RediShred Capital Corp.

Consolidated Financial Statements
December 31, 2012 and 2011

(expressed in Canadian dollars)

April 30, 2013

Management's Responsibility for the Financial Statements

The accompanying consolidated financial statements of **RediShred Capital Corp.** have been prepared by the Company's management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and contain estimates based on management's judgment. Internal control systems are maintained by management to provide reasonable assurances that assets are safeguarded and financial information is reliable.

The Board of Directors of the Company are responsible for ensuring that management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements and the accompanying management discussion and analysis. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board of Directors. It meets with the Company's management and auditors and reviews internal control and financial reporting matters to ensure that management is properly discharging its responsibilities before submitting the financial statements to the Board of Directors for approval.

Grant Thornton LLP, appointed as the Company's auditors by the shareholders, has audited these consolidated financial statements and their report follows.

(signed) "*Jeffrey Hasham*"
Chief Executive Officer
Mississauga, Ontario

(signed) "*Kasia Pawluk*"
Chief Financial Officer
Mississauga, Ontario

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Independent auditor's report

To the Shareholders of RediShred Capital Corp.

We have audited the accompanying consolidated financial statements of RediShred Capital Corp. which comprise the consolidated statement of financial position as at December 31, 2012, and the statements of consolidated comprehensive income/loss, changes in equity and cash flows for the year ended December 31, 2012, 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 financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 company'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 company'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 financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of RediShred Capital Corp. as at December 31, 2012 and its financial performance and its cash flows for the year ended December 31, 2012 in accordance with International Financial Reporting Standards.

Other matter

The financial statements of RediShred Capital Corp. for the year ended December 31, 2011 and 2010 were audited by another auditor who expressed an unqualified opinion on those financial statements on April 30, 2012.

Grant Thornton LLP

Burlington, Canada
April 30, 2013

Chartered Accountants
Licensed Public Accountants

RediShred Capital Corp.

Consolidated Statements of Financial Position

As at December 31, 2012 and 2011

(expressed in Canadian dollars)

	December 31, 2012 $	December 31, 2011 $	December 31, 2010 $
Assets			
Current assets			
Cash	532,040	3,011,786	988,592
Cash attributable to the Advertising Fund (note 5)	48,031	137,818	–
Trade receivables (note 6)	424,064	460,114	414,910
Prepaid expenses	97,949	63,596	45,021
Notes receivable from franchisees (note 7)	40,765	62,859	33,178
Income taxes recoverable	–	17,603	–
	1,142,849	3,753,776	1,481,701
Non-current assets			
Notes receivable from franchisees (note 7)	193,669	183,619	108,705
Equipment (note 9)	1,112,105	565,294	660,506
Intangible assets (note 10)	3,210,580	3,558,806	3,179,759
Goodwill (notes 11 and 12)	1,361,705	878,270	1,112,232
	7,020,908	8,939,765	6,542,903
Assets classified as held for sale (note 13)	286,952	–	–
Total assets	7,307,860	8,939,765	6,542,903
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities (note 14)	504,510	686,167	513,559
Current portion of notes payable	81,383	22,028	127,841
Deferred revenue	–	10,170	–
Current portion of long-term debt (note 15)	99,692	53,176	–
Contingent consideration (note 8)	14,924	–	–
	700,509	771,541	641,400
Non-current liabilities			
Long-term debt (note 15)	6,292,452	5,478,546	2,701,655
Long-term notes payable	137,410	–	–
Deferred tax liability (note 21)	214,188	410,110	490,232
Convertible debenture (note 17)	333,119	–	–
	7,677,678	6,660,196	3,833,287
Liabilities directly associated with the assets classified as held for sale (note 13)	105,178	–	–
Total liabilities	7,782,856	6,660,196	3,833,287
Shareholders' (Deficiency) Equity	(474,996)	2,279,568	2,709,616
Total liabilities and shareholders' equity	7,307,860	8,939,765	6,542,903

Commitments and contingency (note 22)

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

Approved on behalf of the Board of Directors

(signed) "*Phillip H. Gaunce*" Director

(signed) "*Brad Foster*" Director

RediShred Capital Corp.

Consolidated Statements of Comprehensive Loss

For the years ended December 31, 2012 and 2011

(expressed in Canadian dollars)

	2012 $	2011 $
Continuing operations		
Revenue (note 18)	4,049,150	3,379,383
Corporate operating locations expenses (note 19)	(2,786,617)	(1,519,232)
Selling, general and administrative expenses (note 20)	(2,565,820)	(2,729,582)
Loss before interest, income taxes and other items	(1,303,287)	(869,431)
(Impairment) reversal of impairment of intangible assets (note 12)	(312,904)	836,919
Impairment of goodwill (note 12)	(232,103)	(247,688)
Gain on re-acquired rights (note 8)	138,439	–
Loss on settlement of pre-existing litigation (note 8)	(712,567)	–
Gain on sale of assets (note 9)	7,540	–
Loss before interest and income taxes	(2,414,882)	(280,200)
Interest expense	(591,983)	(286,915)
Interest income	4,785	2,946
Loss before income taxes	(3,002,080)	(564,169)
Income tax recovery (note 21)	195,268	109,086
Net loss for the year from continuing operations	(2,806,812)	(455,083)
Discontinued operations		
Income after tax from discontinued operations (note 13)	4,276	–
Net loss for the year	(2,802,536)	(455,083)
Other comprehensive (loss) income, net of tax		
Foreign currency translation (loss) income	(5,038)	7,927
Comprehensive loss for the year	(2,807,574)	(447,156)
Net loss per share		
Basic and diluted	(0.10)	(0.02)
Weighted average number of commons shares outstanding – basic and diluted	28,884,658	28,884,658

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

RediShred Capital Corp.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2012 and 2011

(expressed in Canadian dollars)

	Capital stock and warrants $ (note 16)	Contributed surplus $	Accumulated other comprehensive income (loss) $	Deficit $	Total shareholders' equity/(deficiency) $
Balance – January 1, 2011	8,585,808	297,839	(74,450)	(6,099,581)	2,709,616
Net loss for the year	–	–	–	(455,083)	(455,083)
Other comprehensive income					
Foreign currency translation gain	–	–	7,927	–	7,927
Comprehensive loss for the year	–	–	–	–	(447,156)
Stock-based compensation (note 16)	–	17,108	–	–	17,108
Balance – December 31, 2011	8,585,808	314,947	(66,523)	(6,554,664)	2,279,568
Net loss for the year	–	–	–	(2,802,536)	(2,802,536)
Other comprehensive income					
Foreign currency translation loss	–	–	(5,038)	–	(5,038)
Comprehensive loss for the year	–	–	–	–	(2,807,574)
Issue of convertible debentures (net of costs) (note 17)	–	20,077	–	–	20,077
Stock-based compensation (note 16)	–	32,933	–	–	32,933
Balance – December 31, 2012	8,585,808	367,957	(71,561)	(9,357,200)	(474,996)

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

RediShred Capital Corp.

Consolidated Statements of Cash Flows

For the years ended December 31, 2012 and 2011

(expressed in Canadian dollars)

Cash provided by (used in)	2012 $	2011 $
Operating activities		
Net loss for the year	(2,802,536)	(455,083)
Items not affecting cash		
Amortization of equipment and intangible assets	1,004,616	652,330
Stock-based compensation	32,933	17,108
Unrealized foreign currency loss (gain)	11,836	(59,474)
Impairment of goodwill	232,103	247,688
Impairment (reversal) of impairment of intangibles	312,904	(836,919)
Impairment of note receivable	–	59,328
Loss on settlement of pre-existing litigation	712,566	–
Gain on re-acquired rights	(138,439)	–
Gain on sale of assets	(7,540)	–
Income tax recovery	195,268	109,086
Income taxes paid	–	(17,115)
	(841,101)	(501,223)
Net change in non-cash working capital balances		
Decrease (increase) in trade receivables	36,050	(35,205)
(Increase) decrease in prepaid expenses	(12,355)	(17,555)
(Increase) decrease in notes receivable from franchisees	12,043	(158,422)
Decrease in income taxes recoverable	17,603	–
(Decrease) Increase in deferred revenue	(10,170)	9,888
(Decrease) increase in accounts payable and accrued liabilities	(239,009)	184,828
Repayment of notes payable	–	(106,424)
Net cash used in continuing operations	(1,036,939)	(624,113)
Net cash from discontinued operations	7,233	–
	(1,029,706)	(624,113)
Financing activities		
Borrowings from long-term debt	909,651	2,802,902
Repayment of long-term debt	(73,653)	–
Proceeds from notes payable	–	–
Repayment of notes payable	(19,366)	–
Convertible debentures (net of transaction costs)	353,198	–
	1,169,830	2,802,902
Investing activities		
Cash paid on acquisition of franchises	(2,414,260)	–
Cash held by advertising fund	89,787	(135,122)
Purchase of capital assets	(285,349)	(29,821)
	(2,609,822)	(164,943)
Effect of foreign exchange rate changes on cash	(10,048)	9,348
Net change in cash for the year	(2,479,746)	2,023,194
Cash – Beginning of year	3,011,786	988,592
Cash – End of year	532,040	3,011,786

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

(expressed in Canadian dollars)

1 Corporate information and nature of operations

Redishred Capital Corp. ("Redishred" or the "Company") was incorporated under the Canada Business Corporations Act on October 18, 2006 and is domiciled in Canada. Redishred's common shares are listed for trading on the TSX Venture Exchange under the symbol "KUT". The registered address of the Company is 6790 Century Avenue, Suite 200, Mississauga, Ontario, L5N 2V8.

Redishred manages and operates the Proshred brand and business platform ("system") in the United States and internationally (with the exception of Canada). Redishred operates the Proshred system under three business models, (1) franchising in the United States, (2) via direct ownership of shredding trucks and facilities in five locations in the United States, as of December 31, 2012 and, (3) licensing internationally.

2 Basis of presentation

These annual consolidated financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The Company has consistently applied the accounting policies used in the preparation of its IFRS statement of financial position at December 31, 2012 and December 31, 2011.

These consolidated financial statements comprise the financial statements of Redishred and its subsidiaries as at December 31, 2012. Together, Redishred and its subsidiaries are referred to as "the Company."

The consolidated financial statements of the Company for the year ended December 31, 2012 were authorized for issue in accordance with a resolution of the Directors on April 30, 2013.

3 Significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements are as follows:

Basis of measurement

These consolidated financial statements were prepared on a going concern basis, under the historical cost convention. The consolidated financial statements are presented in Canadian dollars, which is Redishred's presentation currency.

Basis of consolidation

These consolidated financial statements include the accounts of Redishred and its subsidiaries, which are entities controlled by Redishred. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefit from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date control ceases. All significant intercompany balances and transactions have been eliminated.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

The Company's wholly-owned subsidiaries include:

Subsidiary name:	Incorporated in:	Functional currency:
Professional Shredding Corporation	Ontario, Canada	Canadian Dollar
Proshred Franchising Corp.	Delaware, United States	US Dollar
Redishred Holdings US Inc.	Delaware, United States	US Dollar
Redishred Acquisition Inc.	Delaware, United States	US Dollar

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments and has been identified as the chief executive officer of Redishred.

Foreign currency translation

The Company's functional currency is Canadian dollars and the Company has elected to use the Canadian dollar as its' presentation currency. The functional currency of the Company's foreign subsidiaries, Proshred Franchising Corp. ("PFC"), Redishred Holdings US Inc. ("RHI") and Redishred Acquisition Inc. ("RAI") is the US dollar, as it is the currency of the primary economic environment in which they operate. These consolidated financial statements have been translated to the Canadian dollar in accordance with *IAS 21, The Effects of Changes in Foreign Exchange Rates*.

The financial statements of subsidiaries that have a functional currency different from that of Redishred Capital Corp. ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities - at the closing rate at the date of the statements of financial position and income and expenses - at the average rate of the period (as this is considered a reasonable approximation of actual rates prevailing at the transaction dates). All resulting changes are recognized in other comprehensive income as foreign currency translation adjustments.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an entities' functional currency are recognized in the statement of income in foreign exchange gain (loss).

Cash

The Company's cash balances are held in bank accounts in Canada and the United States, which the Company has full access to. Refer to note 25 for cash balances by operating segment.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires. Financial assets and liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. Transaction costs in respect of an asset or liability not recorded at fair value through net earnings are added to the initial carrying amount. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's financial instruments categorized as loans and receivables are comprised of cash, trade receivables and note receivables from franchisees. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, these instruments are accounted for at amortized cost using the effective interest rate method less a provision for impairment.

ii) Financial liabilities at amortized cost

Financial liabilities at amortized cost include accounts payable, accrued liabilities, notes payable, convertible debentures and long-term debt. Accounts payable and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payable and accrued liabilities are measured at amortized cost using the effective interest method. Long-term debt, notes payable and convertible debentures are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. They are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

The criteria used to determine if objective evidence of an impairment loss exists include:

(i) significant financial difficulty of the obligor;

(ii) delinquencies in interest or principal payments; and

(iii) if it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Impairment of financial assets (continued)

If such evidence exists, the Company recognizes an impairment loss as follows:

Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Equipment and amortization

Equipment is stated at cost less accumulated depreciation and accumulated impairment losses. The cost consists of expenditures directly attributable to the acquisition of the asset including costs directly attributable to bringing the asset to the location and condition necessary for its intended use. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. Maintenance and repair costs are expensed as incurred.

Depreciation is provided for on a straight-line basis over the estimated useful lives of the assets as follows:

Computer equipment	2-5 years
Furniture and fixtures	3 years
Bins and shredding containers	5 years
Shredding vehicles – chassis	3-10 years
Shredding vehicles – box	3-10 years
Recycling equipment	5 years
Vehicles	3-5 years

The Company allocates the amount initially recognized in respect of an item of equipment to its significant parts and depreciates separately each such part. The estimated useful lives and amortization method are reviewed annually, with the effect of any changes in estimate accounted for on a prospective basis.

Intangible assets

Identifiable intangible assets

The Company's identifiable intangible assets are stated at cost less accumulated amortization and impairment losses. These assets are capitalized and amortized on a straight-line basis in the statement of comprehensive loss over their estimated useful lives. The re-acquired franchise rights are amortized over the remaining term of the initial Franchise Agreements.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

The estimated useful lives of these assets are as follows:

Trademarks and intellectual property	10 years
Franchise agreements	10 years
Re-acquired franchise rights	2-8 years
Proshred system	10 years
Customer relationships	10 years
Computer software	3 years

The assessment of the useful lives of the identifiable intangible assets is reviewed annually. Changes in useful lives or the useful life from indefinite to finite are made on a prospective basis.

Goodwill

Goodwill represents the excess of the business acquisition over the fair value of the Company's share of the identifiable net assets of the acquired business at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses. Goodwill is allocated on the date of acquisition to each cash-generating unit ("CGU") or group of CGUs that are expected to benefit from the related business combination.

Impairment of non-financial assets

Equipment and identifiable definite life intangible assets (other than goodwill) are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or "CGUs"). An impairment loss is recognized when the carrying value of an asset or CGU exceeds the recoverable amount. The recoverable amount of an asset or CGU is the greater of its value-in-use and its fair value less costs to sell. In assessing value-in-use and fair value less costs to sell, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Goodwill is reviewed for impairment annually or at any time if an indicator of impairment exists. Impairment of goodwill is tested at a level where goodwill is monitored for internal management purposes. Therefore, goodwill may be assessed for impairment at the level of either an individual CGU or a group of CGUs which are expected to benefit from the synergies of the combination. The carrying amount of a CGU is compared to its recoverable amount, which is the higher of its value-in-use or fair value less costs to sell, to determine if impairment exists.

Impairment losses are recognized in the Statement of Comprehensive Loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis. Impairment losses for assets other than goodwill are reversed in future periods if the circumstances that led to the impairment no longer exist. The reversal is limited to restoring the carrying amount such that it does not exceed the carrying amount that would have been determined, net of amortization, had no impairment loss been recognized in prior periods.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Provisions

Provisions are recognized in other liabilities when the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted where the effect is material.

Income tax

Income tax comprises current and deferred income tax. Income tax is recognized in the statement of comprehensive income (loss) except to the extent that it relates to items recognized directly in other comprehensive income (loss) or directly in equity, in which case the income tax is also recognized directly in other comprehensive loss or equity, respectively.

(i) Current income tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted, at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

(ii) Deferred income taxes

Deferred income taxes is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements, except where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss.

Deferred income taxes are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the date of the statement of financial position. Deferred income tax assets and liabilities are presented as non-current and determined on a non-discounted basis. Deferred income tax assets are recognized only to the extent that it is considered probable that taxable profit will be available against which deductible temporary differences, carried forward tax credits or tax losses can be utilized. The carrying value of deferred income tax assets are reviewed at the end of each reporting period and increased or reduced to the extent it is determined probable that sufficient taxable profits will, or will not, be available to allow all or part of the income tax asset to be recovered.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Revenue recognition

(i) Franchising and licensing business

The Company earns revenue from initial franchise and license fees paid to secure territories for a specific period and from royalties, license and service fees paid as a percentage of the franchisees monthly sales volumes. The initial franchise or license fee is recognized as revenue when the franchisee or licensee has fully executed a franchise or license agreement has been provided the required training and the collection of the initial fee is reasonably assured. Royalties, license and service revenue is accrued monthly based on sales reported by franchisees or licensees if collection is reasonably assured. Interest income on notes receivable is recognized in the month earned.

(ii) Corporate operations – shredding and recycling services

The Company earns revenue from providing shredding services to clients and by way of the sale of paper to recycling facilities. Shredding service revenue is recorded when the shredding service has been performed, the Company has provided a certificate of destruction and an invoice to the client, and collections are reasonably assured. Recycling revenue is recognized when the collected paper has been delivered to the recycling facility and collections are reasonably assured.

Share-based payments

The Company issues share-based awards to certain employees and non-employee directors whereby employees render services as consideration for equity instruments (equity-settled transactions). The cost of equity-settled transactions is recognized, together with a corresponding increase in contributed surplus in equity, over the period in which the performance and/or service conditions are fulfilled. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest. This number is reviewed at least annually, with any changes in estimate recognized immediately in compensation expense with a corresponding adjustment to contributed surplus.

Where an equity-settled award is cancelled, it is treated as if it vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. This includes any award where non-vesting conditions within the control of either the entity or the employee are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award,. All cancellations of equity-settled transaction awards are treated equally.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Convertible debentures

Convertible debentures are separated into liability and equity components based on the terms of the contract. On issuance of the convertible debentures, the fair value of the liability component is determined using a market rate for an equivalent non-convertible debenture. This amount is classified as a financial liability measured at amortized cost (net of transaction costs) until it is extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option and is recognised and included in equity. Transaction costs are deducted from equity, net of associated income tax. The carrying amount of the conversion option is not re-measured in subsequent years. Transaction costs are apportioned between the liability and equity components of the convertible debenture based on the allocation of proceeds to the liability and equity components when the instruments are initially recognized.

Non-current assets and liabilities held for sale

The Company classifies non-current assets and liabilities as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. Non-current assets and liabilities classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the Statement of Comprehensive Loss. Property, plant and equipment and intangible assets are not depreciated or amortized once classified as held for sale.

Interest in a joint operation

The Company has a joint arrangement, which is an arrangement between two or more parties that are bound by a contractual agreement which gives the parties joint control of the arrangement. The arrangement requires unanimous consent for the decisions about the relevant activities of the joint arrangement. The arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses. As such, the Company recognizes the assets and liabilities used for the specific tasks and recognizes its share of the revenues and expenses in accordance to the contractual agreement. The Company earns rental revenue for the use of the shredding vehicle and royalty revenues and service fees based on a percentage of total monthly gross revenues. The Company incurs monthly finance costs on the truck loan payments and incurs depreciation and amortization expense on the tangible and intangible assets.

Business combinations

Acquisitions of subsidiaries and businesses (other than entities which were under the control of the parent) are accounted for using the acquisition method. The cost of the business combination is measured as the aggregate of the fair value (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3, *Business Combinations* are recognized at their fair value at the acquisition date except for noncurrent assets that are classified as held for sale in accordance with IFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations,* which are recognized and measured at fair value less cost to sell.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Deferred financing charges

Deferred financing charges consist of costs incurred relating to the issuance of a revolving line of credit obtained on December 23, 2009 and are amortized over the term of the facility which expires on November 27, 2014.

Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing net income (loss) for the year attributable to equity owners of the Company by the weighted average number of common shares outstanding during the reporting period. Diluted loss per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments such as options and warrants. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. Since the Company has losses, the exercise of outstanding stock options has not been included in the calculation of diluted loss per share as it would be anti-dilutive.

Accounting standards and amendments issued but not yet effective

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet fully assessed the impact of these standards and amendments.

(i) IFRS 9, *Financial Instruments,* was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is effective on or after January 1, 2015. Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

(ii) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces *SIC-12, Consolidation - Special Purpose Entities* and parts of IAS 27, *Consolidated and Separate Financial Statements*.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

(iii) IFRS 11, *Joint Arrangements*, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities - Non-monetary Contributions by Venturers.*

(iv) IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.

(v) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

(vi) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

(vii) IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

(viii) IAS 19, *Employee Benefits (Revised)* has had numerous amendments. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The Group made a voluntary change in accounting policy to recognise actuarial gains and losses in other comprehensive income in the current period. However, the amended standard will impact the net benefit expense as the expected return on plan assets will be calculated using the same interest rate as applied for the purpose of discounting the benefit obligation. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

(ix) IAS 32, *Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32* clarify the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Group's financial position or performance and become effective for annual periods beginning on or after 1 January 2014.

(expressed in Canadian dollars)

3 Significant accounting policies (continued)

Accounting standards and amendments issued but not yet adopted (continued)

(x) *IFRS 1 Government Loans – Amendments to IFRS 1* amendments require first-time adopters to apply the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance,* prospectively to government loans existing at the date of transition to IFRS. Entities may choose to apply the requirements of IFRS 9 (or IAS 39, as applicable) and IAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for that loan. The exception would give first-time adopters relief from retrospective measurement of government loans with a below-market rate of interest. The amendment is effective for annual periods on or after 1 January 2013. The amendment has no impact on the Group.

(xi) *IFRS 7 Disclosures — Offsetting Financial Assets and Financial Liabilities — Amendments to IFRS 7* amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Group's financial position or performance and become effective for annual periods beginning on or after 1 January 2013.

4 Critical accounting estimates and judgements

The preparation of financial statements requires management to use judgment in applying its accounting policies and in developing estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions. These estimates and underlying assumptions are reviewed on an ongoing basis and are based on management's experience and other factors, including expectations about 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 in the period of the revision and future periods if the revision affects both current and future periods. The following discusses the most significant accounting judgements and estimates that the Company has made in the preparation of the financial statements.

Significant accounting judgements

i) Legal contingencies

The Company's subsidiary, PFC is party to litigation with one franchisee. The outcome of this matter may have a material effect on the Company's consolidated financial position, results of operations or cash flows. Management regularly analyzes current information about this matter to determine whether provisions for the estimate of legal expenses to resolve the matter can be reasonably estimated. External lawyers are used for this assessment. In making the decision regarding the need for provisions, management considers the degree of probability of an unfavourable outcome and the ability to make a sufficiently reliable estimate of the amount of loss. The filing of a suit or formal assertion of a claim or disclosure of any such suit or assertion does not automatically indicate that a provision may be appropriate.

(expressed in Canadian dollars)

4 Critical accounting estimates and judgements (continued)

Significant accounting judgements (continued)

ii) Assets held for sale

On December 31, 2012, the Company committed to a plan to sell the Miami business acquired on July 13, 2012 and therefore classified it as a disposal group held for sale. The Company considered that the subsidiary met the criteria to be classified as held for sale at that date for the following reasons: the business was available for immediate sale in its present condition; management committed to a plan to sell the business, including actively advertising on its website to locate a buyer and complete the sale; and lastly, the Board of Director's approved the plan to sell the business. The Company would also be required to invest in infrastructure and additional staff to run the operations effectively, which would result in lower margins. The Company expects negotiations to be finalized and the sale to be completed by the summer of 2013. For more details on the assets held for sale, refer to note 13.

Significant accounting estimates

i) Impairment and reversals of impairment

The Company reviews goodwill at least annually and other non-financial assets when there is any indication that the asset might be impaired. The determination of the value in use and fair value of a CGU to which goodwill is allocated to involves the use of estimates by management. The Company uses discounted cash flow based methods to determine these values. These discounted cash flow calculations typically use five-year and seven-year projections that are based on the operative plans approved by management. Cash flow projections take into account past experience and represent management's best estimate of future developments. Cash flows after the planning period are extrapolated using estimated growth rates. Key assumptions on which management has based its determination of fair value less costs to sell and value-in-use include estimated growth rates, discount rates, future cash flows, margins and tax rates. These estimates, including the methodology used, can have a material impact on the respective values and ultimately the amount of any impairment or reversal of impairment. Refer to note 12 for estimates and assumptions made.

ii) Deferred income taxes

The Company, including its subsidiaries, operate and earn income in multiple countries and is subject to changing tax laws in multiple jurisdictions within these countries. Significant judgements are necessary in determining income tax assets and liabilities. Although management believes that it has made reasonable estimates about the final outcome of tax uncertainties, no assurance can be given that the final outcome of these tax matters will be consistent with what is reflected in the historical income tax provisions. Such differences could have an effect on the deferred tax assets and liabilities in the period in which such determinations are made. At each date of Statement of Financial Position, the Company assesses whether the realization of future tax benefits is sufficiently probable to recognize deferred tax assets and liabilities. This assessment requires the exercise of judgement on the part of management with respect to, among other things, benefits that could be realized from available tax strategies and future taxable income, as well as other positive and negative factors. The recorded amount of total deferred tax assets and liabilities could be materially affected if changes in current tax regulations are enacted. Refer to note 21 for estimates and assumptions used.

(expressed in Canadian dollars)

4 Critical accounting estimates and judgements (continued)

Significant accounting estimates (continued)

iii) Useful lives of tangible and intangible assets

Management estimates the useful lives of tangible and definite life intangible assets based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for amortization of these assets for any period are affected by these estimated useful lives. On an annual basis, the Company assesses the useful lives of its tangible and intangible assets with definite lives and the useful lives updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's tangible and definite life intangible assets in the future. Refer to note 9, 10 and 11 for estimates and assumptions used.

5 Advertising fund

The Company manages an advertising fund (the "Ad Fund") established to collect and administer funds contributed for use in regional and national advertising programs, and amongst other things, initiatives designed to increase sales and enhance general public recognition, acceptance and use of the Proshred System. Contributions to the Ad Fund are required to be made from both franchised and Company owned and operated locations and are based on a percentage of each location's revenue. In accordance with *IAS 18 – Revenue*, the revenue, expenses and cash flows of the Ad Fund are not included in the Company's Statements of Comprehensive Loss because the contributions to the Ad Fund are segregated, designated for a specific purpose, and the Company acts, in substance, as an agent with regard to these contributions. As at December 31, 2012, the Ad Fund was in a net surplus position of $121,469 (2011 – $160,100), including cash attributable to the Ad Fund amounting to $48,031 (2011 - $137,818).

6 Trade receivables

Trade receivables include receivables from franchisees and receivables from shredding customers. The trade receivables as at December 31, 2012, December 31, 2011 are as follows:

	December 31, 2012	December 31, 2011
	$	$
Trade receivables	426,927	549,713
Less: Allowance for doubtful accounts	(2,863)	(89,599)
Trade receivables – net	424,064	460,114

(expressed in Canadian dollars)

7 Notes receivable from franchisees

Notes receivable arise from the financing of the initial franchise fee by franchisees and are guaranteed by the respective owners of the franchises. The notes receivable bear interest rates ranging from 4.25% to 8.25% per annum with monthly blended payments of principal and interest ranging from US$670 to US$2,278. The payments on the notes commence between dates ranging from October 1, 2010 to March 1, 2014 and mature between dates ranging from March 1, 2013 to August 15, 2017.

The notes receivable as at December 31, 2012 and December 31, 2011 are as follows:

	December 31, 2012	December 31, 2011
	$	$
Principal	234,434	361,264
Less: Allowance for impairment	-	(114,786)
Less: Current portion	(40,765)	(62,859)
	193,669	183,619

At December 31, 2012, there are no past due notes receivable from franchisees. As such, the Company has not recorded an allowance for credit losses related to the notes receivable.

Notes receivable from franchisees past due but not impaired comprise:

	Up to 30 days	Up to 60 days	60 days or more	Total
	$	$	$	$
At December 31, 2012	-	-	-	-
At December 31, 2011	-	3,089	31,878	34,964

8 Acquisition of franchises

During the year ended December 31, 2012, the Company, through its wholly-owned subsidiary, Redishred Acquisition Inc., acquired the following franchises:

- Proshred New York City, on January 1, 2012;
- Proshred Miami, on July 13, 2012.

The Company conducted the New York City acquisition to (1) settle the legal complaint filed against the Company, (2) increase the Company's long term cash flows, and (3) to enter into a strong market and establish regional headquarters to allow for further expansion by way of additional acquisitions or by way of establishing satellite offices in nearby cities. The Company conducted the Miami acquisition to settle the legal complaint filed against the Company and to maintain a loyal customer base.

(expressed in Canadian dollars)

8 Acquisition of franchisees (continued)

The business combinations resulted in the recognition of goodwill of $743,927, determined on the basis of an allocation of the purchase price to the assets acquired (including all identifiable intangible assets arising from the purchases) based on their estimated fair value at the date of each respective acquisition.

Goodwill from the New York City business combination represents synergies the Company is expected to generate, the assembled workforces of skilled employees that are knowledgeable about the Company's procedures and possess expertise in certain fields that are important to continued profitability and growth. In addition, the reacquired rights to the entire geographical areas of New York City, Long Island and surrounding counties; the growth potentials in outlying areas; and the ability to secure regional contracts.

The following table outlines the assets purchased and consideration given on the closing date of each acquisition.

	New York City $	Miami $	Total $
Assets acquired			
Working capital	22,198	–	22,198
Equipment	496,882	171,175	668,057
Indemnification asset	45,406	–	45,405
Customer relationships	676,030	91,359	767,389
Re-acquired franchise rights	272,430	50,755	323,185
Goodwill	743,927	–	743,927
	2,256,873	313,289	2,570,161
Liabilities acquired			
Loan	–	(122,957)	(122,957)
Unfavourable lease	(57,049)	–	(57,048)
Settlement of pre-existing litigation	676,030	43,620	719,650
Removal of original franchise agreement	(126,666)	(56,815)	(183,481)
(Gain) loss on franchise agreement	(145,764)	6,060	(139,704)
	403,600	(7,135)	396,465
Total	2,603,424	183,197	2,786,621
Consideration given			
Cash	2,292,448	121,812	2,414,260
Forgiveness of accounts receivable	94,846	46,158	141,004
Contingent consideration	–	15,227	15,227
Notes payable	216,130	–	216,130
	2,603,424	183,197	2,786,621
Acquisition costs (expensed in statement of comprehensive loss)	39,594	10,945	50,539

(expressed in Canadian dollars)

8 Acquisition of franchisees (continued)

The Company translated the fair values of all assets acquired and consideration given using the exchange rate on the date of each respective acquisition. In the above table, the New York City acquisition was translated at $1USD = $1.0090CAD and the Miami acquisition was translated at $1USD = $1.0151CAD. On December 31, 2012, the assets and liabilities acquired are converted at the year-end rate at $1USD = $0.9949CAD in the Statement of Financial Position.

As part of the purchase price, on January 1, 2012, the Company committed to make three payments of US$75,000 over the next three years, due on an annual basis, referred to as the Notes payable. Redishred has recorded the notes payable at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement.* Subsequent to the acquisition date, the Company has measured the notes payable at amortized cost using the effective interest method.

The Company is committed to pay contingent consideration in respect of the Miami acquisition, if the business achieves certain performance targets on a quarterly basis for a period of nine months. In accordance with IFRS 3, the Company has recorded a liability for the estimated fair value of the contingent consideration at the acquisition date. The fair values of the assets were determined on the basis of observable market prices, where possible. The fair values of the re-acquired franchise rights were determined by discounting the cash flows from the franchise royalty stream over the remaining contractual term of the franchise agreement. The fair values of the customer relationships were determined by estimating the discounted level of future cash flows anticipated from the recurring customer relationships purchased.

The Company has earned $1,196,215 in revenues and incurred a loss of $505,677 from the New York City business during the year ended December 31, 2012 since the acquisition date. Refer to note 13 for revenues and loss related to the Miami business.

(expressed in Canadian dollars)

9 Equipment

Cost	Computer equipment	Furniture & fixtures	Bins & shredding containers	Shredding vehicles - chassis	Shredding vehicles - box	Recycling equipment	Vehicles	Total
	$	$	$	$	$	$	$	$
As at January 1, 2011	90,544	53,110	30,853	212,939	464,013	6,356	–	857,815
Additions	702	–	19,728	2,691	–	–	6,700	29,821
Foreign exchange	122	93	903	3,991	8,597	106	114	13,926
As at December 31, 2011	91,368	53,203	51,484	219,621	472,610	6,462	6,814	901,562
Additions	28,062	921	16,206	123,696	257,034	–	–	425,919
Acquisitions	7,500	5,750	87,750	125,875	301,290	90,000	46,200	664,365
Sale of assets	–	–	–	(43,144)	(102,559)	(3,000)	–	(148,703)
Assets held for sale (note 13)	–	–	(17,750)	(39,375)	(84,790)	–	(30,000)	(171,915)
Foreign exchange	(731)	(389)	(877)	(2,056)	(4,819)	(561)	(304)	(9,737)
As at December 31, 2012	126,199	59,485	136,813	384,617	838,766	92,901	22,710	1,661,491

Accumulated depreciation and impairment	Computer equipment	Furniture & fixtures	Bins & shredding containers	Shredding vehicles - chassis	Shredding vehicles - box	Recycling equipment	Vehicles	Total
	$	$	$	$	$	$	$	$
As at January 1, 2011	81,404	48,185	2,449	19,010	44,672	1,589	–	197,309
Depreciation	6,808	1,811	8,396	37,387	75,474	3,177	2,233	135,286
Foreign exchange	252	43	87	1,184	1,988	81	38	3,673
As at December 31, 2011	88,464	50,039	10,932	57,581	122,134	4,847	2,271	336,268
Depreciation	8,174	3,793	28,500	55,712	121,351	21,539	9,125	248,194
Sale of assets	–	–	–	(3,664)	(9,009)	(3,000)	–	(15,673)
Assets held for sale (note 13)	–	–	(1,650)	(3,662)	(7,885)	–	(2,790)	(15,987)
Foreign exchange	(577)	(359)	(285)	(570)	(1,280)	(203)	(142)	(3,146)
As at December 31, 2012	96,061	53,473	37,497	105,397	225,311	23,183	8,464	549,386
Net book value								
As at December 31, 2011	2,904	3,164	40,552	162,040	350,476	1,615	4,543	565,294
As at December 31, 2012	30,138	6,012	99,316	279,220	613,455	69,718	14,246	1,112,105

The Company acquired equipment as part of the franchise acquisitions entered into during the year ended December 31, 2012 (see note 8). During the year ended December 31, 2012, the Company also purchased computers, bins, shredding containers and handheld devices. During the twelve months ended December 31, 2012, the Company sold two of its' shredding vehicles and purchased two new shredding vehicles obtaining vendor financing (refer to note 15). The foreign exchange adjustment is a result of the translation of corporate equipment from US functional currency dollars to Canadian presentation dollars at December 31, 2012, and December 31, 2011. Depreciation related to the corporate stores is included in the statement of comprehensive loss in "corporate operating expenses." Depreciation related to the franchising and licensing business is included in the statement of comprehensive loss in "selling, general & administrative expenses."

(expressed in Canadian dollars)

10 Intangible assets

Cost	Franchise agreements	Proshred system	Computer software	Trademarks and intellectual property	Re-acquired franchise rights	Customer relationships	Total
	$	$	$	$	$	$	$
As at January 1, 2011	2,743,927	978,000	432,534	1,672,500	529,205	274,588	6,630,754
Foreign exchange	46,649	–	–	–	9,805	5,088	61,542
As at December 31, 2011	2,790,576	978,000	432,534	1,672,500	539,010	279,676	6,692,296
Acquisitions	–	–	–	–	320,000	760,000	1,080,000
Removal of original franchise agreements (note 8)	(372,000)	–	–	–	–	–	(372,000)
Assets held for sale (note 13)	–	–	–	–	(50,000)	(90,000)	(140,000)
Foreign exchange	(53,215)	–	–	–	(13,344)	(9,954)	(76,514)
As at December 31, 2012	2,365,361	978,000	432,534	1,672,500	795,666	939,722	7,183,783

Accumulated amortization and impairment	Franchise agreements	Proshred system	Computer software	Trademarks and intellectual property	Re-acquired franchise rights	Customer relationships	Total
	$	$	$	$	$	$	$
As at January 1, 2011	1,051,426	688,655	429,520	1,248,176	28,327	4,891	3,450,955
Amortization	236,445	40,374	3,014	59,208	132,857	27,492	499,390
Reversal of impairment	(75,546)	(322,860)	–	(439,359)	–	–	(837,765)
Foreign exchange	17,425	–	–	–	2,783	662	20,870
As at December 31, 2011	1,229,750	406,169	432,534	868,025	163,967	33,045	3,133,490
Amortization	248,700	92,725	–	130,453	183,768	98,655	754,301
Removal of original franchise agreements (note 8)	(190,493)	–	–	–	–	–	(190,493)
Impairment (note 12)	158,757	64,237	–	89,974	–	–	312,968
Assets held for sale (note 13)	–	–	–	–	(4,625)	(4,163)	(8,788)
Foreign exchange	(22,463)	–	–	–	(4,500)	(1,312)	(28,275)
As at December 31, 2012	1,424,251	563,131	432,534	1,088,452	338,610	126,225	3,973,203
Net book value							
As at December 31, 2011	1,560,826	571,831	–	804,475	375,043	246,631	3,558,806
As at December 31, 2012	941,110	414,869	–	584,048	457,056	813,497	3,210,580

(expressed in Canadian dollars)

10 Intangible assets (continued)

As a result of the acquisition of the New York City and Miami locations, customer relationships and re-acquired franchise rights were recorded as intangible assets in 2012. There were no additions to intangible assets during the year ended December 31, 2011. The foreign exchange adjustment is a result of the translation of foreign operation intangible assets in US dollars to Canadian dollars at December 31, 2012 and December 31, 2011. Amortization of reacquired franchise rights and customer relationships for the year is included in the statement of comprehensive loss in "corporate operating expenses" and amortization of the remaining intangible assets is included in the statement of comprehensive loss in "selling, general and administrative expenses." The Company's franchise agreements, customer lists and re-acquired franchise rights are attributed to the Company's franchises and corporately owned locations in the US. At December 31, 2012, the Company has determined that there is an impairment of intangible assets of $312,904. The Company has allocated the impairment loss on a pro-rata basis to its corporate assets including the franchise agreements, Proshred system, Trademarks and intellectual property. At December 31, 2011 the Company recorded a reversal of a portion of the previously reported impairment of $836,919.

11 Goodwill

The following table presents goodwill for the years ended December 31, 2012 and 2011:

	December 31, 2012	December 31, 2011
	$	$
Opening balance	878,270	1,112,232
Acquisitions	737,292	–
Impairment of goodwill (note 12)	(232,196)	(250,494)
Foreign currency translation	(21,661)	16,532
Closing balance	1,361,705	878,270

12 Impairment of goodwill and long-lived assets

The Company performs an impairment test of long-lived assets when there is an indication of permanent impairment, which includes indicators such as when actual sales are less than budgeted, profits are less than prior years' profits, and when significant events and circumstances indicate that the carrying amount may not be recoverable. Goodwill is tested for impairment at least annually.

The Company has identified each franchise and corporate location as being a CGU and has completed a review for impairment for each CGU, comparing the carrying amount of the CGU with the recoverable amount of the CGU. The Company's unallocated assets consist of computer equipment, furniture, computer software, the Proshred system, trademarks and intellectual property. The carrying amount of the group of CGUs that include the unallocated corporate assets is compared with the recoverable amount of the group of CGUs in testing for impairment.

(expressed in Canadian dollars)

12 Impairment of goodwill and long-lived assets (continued)

The Company performed its annual test for goodwill impairment in accordance with its policy described in note 3. The Company compared the aggregate recoverable amount of the assets included in the CGUs of the corporate locations to their respective carrying amounts. The recoverable amount of the corporate location CGU's were more than the carrying amounts except for New York City. Therefore the Company recorded an impairment loss of $232,103 at December 31, 2012, which was allocated to the goodwill of the New York City CGU. The Company recorded an impairment loss of $247,688 at December 31, 2011 which was allocated to the goodwill of the Milwaukee CGU. Based on sensitivity analysis, a reasonable possible change in assumptions would not cause an impairment loss.

The carrying value of goodwill for each CGU is identified as follows:

Cash Generating Unit	December 31, 2012	December 31, 2011
	$	$
Syracuse	129,587	132,465
Albany	90,369	92,376
Milwaukee	639,229	653,429
New York City	502,520	–
Total goodwill	1,361,705	878,270

The Company assessed its impairment indicators related to its long-lived assets at December 31, 2012. At December 31, 2012, there was sufficient indication of impairment on certain CGUs to warrant an analysis to be performed.

The recoverable amount of each CGU has been determined based on a value-in-use calculation. The value-in-use calculation uses cash flow projections based on financial budgets approved by management. The Company then performed the impairment test for the unallocated, aggregate corporate assets and assessed whether impairment exists at a Company-wide level. The recoverable amount was determined using value-in-use. The value-in-use calculation uses cash flow projections based on financial budgets approved by management.

The key assumptions included the following:

i. Revenue growth of each franchise and corporate location, which reflect the past experience of each location. Management has used growth rate ranges of 2.5% to 53% based on prior results of existing franchisees and the franchisees time in the system. During the first five years of a franchisee's operation, higher growth rates are typically achieved.

ii. Post-tax discount rates ranging from 16% to 17% (December 31, 2011– 16% to 20%) was used and reflects the risks specific to each CGU.

iii. Cash flows from franchising are based on the current royalty rate charged to each franchise, as the rates are expected to continue in the future.

iv. For franchise CGUs, a cash flow period of up to 5 years was used, covering the remaining useful life of the franchise agreements. Management believes that this period is reasonable in light of the contractual terms of the franchise agreements as this is consistent with the assessed remaining useful life of the franchise agreements as originally determined.

(expressed in Canadian dollars)

12 Impairment of goodwill and long-lived assets (continued)

v. For corporate location CGUs, a 5 year cash flow period was used based on financial budgets approved by management including growth rates of 2.5% to 20% and a perpetual growth rate of 2.5%. Revenue growth was determined based on the Company's internal budget and considered past experience, and economic, industry and market trends. The growth rate does not exceed the long-term average growth rates projected for the document destruction industry.

vi. For corporate location CGUs, budget-operating margins, which were determined using average operating margins achieved in the periods immediately before the budget period. Management believes the operating margins are reasonably achievable.

Based on the impairment review performed at December 31, 2012, the recoverable amount of certain CGUs was lower than the carrying amounts at the Company-wide level and the Company recorded an impairment loss of $312,904. At December 31, 2011, the Company determined the recoverable amount of certain CGUs was higher than their carrying amounts and recorded a reversal of impairment of $836,919. The reversal of impairment was limited to restoring the carrying amounts such that they did not exceed the carrying amounts that would have been determined, net of amortization, had no impairment loss been recognized in prior periods.

13 Assets classified as held for sale

On December 31, 2012, the Company committed to a plan to sell the Miami business acquired on July 13, 2012. Given the geographic location of the business in relation to the Company's other corporate locations, the Company decided that the customers would be best served by locations in closer proximity to Miami. The Company also determined that the Miami location might also be required to invest in infrastructure and additional staff to run the operations effectively, which would result in lower cash flow margins. The Company currently has a joint arrangement with the franchise in Tampa Bay, Florida to operate the Miami business (please refer to Note 26). The Company is currently reviewing a Letter of Intent to purchase the business by the franchise in Tampa Bay. Florida. At December 31, 2012 the Company classified the Miami business as a disposal group held for sale and as a discontinued operation. The Company is in a joint operation with the Tampa franchise to operate the Miami business. The results of the Miami business for the year have been accounted for as a joint arrangement with the Tampa Bay franchise. Within the joint arrangement, the Company earns royalty and service fees on the gross Miami revenues and rental revenue for the use of the shredding truck. The Company incurs finance costs on the monthly truck loan payments and depreciation and amortization on the Miami tangible and intangible assets. The Company's rental revenues and expenses from the Miami business that are associated with the disposal group are presented below:

	For the year ended December 31, 2012
	$
Revenue	29,410
Expenses	
Operating expenses	(1,828)
Depreciation and amortization	(20,142)
	(21,970)
Income from discontinued operations	7,440
Finance costs	(3,164)
Income for the year associated with the disposal group	4,276

(expressed in Canadian dollars)

13 Assets classified as held for sale (continued)

The major classes of assets and liabilities of the Miami business classified as held for sale as at December 31, 2012 are as follows:

	December 31, 2012
	$
Assets	
Equipment	155,740
Intangible assets	131,212
	286,952
Liabilities	
Truck loan (details below)	105,178
Net assets directly associated with disposal group	**181,774**

On July 5, 2012, the Company entered into a loan and security agreement in the amount of US$121,128, repayable with monthly blended payments of principal and interest of US$3,718 maturing July 5, 2015. The loan bears interest at 6.502% per annum and is secured by one shredding vehicle with a carrying value of $112,044. The value of the loan on December 31, 2012 is $105,178.

The net cash flows incurred by the Miami business are as follows:

	December 31, 2012
	$
Operating activities	
Profit for the year associated with disposal group	4,276
Adjustments not affecting cash:	
Depreciation and amortization	20,151
	24.427
Financing activities	
Repayment of truck loan	(15,411)
Borrowings from related parties	(1,783)
Net change in cash for the year	7,233
Cash –beginning of the year	–
Cash – end of the year	7,233

(expressed in Canadian dollars)

14 Accounts payable and accrued liabilities

As at December 31, 2012 and December 31, 2011, accounts payable and accrued liabilities are comprised of:

	December 31, 2012	December 31, 2011
	$	$
Accounts payable	235,903	370,936
Accrued liabilities	268,607	315,231
Accounts payable and accrued liabilities	504,510	686,167

15 Long-term debt

As at December 31, 2012 and December 31, 2011 long-term debt is comprised of:

	December 31, 2012	December 31, 2011
	$	$
Line of credit (i)	6,033,094	5,370,000
Less: deferred financing charges	(44,172)	(66,259)
Line of credit net of deferred financing charges	5,988,922	5,303,741
Truck loans (ii)	403,222	227,981
Total long-term debt	6,392,144	5,553,722
Less: current portion	(99,692)	(53,176)
Total	6,292,452	5,478,546

(i) The line of credit was entered into on November 27, 2009 with a related party entity (refer to note 26) for a maximum amount of $4 million. The line of credit is repayable on November 27, 2014, bearing interest at a fixed rate of 10% per annum, and secured by a general security agreement over the Company's assets. Deferred financing charges in respect of this facility are charged to expense over the term of the facility. During the year ended December 31, 2011, the line of credit limit was increased to $5.37 million. During the year ended December 31, 2012, the line of credit was increased to $6.03 million. The terms of the agreement remained unchanged upon increasing the line of credit. The Company has drawn from its line of credit in order to finance the purchase of its' corporate locations including Syracuse, Albany, Milwaukee in 2010 and New York City and Miami in 2012 and for general business purposes.

(ii) On November 11, 2011, the Company entered into a loan and security agreement in the amount of US$240,000, repayable with monthly blended payments of principal and interest of US$5,690 maturing October 3, 2015. The loan bears interest at 8.14% per annum and is secured by two shredding vehicles with a carrying value of US$266,636. The value of the loan on December 31, 2012 is $171,357.

(ii) On August 3, 2012, the Company entered into a loan and security agreement in the amount of US$125,556, repayable with monthly blended payments of principal and interest of US$2,545 maturing August 13, 2017. The loan bears interest at 8% per annum and is secured by one shredding vehicle with a carrying value of $180,357. The value of the loan on December 31, 2012 is $118,047.

(expressed in Canadian dollars)

15 Long-term debt (continued)

(ii) On August 8, 2012, the Company entered into a loan and security agreement in the amount of US$121,000, repayable with monthly blended payments of US$2,379 maturing August 8, 2017. The loan bears interest at 6.506% per annum and is secured by one shredding vehicle with a carrying value of $176,675. The value of the loan on December 31, 2012 is $113,818.

16 Capital stock

a) Authorized

Unlimited number of common shares, without nominal or par value.
Unlimited number of preferred shares, without nominal or par value.

b) Issued and fully paid

For the years ended December 31, 2012 and December 31, 2011, there were no changes in issued common shares of the Company.

The following are the balances of issued common shares of the Company:

	Common stock		Warrants		
	Number	$	Number	$	Total $
Balance, December 31, 2011 and December 31, 2012	28,884,658	8,297,602	4,000,000	288,206	8,585,808

c) Weighted average common shares

The basic weighted average number of common shares outstanding for the years ended December 31, 2012, was 28,884,658 (December 31, 2011 - 28,884,658).

d) Stock options

Under the terms of the stock option plan:

i) From time to time, the Company designates eligible participants to whom options will be granted and the number of shares to be optioned to each;

ii) Eligible participants are persons who are directors, officers, employees and technical consultants of the Company;

iii) Options to purchase shares are non-transferable and are exercisable for a period of up to five years from the date of grant;

iv) Shares to be optioned shall not exceed 2,888,465 and the total number of shares to be optioned to any eligible participant shall not exceed 10% of the issued and outstanding shares of the class as at the date such option is granted;

(expressed in Canadian dollars)

16 Capital stock (continued)

d) Stock options (continued)

vi) The option price for the shares is determined at the time of granting of the option but cannot be less than the fair market value of the shares at the time the option is granted less any applicable discount permitted by the Toronto Venture Exchange; and

vii) The term during which any option granted may be exercised is determined by the Company at the time the option is granted but may not exceed the maximum period permitted from time to time by the Toronto Venture Exchange.

The following table summarizes the movements in the Company's stock options during the years ended:

	December 31, 2012		December 31, 2011	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	1,677,500	0.24	1,687,500	0.26
Granted	992,500	0.20	150,000	0.12
Expired	(978,750)	0.20	(160,000)	0.35
Outstanding – End of year	1,691,250	0.24	1,677,500	0.24

The following table summarizes the stock options outstanding as at:

		December 31, 2012			December 31, 2011		
Exercise price $	Issue date	Number of options outstanding	Weighted average remaining contractual life (yrs)	Options exercisable	Number of options outstanding	Weighted average remaining contractual life (yrs)	Options exercisable
0.20	Aug 29, 2007	–	0.00	–	975,000	0.66	975,000
0.52	Mar 17, 2008	262,500	0.21	262,500	262,500	1.21	197,500
0.14	May 27, 2010	280,000	1.40	280,000	280,000	2.40	280,000
0.15	Oct 19, 2010	10,000	2.81	5,000	10,000	3.81	2,500
0.12	May 2, 2011	140,000	2.34	140,000	140,000	3.34	140,000
0.10	Sept 26, 2011	5,000	3.74	1,250	5,000	4.74	–
0.10	Oct 26, 2011	5,000	3.82	1,250	5,000	4.82	–
0.10	Jan 2, 2012	5,000	3.01	1,250	–	–	–
0.10	May 31, 2012	5,000	4.42	5,000	–	–	–
0.10	July 9, 2012	5,000	9.53	1,250	–	–	–
0.10	Aug 1, 2012	2,500	2.58	2,500	–	–	–
0.20	Nov 23, 2012	975,000	4.90	975,000	–	–	–
		1,694,500	3.35	1,675,000	1,677,500	1.31	1,595,000

(expressed in Canadian dollars)

16 Capital stock (continued)

d) Stock options (continued)

The compensation charge for the options issued was determined based on the fair value of the options at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2012	2011
Expected option life	5.00 years	4 years
Risk-free interest rate	1.27%	2.28%
Expected dividend yield	$nil	$nil
Expected volatility	193%	200%

992,500 options were granted during the year ended December 31, 2012 (2011 - 150,000). The weighted average grant-date fair value of options granted during 2012 amounted to $0.03 per option. The net stock compensation charge, after adjusting for stock option forfeitures, amounted to $32,933 (2011 - $17,108).

e) Warrants

The Company issued two tranches of warrants in 2009. The first tranche was issued in connection with the private placement and the second related to the line of credit obtained. Details are as follows:

	2012			
	Exercise price $	Number of warrants outstanding or to be issued	Remaining contractual life	Assigned value $
Tranche 1	0.25 to 0.45	3,000,000	1.98 years	204,406
Tranche 2	0.25 to 0.45	1,000,000	1.90 years	83,800

The fair values for both tranches of warrants were determined using the following assumptions under the Black-Scholes option pricing model:

Expected warrant life	2 years
Risk-free interest rate	1.06%
Expected dividend yield	$nil
Expected volatility	234%

In connection with the line of credit, 1,000,000 warrants were issued on April 28, 2010 when the line of credit was first drawn upon in accordance with the line of credit agreement. These warrants were recorded in the consolidated financial statements in 2009 as performance by the counterparty was complete at that date. The fair value of these warrants has been recorded as deferred financing charges and is being amortized into income over the term of the facility and is also subject to a two-year holding period commencing on the date of issuance. This is a non-cash transaction and has been excluded from the consolidated statements of cash flows. Tranches 1 and 2 of warrants expire on November 27, 2014 and December 23, 2014, respectively.

(expressed in Canadian dollars)

17 Convertible debentures

On December 31, 2012, the Company issued $375,000 convertible, unsecured subordinated, debentures. The debentures have a five year term and a coupon of 7.5% interest per annum. Each $1,000 principal amount of debenture entitles the holder to convert to approximately 3,333 common shares at a conversion price of $0.30 per share at any time prior to maturity.

Conversion may occur at any time prior to the maturity date of December 31, 2017. The Company may, at its option, redeem the debentures, in whole or in part, at a redemption price equal to the principal amount plus accrued interest and unpaid interest. Interest of 7.5% per annum will be paid annually on the anniversary of the grant date. Debenture holders may defer interest otherwise due and payable until the next interest payment date, in which case such deferred interest payment shall accrue additional interest at 7.5% per annum.

The convertible debentures contain two components: liability and equity elements. The equity element is presented in equity under the label of 'issue of convertible debentures' as contributed surplus. The effective interest rate of the liability element on initial recognition is 9.5% per annum.

	December 31, 2012
	$
Proceeds of issue	375,000
Less: Liability component at the date of issue	(346,202)
Equity component	28,798
Transaction costs	
Liability component of transaction costs	(13,083)
Equity component of transaction costs	(1,088)
Total Transaction costs	(14,171)
Liability component net of transaction costs	333,119
Equity component net of transaction costs	27,710
Deferred tax liability related to the equity component	7,633
Equity component net of transaction costs and tax	20,077

(expressed in Canadian dollars)

18 Revenue

The revenue earned by the Company is broken down as follows:

	2012	2011
	$	$
Royalties	812,750	934,192
Franchise fees	300,100	433,396
License fees	4,378	-
Shredding services	2,363,002	1,437,817
Sale of paper products	568,920	573,978
Total revenue	4,049,150	3,379,383

On January 1, 2012 the Company acquired the New York City franchise location. In 2012, the Company earned revenue from shredding services and through the sale of paper products related to the New York City corporate location. In 2011 the Company earned royalty revenue from the New York City franchise location.

19 Corporate operating locations expenses by nature

The corporate operating locations expenses of the Company are broken down as follows:

	2012	2011
	$	$
Shredding vehicle and related expenses	712,470	358,915
Employee wages expense	997,022	572,507
Employee benefit expense	200,957	92,303
Office and administration expense	417,891	206,418
Depreciation – equipment	231,018	130,536
Amortization – intangible assets	227,264	158,553
Total corporate operating expenses	2,786,617	1,519,232

During the year ended December 31, 2012, the Company operated four corporate locations – Syracuse, Albany, Milwaukee and New York City. During the year ended December 31, 2011, the Company operated three corporate locations – Syracuse, Albany and Milwaukee.

(expressed in Canadian dollars)

20 Selling, general and administrative expenses by nature

The selling, general and administrative expenses of the Company are broken down as follows:

	2012	2011
	$	$
Employee wages expense	820,726	770,867
Employee benefits expense	35,447	54,179
Share-based compensation	32,933	17,108
Professional fees	379,494	854,674
Technology	154,491	111,558
Rent and office expense	73,604	75,302
Selling and development	160,334	203,793
Bad debt expense	-	103,320
Amortization of deferred financing charges	22,086	22,086
Depreciation – equipment	-	3,014
Amortization – intangible assets	524,253	338,141
Foreign exchange loss/(gain)	132,505	(66,163)
Other	229,947	241,703
Total selling, general and administrative expenses	2,565,820	2,729,582

Compensation of key management

Included in employee wages and benefits expense above is key management personnel compensation as follows:

	2012	2011
	$	$
Wages and benefits	593,033	658,336
Severance pay	71,250	-
Share-based compensation	32,933	17,108
Total	697,216	675,444

Key management personnel are comprised of the Company's Board of Directors, Chief Executive Officer, Chief Financial Officer, President, Vice President of Operations, and former Chief Operating Officer.

(expressed in Canadian dollars)

21 Income taxes

Reconciliation of total tax recovery

The effective rate on the Company's loss before income tax differs from the expected amount that would arise using the statutory income tax rates. A reconciliation of the difference is as follows:

	2012	2011
	$	$
Statutory income tax rate	26.5%	28%
Expected income tax recovery based on above rates	(795,552)	(159,000)
Non-deductible expenses	329,088	12,000
Unrecognized deductible temporary differences and other	425,164	37,914
Effect of foreign tax rates	(153,968)	–
Income tax recovery	(195,268)	(109,086)

The enacted tax rate in Canada, where the Company operates, is 26.50% (28.00% in 2011) and has been applied in the tax provision calculation. The combined Canadian federal and provincial statutory rate has decreased from the prior period due to a scheduled enacted rate reduction. This decrease has not materially affected the measurement of deferred tax obligations arising from temporary differences as these scheduled reductions were enacted at December 31, 2011.

	2012	2011
	$	$
Provision for (recovery of) income taxes is comprised of:		
Current income taxes	–	(17,603)
Deferred income taxes	(195,268)	(91,483)
	(195,268)	(109,086)

Deferred tax

Components of the net deferred income tax liability are as follows:

	December 31, 2012	December 31, 2011
	$	$
Deferred income tax liability:		
Intangible assets	(249,620)	(468,110)
Deferred income tax asset:		
Non-capital losses	35,432	58,000
Net deferred income tax liability	(214,188)	(410,110)

(expressed in Canadian dollars)

21 Income taxes (continued)

The following temporary differences and non-capital losses have not been recognized as realization is not considered probable:

	December 31, 2012	December 31, 2011
	$	$
Non-capital losses	6,462,591	5,815,000
Property, plant and equipment	20,565	835,000
Intangible assets	1,851,816	–
Tax deductible share issue costs	33,400	153,000
Financing costs	17,083	–
Other	176,343	–

The Company has incurred Canadian non-capital losses of $6,112,000 that can be carried forward to reduce taxes payable in Canada. The losses expire at various times through December 31, 2031. The Company has incurred US non-capital losses of $745,000 that can be carried forward to reduce taxes payable in the US. The losses expire at various times through December 31, 2031.

22 Commitments and contingency

Commitments

The Company leases office premises in Mississauga, Ontario, Canada. The lease expires on September 30, 2013. Additionally, the Company leases facilities in Albany, which expires on March 31, 2014, Syracuse, which expires on August 31, 2015, Milwaukee, which expires on August 31, 2016 and New York City, which expires on April 30, 2013 and September 30, 2015. During the year ended December 31, 2012, the Company entered into three new leases in Milwaukee, Albany and New York City. Certain contracts include renewal options for various periods of time. For the year ended December 31, 2012, the Company incurred $248,314 (December 31, 2011 - $116,458) in lease payments as an expense included in 'selling, general and administrative expenses' and 'corporate operating expenses'.

Non-cancellable operating lease rentals are payable as follows:

	$
Less than 1 year	227,599
Between 1 and 5 years	208,136
Total	435,735

(expressed in Canadian dollars)

22 Commitments and contingency

Contingency

During the second quarter of 2010, four franchisees filed a complaint with the United States District Court, South District of New York, which management of the Company believes is without merit. The complaint has listed the following causes of action, (1) breach of contract and breach of the implied covenant of good faith and fair dealing by PFC, (2) fraudulent misrepresentation by PFC, (3) negligent misrepresentation by PFC, and (4) violation of various state laws by PFC. On July 13, 2012, in conjunction with the purchase of the Proshred Miami business, the Miami franchisee permanently withdrew from the legal complaint. As of December 31, 2012, one franchisee remains in the legal complaint and three franchisees have permanently withdrawn.

The Company intends to vigorously defend against this remaining claim. The Company is strongly of the view that it (1) has not breached any contracts or agreements with its franchisees and has acted in good faith with all franchisees, (2) has not made any fraudulent misrepresentations to any franchisees, (3) has not made any negligent misrepresentations to any franchisees, and (4) has complied with all state laws as well as Federal Trade Commission rules and regulations regarding franchising.

The final outcome with respect to this claim cannot be predicted nor can the costs to defend this claim be reliably estimated and therefore there can be no assurance that its resolution will not have an adverse effect on the Company's consolidated financial position. No amounts, other than legal costs, have been accrued in these consolidated financial statements relating to this claim.

23 Financial instruments and fair values

The Company has various financial assets that consist of: cash, trade receivables and notes receivable from franchisees. The Company's financial liabilities include accounts payable, accrued liabilities, notes payable, long-term debt and convertible debenture liability.

The Company, through its financial assets and liabilities, has exposure to the following risks from its use of financial instruments: interest rate risk, credit risk, foreign exchange risk and liquidity risk. Senior management is responsible for setting acceptable levels of risk and reviewing risk management activities as necessary.

Interest rate risk

The Company's cash is subject to cash flow risk, as it earns interest at prevailing and fluctuating market rates. The Company has a fixed rate on notes receivable from franchisees ranging from 4.25% to 8.25% per annum, and the line of credit facility has a fixed interest rate of 10% per annum. The truck loans have fixed interest rates ranging from 6.502% to 8.14% per annum. These financial instruments are subject to interest rate fair value risk, as their fair values will fluctuate as a result of changes in market rates.

(expressed in Canadian dollars)

23 Financial instruments and fair values (continued)

Credit risk

In accordance with its investment policy, the Company maintains cash deposits with banks. The credit risk on cash is limited because the counterparties are banks with high-credit ratings assigned by international credit-rating agencies.

Receivables related to franchising and licensing

The accounts and notes receivable from franchisees are exposed to credit risk from the possibility that franchisees may experience financial difficulty. The Company mitigates the risk of credit loss by limiting its exposure to any one franchisee. Credit assessments are conducted with respect to all new franchisees and existing franchisees. In addition, the receivable balances are monitored on an ongoing basis. As of December 31, 2012, 6 franchisees accounted for 83% of the accounts receivable and notes receivable balance related to franchising and licensing (December 31, 2011 - 6 franchises accounted for 73%). For the year ended December 31, 2012, 3 franchisees accounted for 36% of the Company's revenues related to franchising and licensing (December 31, 2011 - 3 franchisees accounted for 28%). As of December 31, 2012, there are no accounts and notes receivable over 90 days old (December 31, 2011 – 37% of accounts receivable were over 90 days old and related to two franchises). The over 90 day old accounts and notes receivable at December 31, 2011 were settled as a result of the purchase of the New York City and Miami franchises on January 1, 2012 and July 13, 2012, respectively.

At December 31, 2012, all trade accounts receivable and notes receivable were current. The aging analysis for trade accounts receivable from franchisees is as follows:

	December 31, 2012	December 31, 2011
	$	$
Past due but not impaired		
60 to 90 days	–	10,420
91 days to 180 days	–	83,580
Over 181 days	–	–
Impaired		
60 to 90 days	–	6,912
91 days to 180 days	–	12,049
Over 181 days	–	67,803

(expressed in Canadian dollars)

23 Financial instruments and fair values (continued)

Credit risk (continued)

Receivables related to franchising and licensing (continued)

The following is a reconciliation of the allowance for credit losses from trade receivables from franchisees:

	December 31, 2012	December 31, 2011
	$	$
Opening balance	86,764	40,762
Additions		44,552
Recovery of trade receivables	(86,764)	–
Foreign exchange	–	1,450
Closing balance	–	86,764

Also refer to note 7 for details of notes receivable from franchisees.

Receivables related to corporate operations

The accounts receivable are exposed to credit risk from the possibility that customers may experience financial difficulty. The Company mitigates the risk of credit loss by limiting its exposure to any one customer. All new, one-time customers are required to make payments for services by way of preapproved credit card. In addition, the receivable balances with customers are monitored on an ongoing basis and collection efforts are dedicated on an ongoing basis to limit the Company's exposure to bad debt. At December 31, 2012 and December 31, 2011, no customer accounted for more than 10% of the accounts receivable balance. For the years ended December 31, 2012 and December 31, 2011, no customer accounted for more than 10% of the Company's revenues in this category. As of December 31, 2012, 13% of accounts receivable in this category was over 90 days old. The Company has recorded an allowance of $2,682 for credit losses from accounts receivable from shredding customers (December 31, 2011 - $2,835). The Company does not have any reason to believe it will not collect all remaining balances.

The aging analysis for accounts receivable past due related to corporate operations is as follows:

	December 31, 2012	December 31, 2011
	$	$
Past due but not impaired		
60 to 90 days	22,130	18,194
91 days to 180 days	39,133	33,663
Impaired		
60 to 90 days	2,863	2,834
91 days to 180 days	–	–

(expressed in Canadian dollars)

23 Financial instruments and fair values (continued)

Foreign exchange risk

Since the Company operates internationally, it is exposed to currency risks as a result of potential exchange rate fluctuations related to non-intragroup transactions. Fluctuations in the Canadian dollar (CAD) and the US dollar (USD) exchange rates could have a potentially significant impact on the Company's results of operations. If there were a foreign exchange rate variation of -5% (depreciation of the USD) or a +5% (appreciation of the USD) against the CAD, from an average rate of USD$1.00 = CAD$0.9996, the total impact to net loss would be a decrease/increase of approximately $77,000.

Liquidity risk

The Company's objective is to have sufficient liquidity to meet liabilities when due. The Company has incurred significant losses to date, and has a deficit of $9.4 million at December 31, 2012. Cash flow forecasting is performed by management, which monitors rolling forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs at all times. Although management considers its assumptions used in its cash flow forecasts to be reasonable, there is no assurance that the cash flow forecasts will be achieved. The Company monitors its cash balances and cash flows generated from operations to meet requirements. Based on overall cash generation capacity and overall financial position, while there can be no assurance, management believes the Company will be able to meet financial obligations as they come due. The Company does not have any financial covenants to comply with.

The current liabilities of $700,509 at December 31, 2012 (December 31, 2011 - $771,541), are due to be settled within one year from the date of the Statement of Financial Position.

At December 31, 2012, the Company has cash of $532,040 and working capital of $440,707.

(expressed in Canadian dollars)

23 Financial instruments and fair values (continued)

Liquidity risk (continued)

Principal	**Less than 3 months $**	**3 months to 1 year $**	**2 – 5 years $**	**Over 5 years $**
Accounts payable and accrued liabilities	504,510	–	–	–
Notes payable	74,231	4,937	148,984	–
Contingent consideration	4,975	9,949	–	–
Convertible debentures	–	–	333,119	–
Long-term debt[(1)]	24,537	75,066	6,336,269	–

Interest	**Less than 3 months $**	**3 months to 1 year $**	**2 – 5 years $**	**Over 5 years $**
Notes payable	194	452	308	–
Convertible debentures	–	28,125	112,500	–
Long-term debt[(1)]	9,241	630,558	642,991	–

Liquidity risk

Total principal and interest	**Less than 3 months $**	**3 months to 1 year $**	**2 – 5 years $**	**Over 5 years $**
Accounts payable and accrued liabilities	504,510	–	–	–
Notes payable	74,425	5,389	149,292	–
Contingent consideration	4,975	9,949	–	–
Convertible debentures	–	28,125	445,619	–
Long-term debt[(1)]	43,215	734,797	7,002,392	–

(1) Long-term debt includes a truck loan of $105,178 currently classified as part of a disposal group held for sale.

(expressed in Canadian dollars)

23 Financial instruments and fair values (continued)

Fair value of financial instruments

The carrying value amounts of many of the Company's financial instruments, including cash, trade receivables, trade payables and accrued liabilities, which are all carried at amortized cost, approximate their fair value due primarily to the short-term maturity of the related instruments. The fair value estimates of the Company's notes receivable from franchisees (note 7), are made as at a specific point in time based on estimates using present value or other valuation techniques. The carrying value of the Company's notes payable and long-term debt approximates fair value as the rates are similar to rates currently available to the Company.

These techniques involve uncertainties and are affected by the assumptions used and the judgments made regarding risk characteristics of various financial instruments, discount rates, estimate of future cash flows, future expected loss experience and other factors. The carrying value of the Company's notes receivable from franchisees at December 31, 2012, amounted to $234,434 (December 31, 2011 - $246,478) with fair value estimated to amount to $212,694 (December 31, 2011 - $225,081), respectively.

24 Capital management

The Company defines capital as shareholders' equity. The primary objective of the Company's capital management is to ensure that it maintains the appropriate capital levels to support its business and maximize shareholder value. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may issue new shares or issue debt securities.

25 Segment reporting

The business segments presented reflect the management structure of the Company and the way in which the Company's management reviews business performance. Prior to April 30, 2010, the Company operated one business segment, (1) the granting and managing of shredding business franchises under the "Proshred" trademark (Franchising and licensing). Upon the acquisition of Syracuse, Albany, Milwaukee and New York City, the Company operates two reportable operating segments, (1) the granting and managing of shredding business franchises under the "Proshred" trademark (Franchising and licensing), and (2) the operation of corporately owned shredding businesses (Corporate locations).

(expressed in Canadian dollars)

25 Segment reporting (continued)

Total assets and liabilities by reportable operating segment are as follows:

	Franchising and licensing	Corporate locations	Corporate Overhead	Total
	December 31, 2012	December 31, 2012	December 31, 2012	December 31, 2012
ASSETS	$	$	$	$
Current assets				
Cash	47,781	96,716	387,543	532,040
Cash attributable to the Ad Fund	48,031	–	–	48,031
Trade receivables	117,373	295,503	11,188	424,064
Prepaid expenses	31,059	46,562	20,328	97,949
Notes receivable from franchisees	40,765	–	–	40,765
Total current assets	285,010	438,781	419,059	1,142,849
Non-current assets				
Notes receivable from franchisees	193,669	–	–	193,669
Equipment	–	1,109,993	2,112	1,112,105
Intangible assets	941,110	1,270,551	998,919	3,210,580
Goodwill	–	1,361,705	–	1,361,705
Assets held for sale	–	286,952	–	286,952
Total assets	1,419,789	4,468,651	1,420,090	7,307,860
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	144,610	248,085	111,815	504,510
Current portion of notes payable	15,213	66,170	–	81,383
Current portion of long-term debt	–	99,692	–	99,692
Contingent consideration	–	14,924	–	14,924
Total current liabilities	159,823	428,871	111,815	700,509
Non-current liabilities				
Long-term debt	–	6,292,452	–	6,292,452
Current portion of notes payable	–	137,410	–	137,410
Convertible debenture	–	–	333,119	333,119
Deferred tax liability	214,188	–	–	214,188
Liabilities associated with assets held for sale	–	105,178	–	105,178
Total liabilities	374,011	6,963,911	444,934	7,782,856

(expressed in Canadian dollars)

25 Segment reporting (continued)

	Franchising and licensing	Corporate locations	Corporate overhead	Total
ASSETS	December 31, 2011 $	December 31, 2011 $	December 31, 2011 $	December 31, 2011 $
Current assets				
Cash	119,399	2,793,500	98,887	3,011,786
Cash attributable to the Ad Fund	137,818	–	–	137,818
Trade receivables	165,310	258,142	36,662	460,114
Prepaid expenses	7,115	40,807	15,674	63,596
Notes receivable from franchisees	62,859	–	–	62,859
Income tax recoverable	17,603	–	–	17,603
Total current assets	510,104	3,092,449	151,223	3,753,776
Non-current assets				
Notes receivable from franchisees	183,619	–	–	183,619
Equipment	–	565,294	–	565,294
Intangible assets	1,560,823	621,677	1,376,306	3,558,806
Goodwill	–	878,270	–	878,270
Total assets	2,254,546	5,157,690	1,527,529	8,939,765
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	370,013	111,006	205,148	686,167
Deferred revenue	10,170	–	–	10,170
Current portion of notes payable	–	22,028	–	22,028
Current portion of long-term debt	–	53,176	–	53,176
Total current liabilities	380,183	186,210	205,148	771,541
Non-current liabilities				
Long-term debt	–	5,478,546	–	5,478,546
Deferred tax liability	410,110	–	–	410,110
Total liabilities	790,293	5,664,756	205,148	6,660,196

The Company incurred $423,726 in capital expenditures relating to its corporate operations during the year ended December 31, 2012 (December 31, 2011 - $29,821). The Company incurred $661,342 in capital acquisitions relating to its corporate operations during the year ended December 31, 2012 (December 31, 2011 – $nil). The Company incurred $4,059 in capital expenditures related to its franchising operations for the year ended December 31, 2012 (December 31, 2011 - $nil).

(expressed in Canadian dollars)

25 Segment reporting (continued)

Geographic information

Canada	December 31, 2012 $	December 31, 2011 $
Equipment	2,112	–
Intangible assets	998,916	1,376,307
United States		
Notes receivable from franchisees	234,434	246,477
Equipment	1,109,993	565,294
Intangible assets	2,211,661	2,182,499
Goodwill	1,361,705	878,270
Assets held for sale	286,952	–
Total		
Notes receivable from franchisees	234,434	246,477
Equipment	1,112,105	565,294
Intangible assets	3,210,580	3,558,806
Goodwill	1,361,705	878,270
Assets held for sale	286,952	–

Revenue

All revenues were attributed to the United States, with the exception of license fees, which were attributed to the Middle East.

(expressed in Canadian dollars)

25 Segment reporting (continued)

Net loss by operating segment

Total net loss by reportable operating segment is as follows:

	For the year ended December 31, 2012			
	Franchising and licensing $	Corporate locations $	Corporate overhead $	Total $
Revenue	1,117,228	2,931,922	–	4,049,150
Direct costs	–	(2,328,342)	–	(2,328,342)
Corporate overhead	(653,889)	(302,793)	(930,293)	(1,886,975)
Depreciation and amortization	(546,339)	(458,276)	–	(1,004,615)
Foreign currency loss, net	–	–	(132,505)	(132,505)
Interest expense	–	(591,983)	–	(591,983)
Interest income	4,785	–	–	4,785
Gain on franchise agreements	138,439	–	–	138,439
Gain on sale of assets	–	7,540	–	7,540
Loss on settlement of pre-existing litigation	(712,567)	–	–	(712,567)
Impairment of intangible assets	(158,757)	–	(154,147)	(312,904)
Impairment of goodwill	–	(232,103)	–	(232,103)
Income tax recovery	195,268	–	–	195,268
Net loss from continuing operations	(615,832)	(974,035)	(1,216,945)	(2,806,812)

	For the year ended December 31, 2011			
	Franchising and licensing $	Corporate locations $	Corporate overhead $	Total $
Revenue	1,367,588	2,011,795	–	3,379,383
Direct costs	–	(1,230,140)	–	(1,230,140)
Corporate overhead	(819,128)	(173,372)	(1,440,007)	(2,432,507)
Reversal of impairment	–	–	836,919	836,919
Impairment of goodwill	–	(247,688)	–	(247,688)
Depreciation and amortization	(363,241)	(289,089)	–	(652,330)
Foreign currency gain, net	–	–	66,163	66,163
Interest expense	–	(286,915)	–	(286,915)
Interest income	2,946	–	–	2,946
Income tax recovery	109,086	–	–	109,086
Net income (loss) from continuing operations	297,251	(215,409)	(536,925)	(455,083)

For the year ended December 31, 2012, the Company operated four corporate locations. For the year ended December 31, 2011, the Company operated three corporate locations.

(expressed in Canadian dollars)

26 Related party balances and transactions

A Director of the Company is the owner of the Tampa Bay, Florida Proshred franchise. Included in accounts receivable at December 31, 2012, is $1,945 (2011 - $1,592) due from this franchise. During the year ended December 31, 2012, the Company earned royalty and service fees amounting to $78,289 (2011 - $87,165) from this franchise.

The Director's franchise is currently managing on the Company's behalf the Proshred Miami business acquired by the Company. The Company earned royalty and service fees of $10,828 during the year ended December 31, 2012 from the Miami operations. Included in accounts receivable at December 31, 2012 is $2,528 due from the Miami operations.

The Company has a line of credit facility with a related party entity, the Company's main shareholder, for a maximum of $6.03 million, repayable on November 27, 2014, bearing interest at a fixed rate of 10% per annum. The Company has drawn from its line of credit in order to finance the purchase of its' corporate locations including Syracuse, Albany, Milwaukee in 2010 and New York City and Miami in 2012 as well as for general business purposes. Refer to Note 15 for additional information.

Included in selling, general and administrative expenses for the nine months ended December 31, 2012 are insurance premium amounts of $13,037 (December 31, 2011 - $15,317) paid to an insurance brokerage firm owned by a Director of the Company and $3,142 in recruiting services paid to a recruiting firm owned by a Director of the Company.

27 Comparative figures

Certain prior period amounts have been reclassified to conform to the current period's presentation. The deferred financing charges classified as a non-current asset in the prior year has been netted against long-term debt in the Statement of Financial Position in the current year. The increase and collection of notes receivable from franchisees classified as investing activities in the Statement of Cash Flows in the prior year have been re-classified as an (increase) decrease in notes receivable from franchisees in the 'Net change in non-cash working capital' section. The corporate overhead costs previously classified under franchising and licensing in the 'Total assets and liabilities by reportable operating segment' has been segregated as a separate reportable operating segment in the current year.