduced to its recoverable amount, recognizing an impairment loss immediately in profit or loss. Where an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, without exceeding the carrying amount that would have been determined if no impairment loss had been recognized in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

### **(f) Provisions**

The Company recognizes a provision when it has a present obligation (legal or constructive) as a result of a past event, it is probable that it will be required to settle the obligation, and it can make a reliable estimate of the amount of the obligation. The amount it recognizes as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

### **(g) Income taxes**

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that they relate to a business combination, or items recognized directly in equity or in other comprehensive income. Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

## **NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

June 30, 2011 and 2010

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for temporary differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax is measured at tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits, and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

### **(h) Share-based payments**

Where equity-settled share options are awarded to employees, the fair value of the options at the date of grant is charged to the statement of comprehensive loss/income over the vesting period. Performance vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each reporting date so that, ultimately, the cumulative amount recognized over the vesting period is based on the number of options that eventually vest. Non-vesting conditions and market vesting conditions are factored into the fair value of the options granted. As long as all other vesting conditions are satisfied, a charge is made irrespective of whether these vesting conditions are satisfied. The cumulative expense is not adjusted for failure to achieve a market vesting condition or where a non-vesting condition is not satisfied.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the statement of comprehensive loss/income over the remaining vesting period.

All equity-settled share-based payments are reflected in contributed surplus, until exercised. Upon exercise, shares are issued from treasury and the amount reflected in contributed surplus is credited to share capital, adjusted for any consideration paid.

Where a grant of options is cancelled or settled during the vesting period, excluding forfeitures when vesting conditions are not satisfied, the Company immediately accounts for the cancellation as an acceleration of vesting and recognizes the amount that otherwise would have been recognized for services received over the remainder of the vesting period. Any payment made to the employee on the cancellation is accounted for as the repurchase of an equity interest except to the extent the payment exceeds the fair value of the equity instrument granted, measured at the repurchase date. Any such excess is recognized as an expense.

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011 and 2010

### **(i) Convertible debenture and promissory debt**

The Company's convertible debt is considered to be a compound financial instrument that contains both a debt and equity component. On the issuance, the fair value of the debt component is determined by discounting the expected future cash flows over the expected life using a market rate of interest for a non-convertible debt instrument with similar terms. The value is carried as debt on the amortized cost basis until extinguished on conversion or redemption. The remainder of the proceeds are allocated as a separate component of shareholders' equity. Transaction costs are apportioned between the debt and equity components based on their respective carrying amount when the instrument was issued.

On conversion, the carrying amount of the debt component and the equity component are transferred to share capital and no gain or loss is recognized. The interest cost recognized in respect of the debt component represents the accretion of the liability, over the expected life using the effective interest method, to the amount that would be payable if redeemed.

### **(j) Earnings per share**

Basic earnings (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. In years when the Company reports a comprehensive loss, the effect of potential issuances of shares under options and warrants would be anti-dilutive, and therefore, basic and diluted loss (earnings) per share are the same.

### **(k) Foreign currency translation**

The functional currency of the Company is the Canadian dollar. Monetary assets and liabilities denominated in a foreign currency are translated to Canadian dollars at exchange rates in effect at the end of the reporting period and non-monetary assets and liabilities are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in profit or loss.

### **(l) Financial instruments**

The Company's financial instruments consist of cash and cash equivalents, accounts payable, amounts due to employees and consultants, and convertible promissory debt and debentures (see (i) above). The Company has designated its cash and cash equivalents as financial assets at fair value through profit or loss, which are measured at fair value. Accounts payable and amounts due to employees and consultants are classified as other financial liabilities, which are measured at amortized cost.

#### **Financial assets**

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

## **NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

June 30, 2011 and 2010

Fair value through profit or loss - This category comprises derivatives, or assets acquired or incurred principally for the purpose of being sold or repurchased in the near term. They are carried in the balance sheet at fair value with changes in fair value recognized in profit or loss.

Loans and receivables - These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at cost less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counter party will default.

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit and loss.

Available-for-sale - Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized directly in equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in profit and loss.

All financial assets except for those at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, described above.

### **Financial liabilities**

The Company classifies its financial liabilities into one of two categories depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or liabilities acquired or incurred principally for the purpose of being sold or repurchased in the near term. They are carried in the balance sheet at fair value with changes in fair value recognized in profit or loss.

Other financial liabilities - This category includes all other financial liabilities, recognized at amortized cost.

### **3. NEW ACCOUNTING STANDARDS**

The IASB and International Financial Reporting Interpretations Committee ("IFRIC") have issued certain new standards, interpretations, amendments and improvements to existing standards, mandatory for future accounting periods. The most significant of these are as follows, and except as noted below are all effective for annual periods beginning on or after January 1, 2013, with earlier adoption permitted:

## NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011 and 2010

The IASB issued IFRS 9, *Financial Instruments* in November 2009 as the first step in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*; in particular, it introduces new requirements for classifying and measuring financial assets. The IASB intends to expand IFRS 9 before its effective date to add new requirements for classifying and measuring financial liabilities, derecognizing financial instruments, impairment and hedge accounting. The IASB has proposed to adjust the effective date of IFRS 9 to January 1, 2015.

IFRS 10, 11, 12 and 13 were all issued in May 2011. IFRS 10 *Consolidated Financial Statements* replaces the consolidation guidance in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation — Special Purpose Entities* by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee. IFRS 11 *Joint Arrangements* introduces new accounting requirements for joint arrangements, replacing IAS 31 *Interests in Joint Ventures*. It eliminates the option of accounting for jointly controlled entities by using proportionate consolidation. IFRS 12 *Disclosure of Interests in Other Entities* requires enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement.

IFRS 13 *Fair Value Measurement* replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. It defines and provides guidance on determining fair value and requires disclosures about fair value measurements, but does not change the requirements regarding which items are measured or disclosed at fair value.

In June 2011, the IASB amended IAS 1 *Presentation of financial statements* (“IAS 1”) to require presenting items in other comprehensive income in two categories: items that might be reclassified into profit or loss and those that will not be reclassified. The flexibility to present a statement of comprehensive income as one statement or as two separate statements of profit and loss and other comprehensive income remains unchanged. The amendments to IAS 1 are effective for annual periods beginning on or after July 1, 2012.

The Company has not yet determined the impact of these standards and amendments on its financial statements.

#### 4. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, accounts payable, amounts due to employees and consultants and convertible promissory debt and debentures. Unless otherwise noted, the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

##### *Fair value*

The fair value of accounts payable and amounts due to employees and consultants approximates their carrying values due to their short-term maturity.

The methods and assumptions used to measure financial instruments at fair value in the consolidated balance sheets are classified into three levels according to a defined fair value hierarchy:

- Level one includes quoted prices [unadjusted] in active markets for identical assets or liabilities.
- Level two includes inputs that are observable, other than quoted prices included in level one.

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- Level three includes inputs that are not based on observable market data.

The assets carried at fair value are cash and cash equivalents, classified within Level one of the hierarchy.

### **Credit risk**

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the end of the reporting period.

#### **[i] Cash**

The Company minimizes its exposure to credit risk by keeping the majority of its cash as cash on deposit with a major Canadian chartered bank. Management expects the credit risk to be minimal.

### **Foreign currency risk**

The prices paid by the Company for services and supplies are paid in U.S. and Canadian dollars and the Company is raising funds in Canadian dollars. As of June 30, 2011 the Company believes the currency risk is limited and not a risk to be hedged at the present time.

### **Interest rate risk**

Interest rate risk arises because of changes in market interest rates. The Company has no borrowings other than its convertible debt and certain of the amounts due to employees and consultants, all of which is at fixed interest rates, and considers itself to have very minimal exposure to interest rate risk.

### **Liquidity risk**

Liquidity risk includes the risk that the Company will not be able to meet operational liquidity requirements to conduct its business of commercializing the APA System for the treatment of cancer.

The Company's operating cash requirements include amounts necessary to conduct its pivotal clinical trial to obtain regulatory approval to commercialize the APA System in North America. The Company's objective is to maintain sufficient liquid resources to meet operational requirements. As at June 30, 2011, the Company had cash of \$364,448 [2011 - \$522,208]. In addition, at June 30, 2011, the Company's working capital position was negative \$1,153,158 [2011 - negative \$1,457,695]. The Company's continuing operations are dependent upon its ability to secure additional equity capital, divest assets or generate cash flow from operations in the future, none of which are assured. There can be no assurances that the Company's activities will be successful or that sufficient funds can be raised in a timely manner.

### **Capital risk**

The Company's objective when managing capital, defined as its equity, is to safeguard the entity's ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders. The Company is managing its capital structure to convert to equity as much of its current debt as possible and will issue equity to obtain funding to initiate its pivotal clinical trial. The Company is not subject to any externally imposed capital requirements. The Company's objective is to insure adequate working capital to commercialize its APA System for the treatment of cancer and it will use the sale of equity to fund its business to the point of revenue generation and asset based borrowing being sufficient to fund the business fully.

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**5. PRODUCT DEVELOPMENT**

Product development costs represent the costs incurred to date in connection with the development of the Microfocus APA 1000 System including patent and clinical trial expenditures. There will be no amortization of these costs until the system is commercialized.

	June 30, 2011	March 31, 2011	March 31, 2010
	\$	\$	\$
Balance, beginning of period	3,375,471	2,652,167	1,909,550
Expenditures during the period	144,159	723,304	742,617
Balance, end of period	3,519,630	3,375,471	2,652,167

**6. PLANT AND EQUIPMENT**

Plant and equipment are composed of the following:

	Equipment	Furniture and fixtures	Leasehold improvements	Total
	\$	\$	\$	\$
<b>Cost</b>				
As at April 1, 2010	46,995	20,464	10,600	78,059
Additions	—	—	—	—
Disposals	—	—	—	—
As at March 31, 2011	46,995	20,464	10,600	78,09
Additions	—	—	—	—
Disposals	—	—	—	—
As at June 30, 2011	46,995	20,464	10,600	78,059
<b>Accumulated depreciation</b>				
As at April 1, 2010	35,258	13,097	6,950	55,305
Depreciation for the year	3,521	1,473	1,766	6,760
As at March 31, 2011	38,779	14,570	8,716	62,065
Depreciation for the period	617	295	442	1,354
As at June 30, 2011	39,396	14,865	9,158	63,419
<b>Net book value</b>				
As at April 1, 2010	11,737	7,367	3,650	22,754
As at March 31, 2011	8,216	5,894	1,884	15,994
As at June 30, 2011	7,599	5,599	1,442	14,640

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### 7. CONVERTIBLE PROMISSORY NOTE

In 2007, the Company raised bridge financing of USD \$150,000. The bridge financing lender received a promissory note from the Company for USD \$150,000 with interest payable at 1.5% per month on the face value. The face value and accrued interest were payable December 21, 2009, and were extended to September 30, 2010. The interest rate for the extended period has increased to 1.667% per month from 1.5%. The Company paid USD \$15,000, that was applied against outstanding interest, during the year ended March 31, 2011, and the lender agreed to convert USD \$54,000 of accrued interest into 275,510 common shares of the Company. Accordingly, this has been removed from promissory note payable and recorded as shares to be issued. The interest payable on the USD \$150,000 is 1.667% per month plus an additional 1% default interest per month following the default on September 30, 2010. The Company intends to repay the amount plus accrued interest as equity financing becomes available. The balance of \$192,410 includes \$46,010 of accrued interest.

The lender may convert the balance due into common stock of the Company at a discount to market as approved by the TSX-V.

### 8. CONVERTIBLE DEBENTURE

On January 24, 2011, the Company issued various non-brokered unsecured convertible debentures ["Debentures"] in the principal amount of USD \$280,000. The Debentures mature on January 24, 2012. The interest rate on the Debentures is 15% per annum. Upon the request of the Holders, the Debentures plus any accrued interest may be converted in whole, but not in part, into shares of Common Stock of the Company at a price of \$0.11 per Common Share. The Debenture may be prepaid in whole or in part at any time by the Company.

For accounting purposes, the Debentures contain both a debt component and an equity component. At issuance, the Company estimated the fair value of the conversion option by deducting the present value of the future cash outflows of the Debentures from the face value of the principal of the Debentures. The fair value of the debt component was determined by discounting the stream of future payments of interest and principal at the estimated prevailing market rate of 21% for a comparable debt instrument that excluded any conversion privileges. The debt component accretes over the life of the unsecured convertible debenture through periodic charges to expense using the effective interest method. The Company allocated the proceeds using the residual approach as follows:

Debt component	260,268
Accretion of discount	2,920
Accrued interest	18,147
	<u>281,335</u>
Equity component	11,670
	<u>281,335</u>

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**9. CAPITAL STOCK**

**[a] Share capital**

Authorized share capital consists of unlimited common shares with no par value.

The continuity of share capital is as follows:

	<b>Number</b>	<b>Amount</b>
	<b>#</b>	<b>\$</b>
<b>Balance as at March 31, 2010</b>	24,336,445	3,385,892
Shares issued in private placement [i]	2,449,997	734,999
Less share issuance costs [i]		(77,989)
Less allocation to contributed surplus [i]		(319,180)
Extension of warrants [note b]		(385,067)
Shares issued in private placement [ii]	3,745,000	674,100
Less share issuance costs [ii]		(22,502)
Less allocation to contributed surplus [ii]		(192,810)
<b>Balance, March 31, 2011</b>	<b>30,531,442</b>	<b>3,797,443</b>
Shares issued in private placement [iii]	1,000,000	297,374
<b>Balance, June 30, 2011</b>	<b>31,531,442</b>	<b>4,094,817</b>

- [i] On August 7, 2010, the Company completed a private placement of 2,449,997 units at a price of \$0.30 per unit raising gross proceeds of \$734,999. Each unit consisted of one common share and one common share purchase warrant. Each warrant entitled the holder to acquire one common share at an exercise price of \$0.50 until August 7, 2012. Management determined the warrants to have a fair value of \$0.13 per warrant and accordingly, \$319,180 of the proceeds from the issuance was allocated to contributed surplus, and the balance of the proceeds was allocated to common shares. The Company paid finder's fees of \$28,431 and legal fees of \$49,558 that were included in share issuance costs of \$77,989.

A relative fair value calculation was used to determine the carrying value of the warrants. The fair value of the warrants issued was estimated using a Black-Scholes pricing model with the following assumptions:

Risk free interest rate	2.0%
Expected life in years	2 year
Expected volatility	207.0%
Dividends per share	0.0%
Forfeiture rate	0.0%

- [ii] On March 24, 2011, the Company completed a private placement of 3,745,000 units at a price of \$0.18 per unit raising gross proceeds of \$674,100. Each unit consisted of one common share and one common share purchase warrant. Each warrant entitled the holder to acquire one common share at an exercise price of \$0.30 until March 24, 2016. Management determined the warrants to

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have a fair value of \$0.05 per warrant and accordingly, \$192,810 of the proceeds from the issuance was allocated to contributed surplus, and the balance of the proceeds was allocated to common shares. The Company paid legal fees of \$22,502 that were included in share issuance costs.

A relative fair value calculation was used to determine the carrying value of the warrants. The fair value of the warrants issued was estimated using a Black-Scholes pricing model with the following assumptions:

Risk free interest rate	2.0%
Expected life in years	5 year
Expected volatility	70.0%
Dividends per share	0.0%
Forfeiture rate	0.0%

[iii] On June 29, 2011, the Company completed a private placement of 1,000,000 shares at a price of \$0.30 per share raising gross proceeds of \$300,000. The Company paid legal fees of \$2,626 that were included in share issuance costs.

### [b] Share capital to be issued

From time to time the Company will make agreements for the settlement of debt, accrued interest or other expenditures by issuing shares, subject to regulatory and shareholder approval. The value of the shares to be issued is determined by the closing price on the day of the agreement.

The continuity of share capital to be issued is as follows:

	Number #	Amount \$
<b>Balance as at March 31, 2009</b>	<b>3,092,105</b>	<b>463,816</b>
For settlement of debt [i]	500,000	151,500
<b>Balance as at March 31, 2010</b>	<b>3,592,105</b>	<b>615,316</b>
For settlement of accrued interest [ii]	275,510	52,499
For directors [iii]	1,700,000	306,000
For officers [iii]	1,300,000	234,000
<b>Balance, March 31, 2011 and June 30, 2011</b>	<b>6,867,615</b>	<b>1,207,815</b>

[i] The Company agreed to issue 500,000 shares to settle debt of \$151,500.

[ii] The Company agreed to issue 275,510 shares to settle accrued interest of \$52,499. [note 7]

[iii] On March 17, 2011, the Company granted, to directors and officers of the Company, an aggregate of 3,000,000 common shares at a value of \$0.18 per share, in accordance with the Company's approved compensation strategy and subject to regulatory and shareholder approval.

**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

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**[c] Warrants**

As at June 30, 2011, the Company had the following warrants outstanding:

<b>Purchase warrants</b>				
	<b>Number</b>	<b>Exercise price</b>	<b>Expiry date</b>	<b>Year of issue</b>
	<b>#</b>	<b>\$</b>	<b>#</b>	
Share purchase warrants	<b>4,090,755</b>	<b>0.60</b>	11/25/2012	2009
Share purchase warrants	<b>2,449,997</b>	<b>0.50</b>	8/7/2012	2011
Share purchase warrants	<b>3,745,000</b>	<b>0.30</b>	3/24/2016	2011
<b>Outstanding, end of year</b>	<b>10,285,752</b>			

On November 23, 2010, the Company extended the expiry date of 4,090,755 warrants to November 25, 2012, and accordingly, \$385,067 was allocated to contributed surplus. A relative fair value calculation was used to determine the carrying value of the warrants. The fair value of the warrants issued was estimated using a Black-Scholes pricing model with the following assumptions:

Risk free interest rate	2.0%
Expected life in years	2 year
Expected volatility	199.0%
Dividends per share	0.0%
Forfeiture rate	0.0%

The weighted average exercise price of the outstanding warrants as at June 30, 2011 was \$0.47.

**[d] Stock options**

The Company may grant stock options to directors, senior officers and service providers by resolution of the Board of Directors. The exercise price will reflect the market price of the Company's stock on the date of the grant. The Board plans to establish a maximum number of stock options issuable to employees and board members.

On March 17, 2011, the Company granted incentive stock options to the directors and officers of the Company to purchase an aggregate of 3,700,000 common shares subject to regulatory and shareholder approval. The options are exercisable at a price of \$0.20 per common share and expire five years from the date of the grant. 3,000,000 stock options vest immediately and 700,000 options vest in two equal installments with 50% (350,000) vesting immediately and the remainder vesting (350,000) vesting on the first anniversary of their date of grant.

Risk free interest rate	2.0%
Expected life in years	5 year
Expected volatility	70.0%
Dividends per share	0.0%
Forfeiture rate	0.0%

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A summary of the status of the Plan as at June 30, 2011 and changes therein are presented below:

	2011		2010	
	Number	Weighted average exercise price	Number	Weighted average exercise price
	#	\$	#	\$
<b>Outstanding, beginning of period</b>	<b>3,921,666</b>	<b>0.20</b>	<b>221,666</b>	<b>0.20</b>
Forfeited	—	—	—	—
Expired	221,666	0.20	—	—
Granted	3,700,000	0.20	3,700,000	0.20
<b>Outstanding, end of period</b>	<b>3,700,000</b>	<b>0.20</b>	<b>3,921,666</b>	<b>0.20</b>
<b>Options exercisable, end of period</b>	<b>3,437,500</b>		<b>3,571,666</b>	

**[e] Diluted earnings per share**

There has been no impact on diluted earnings per share as a result of outstanding stock options and warrants as the impact would be anti-dilutive.

**10. STATEMENTS OF CASH FLOWS**

The net change in non-cash working capital balances related to operations consists of the following:

	2011	2010
	\$	\$
Prepaid expenses	—	(525)
Harmonization sales taxes recoverable	(3,886)	—
Accounts payable and accrued liabilities	(104,004)	(88,385)
Due to employees and consultants	(20,200)	15,235
Convertible promissory debt	12,572	14,323
	<b>(115,518)</b>	<b>(59,352)</b>

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### 11. RELATED PARTY TRANSACTIONS

Included in amounts expensed and payable is approximately \$173,415 [2011 - \$188,037] owed to the Chief Executive Officer for salary and un-reimbursed expenses. The following amounts were paid as salary and consulting fees in the three months ended June 30,

	<u>2011</u>	<u>2010</u>
Chief Executive Officer	60,000	60,000
Chief Financial Officer	10,000	10,000
Chief Operating Officer	50,000	50,000

There were no share based payments to Directors or Officers during the three months ended June 30, 2011 and June 30, 2010.

The Company has paid marketing fees of \$nil [2011 - \$45,000] and administrative fees of \$nil [2011 - \$10,500] to two Companies in which a Director of Medifocus is also a Director of both of the respective Companies.

### 12. COMMITMENTS

On January 16, 2006 Celsion purchased from Celsion Corporation (*USA*) all of the assets relating to breast cancer Microfocus APA 1000 System (“System”), consisting of the microwave machine technology, the APA technology licensed from MIT, and all related intellectual and regulatory property (collectively, the “Business”). The Company has a commitment to pay a 5% royalty to Celsion on the net sales of products sold by and patent royalties received by the Company and its successors and assignees. Total royalties paid are not to exceed US \$18,500,000. Royalties will not be payable until the System can be placed in the market following successful completion of the pivotal clinical trial and receipt of approval to market the System in the US and Canada from the FDA and Health Canada.

The Company has an additional commitment to pay a 5% royalty to MIT on the net sales of products, upon commercialization. Also, the Company has a commitment to pay MIT an annual maintenance fee as follows:

	<u>USD \$</u>
2012	50,000
2013	50,000
2014	50,000

Future minimum payments under operating leases and contractual commitments are as follows:

2012	\$96,566
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**13. INCOME TAXES**

The provision for income taxes differs from the expense that would be obtained by applying Canadian statutory rates to loss before income taxes as a result of the following:

	2011	2010
	\$	\$
Loss before income taxes	<u>(227,829)</u>	<u>(322,512)</u>
Income tax recovery expected at average statutory rate (2011; 28.5% 2010: 28.5%)	(64,931)	(91,916)
Non-deductible amounts for income-tax purposes	6,020	8,807
Valuation allowance	58,911	83,109
Income tax expense (recovery)	<u>-</u>	<u>-</u>

Deferred income tax assets and liabilities consist of the following:

	2011	2010
	\$	\$
<b>Deferred income tax assets</b>		
Non-capital losses	871,291	812,830
Valuation allowance	(871,291)	(812,830)
<b>Net deferred income tax assets</b>	<u>-</u>	<u>-</u>

In addition, the Company also has Canadian non-capital losses totaling approximately \$3,308,632 that have not been tax benefited and expire as follows:

	\$
2026	12,462
2027	147,253
2028	14,902
2029	540,776
2030	1,112,000
2031	1,422,328
2032	58,911
	<u>3,308,632</u>

No deferred tax assets or liabilities have been recognized in these condensed consolidated financial statements as there is no assurance that the Company will realize the benefits of loss carry forwards.

**U.S. Income Tax Status**

U.S. federal tax legislation was enacted in 2004 to address perceived U.S. tax concerns in “corporate inversion” transactions. A “corporate inversion” generally occurs when a non-U.S. Company acquires “substantially all” of the equity interests in, or the assets of, a U.S. Company or partnership, if, after the acquisition, former equity holders of the U.S. Company or partnership own a specified level of stock in the non-U.S. Company. The tax consequences of these rules depend upon the percentage identity of stock

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ownership that results. Generally, in the “80-percent identity” transactions, i.e. former equity holders of the U.S. Company owns 80% or more of the equity of the non-U.S. acquiring entity (excluding certain equity interests), the tax benefits of the inversion are limited by treating the non-U.S. acquiring entity as a domestic entity for U.S. tax purposes. In the “60-80 percent identity” transactions, the benefits of the inversion are limited by barring certain corporate-level “toll charges” from being offset by certain tax attributes of the U.S. Company (e.g. loss carryforwards), and imposing excise taxes on certain stock based compensation held by “insiders” of the U.S. Company.

Management is of the view that a corporate inversion has resulted from the RTO transaction completed in fiscal 2009, as disclosed in Note 2 to its annual financial statements for the year ended March 31, 2011. However, management has not yet determined whether the Company is subject to the "80 percent" or the "60-80 percent" identity with respect to the transactions undertaken in the fiscal 2009 year since the interpretation of which categories of stock ownership are to be considered under the inversion rules is not yet settled.

### **14. DUE TO EMPLOYEES AND CONSULTANTS**

The Company has liabilities of \$421,762 [2011 - \$441,963] owing to employees and consultants for past compensation. Of this amount, USD \$149,638 bears interest at 5% per annum and was payable by April 1, 2011. Accrued interest of \$26,186 to June 30, 2011 is included in the total liability. The Company has not paid the amounts owing to employees and consultants as at September 28, 2011.

The Company has recognized these as current liabilities.

### **15. IMPACT OF IFRS**

As described in Note 2, the transition to IFRS has not had any material impact on how the Company recognizes or measures the amounts recorded in these financial statements. The transition has, however, changed various aspects of the financial statement presentation, of which the following are the most significant:

#### Presentation of earnings and loss

The Company has amended the presentation of expenses recognized before earnings, to use a classification based on the nature of those expenses.

#### Impairment Losses

The Company did not recognize any additional impairment losses at the transition date as a result of the conversion to IFRS.

### **16. SUBSEQUENT EVENTS**

Of the 2,449,997 shares issued in the private placement described in Note 9(a)[i], 33,333 were cancelled.