



## **CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2008**

**February 25, 2009**

**(Date Issued)**



**IMRIS Inc.**  
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## AUDITORS' REPORT

To the Shareholders of  
IMRIS Inc.

We have audited the consolidated balance sheets of IMRIS Inc. as at December 31, 2008 and 2007 and the consolidated statements of loss and comprehensive loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "Deloitte &amp; Touche LLP". The signature is written in a cursive, flowing style.

Chartered Accountants

Winnipeg, Manitoba  
February 20, 2009

IMRIS INC.  
Consolidated Balance Sheets  
As at December 31  
(In CDN dollars)

	2008	2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents (note 5)	\$ 18,597,333	\$ 30,803,989
Accounts receivable (note 6)	1,208,380	4,113,253
Unbilled receivables	3,051,782	748,395
Investment tax credits receivable	-	260,784
Inventory (note 7)	2,186,283	2,647,101
Prepaid expenses	1,133,570	479,653
	<u>26,177,348</u>	<u>39,053,175</u>
Property, plant, and equipment, net (note 8)	6,884,653	2,764,602
Goodwill	6,462,808	6,462,808
Patents, net (note 9)	323,961	368,646
	<u>6,786,769</u>	<u>6,831,454</u>
<b>Total assets</b>	<b>\$ 39,848,770</b>	<b>\$ 48,649,231</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 6,227,986	\$ 4,014,481
Customer deposits	12,647,883	7,135,834
Current portion of long term debt (note 10)	-	211,593
Current portion of capital lease obligation (note 11)	8,624	10,858
	<u>18,884,493</u>	<u>11,372,766</u>
Long term liabilities		
Long term portion of capital lease obligation (note 11)	-	8,624
	<u>-</u>	<u>8,624</u>
<b>Total liabilities</b>	<b>18,884,493</b>	<b>11,381,390</b>
Commitments (note 14)		
Shareholders' equity		
Capital stock (note 12b)	65,992,820	65,985,620
Contributed surplus (note 12d)	1,228,193	576,065
Deficit	(46,256,736)	(29,293,844)
	<u>20,964,277</u>	<u>37,267,841</u>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 39,848,770</b>	<b>\$ 48,649,231</b>

Approved on behalf of the Board of Directors

/s/ H. David Graves Chairman

/s/ David A. Leslie, F.C.A. Director

See accompanying notes

## IMRIS INC.

## Consolidated Statements of Loss and Comprehensive Loss and Deficit

Years ended December 31

(In CDN dollars)

	2008	2007
Sales	\$ 22,952,486	\$ 17,445,058
Cost of sales	17,875,786	15,180,438
Gross profit	5,076,700	2,264,620
Operating expenses		
Administrative	6,807,248	5,300,845
Sales and marketing	6,450,458	3,497,318
Customer support and operations	4,398,666	3,899,824
Research and development	4,705,505	3,334,511
Amortization	1,457,035	940,632
Total operating expenses	23,818,912	16,973,130
Loss before the following	(18,742,212)	(14,708,510)
Other income		
Foreign exchange gain (loss)	1,118,553	(84,228)
Interest income	660,767	222,545
Total other income	1,779,320	138,317
Loss before income taxes	(16,962,892)	(14,570,193)
Income taxes (note 13a)	-	-
Loss and comprehensive loss for the year	\$ (16,962,892)	\$ (14,570,193)
Deficit, beginning of year	(29,293,844)	(11,503,651)
Dividends (note 12b vii)	-	(3,220,000)
Deficit, end of year	(46,256,736)	(29,293,844)
Weighted average number of common shares	27,351,436	19,554,778
Basic and diluted loss per share	\$ (0.62)	\$ (0.75)

IMRIS INC.  
Consolidated Statements of Cash Flows  
Years ended December 31  
(In CDN dollars)

	2008	2007
<b>OPERATING ACTIVITIES</b>		
Loss for the year:	\$ (16,962,892)	\$ (14,570,193)
Items not affecting cash		
Amortization	1,457,035	940,632
Stock-based compensation	653,044	444,989
	<u>(14,852,813)</u>	<u>(13,184,572)</u>
Changes in non-cash working capital items		
Accounts receivable	2,904,873	(4,090,608)
Unbilled receivables	(2,303,387)	(43,859)
Investment tax credits receivable	260,784	77,777
Inventory	460,818	(2,104,269)
Prepaid expenses	(653,917)	(177,591)
Accounts payable and accrued liabilities	2,213,505	2,195,081
Customer deposits	5,512,049	1,592,169
	<u>8,394,725</u>	<u>(2,551,300)</u>
	<u>(6,458,088)</u>	<u>(15,735,872)</u>
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common shares	6,285	44,555,223
Repayment of long term debt	(211,593)	(173,873)
Repayment of obligation under capital lease	(10,858)	(10,169)
	<u>(216,166)</u>	<u>44,371,181</u>
<b>INVESTING ACTIVITIES</b>		
Acquisition of property, plant, and equipment (net)	(5,532,402)	(744,014)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(12,206,656)</b>	<b>27,891,295</b>
Cash and cash equivalents, beginning of year	30,803,989	2,912,694
<b>Cash and cash equivalents, end of year</b>	<b>\$ 18,597,333</b>	<b>\$ 30,803,989</b>

*Supplemental disclosure of cash flow information*

Cash paid during the year:

Interest	\$ 7,802	\$ 20,673
Income taxes	-	-

See accompanying notes

## 1. DESCRIPTION OF BUSINESS

IMRIS is a supplier of surgical imaging solutions designed to provide surgeons with near real time images during a surgical procedure to assist them in making decisions that ultimately result in improved patient outcomes. The Company's flagship product IMRISneuro is an integrated operating room that uses IMRIS' patented technology to move a magnetic resonance imaging scanner into an operating room from an adjacent suite and position it directly over the patient for imaging during the surgical procedure, without the need to move the patient. The Company's products are currently focused on the neurosurgical market, however the Company is currently developing a solution for MR guided interventional cardiac procedures.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies of the Company include the following:

### a) *Basis of consolidation*

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: IMRIS, Inc (United States), IMRIS (Europe) SPRL (Belgium), IMRIS India Private Limited (India) and IMRIS KK (Japan). All intercompany transactions and balances are eliminated on consolidation.

### b) *Use of estimates*

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the year. Significant estimates include the percentage completion for the systems being installed, the valuation allowance relating to the future income tax assets, the useful lives of capital assets, the amortization of intangible assets, the calculation of investment tax credits receivable, the assumptions used in the determinations of stock-based compensation costs and the fair value information used for purposes of performing the annual goodwill impairment test. Actual results could differ significantly from those estimates. Changes in estimates are recorded in the accounting period in which these changes are determined.

### c) *Revenue recognition*

The Company generates revenues from three principal activities: system sales, sales of ancillary products and services, and extended maintenance services.

Revenues for system sales are recognized on a percentage of completion basis as systems are installed. The degree of completion is generally determined by the ratio of actual costs incurred to date to estimated total costs. Any projected losses are recognized immediately. Funds received from customers in advance of meeting the criteria for revenue recognition are recorded as customer deposits until such time as the revenue is recognized. Revenues recognized in advance of the criteria for invoicing to the customer are recorded as unbilled receivables where the collection of the receivable is probable.

Revenues from ancillary products and services are recognized where there is persuasive evidence of an arrangement and upon delivery or as the services are rendered, respectively. Revenues from extended maintenance service agreements are recognized ratably over the life of the service agreement. Revenues from both ancillary products and services and extended maintenance service agreements are based on pre-determined or determinable sales prices and are only recognized when the collection of the receivable is probable.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### d) *Cash and cash equivalents*

Cash consists of bank deposits. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash with maturities of three months or less from the date of acquisition, and which are subject to an insignificant risk in change in value.

### e) *Inventory*

Materials are valued at the lower of cost, which is determined on an average cost basis, and net realizable value. Cost of materials is determined on the basis of the invoiced value of goods. Work in progress inventories are valued at the lower of cost and net realizable value.

### f) *Property, plant, and equipment*

The Company records all property, plant and equipment acquisitions at their original cost and they are amortized over their estimated useful life using the straight line method at the following rates:

Computer software	3 years
Computer equipment	3 years
Office furnishings and equipment	5 years
Assembly & test equipment	5 years
Demonstration suite & tradeshow equipment	3-5 years
Leasehold improvements	Lesser of their useful life and the term of lease
Assets under capital lease	Policy consistent with respective asset class

### g) *Goodwill and patents*

#### *Goodwill*

Goodwill represents the excess of the purchase price over fair value of the identifiable net tangible assets and intangible assets purchased at the date of acquisition. Goodwill is not amortized, but rather it is tested for impairment annually or more frequently when an event or circumstance occurs that indicates that goodwill might be impaired. When the carrying amount exceeds the fair value, an impairment loss is recognized in the statement of operations in an amount equal to the excess.

#### *Patents*

Patents are accounted for at cost. Amortization is based on their estimated useful life which is generally the life of the patent, using the straight line method. The average remaining life of the patents at the time of acquisition in May 2005 was 11 years.

### h) *Research and development expenditures*

The Company incurs costs for activities which relate to research and development of new products. Research costs are expensed as incurred. Development costs are capitalized and amortized over the expected future benefit period if they meet generally accepted accounting criteria for deferral and amortization.

No development costs were capitalized in the years ended December 31, 2008, and December 31, 2007.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

i) *Investment tax credits*

The Company is entitled to Canadian federal and provincial investment tax credits, which are earned as a percentage of eligible current and capital research and development expenditures incurred in each taxation year. Investment tax credits are recognized when realization of the tax credits is reasonably certain either as an item on the statement of loss or a reduction in deferred development costs or capital assets depending on where the original costs which gave rise to the tax credits have been recorded.

j) *Stock-based compensation*

The Company uses the fair value method to measure compensation expense at the date of granting of stock options to employees. The fair value of options is determined using the Black-Scholes option pricing model and is amortized to earnings over the vesting period with the related credit recorded as contributed surplus. Upon exercise of these stock options, amounts previously credited to contributed surplus are reversed and credited to share capital. Forfeitures are accounted for as they occur.

k) *Income taxes*

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized based on the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax basis, using the enacted and substantively enacted income tax rates for the years in which the differences are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that the future income tax assets will not be realized.

l) *Foreign currency translation*

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end exchange rates and non-monetary assets are translated at the exchange rates prevailing when the asset was acquired.

Revenue and expenses are translated into Canadian dollars at average exchange rates for the year. Exchange gains or losses on translation of foreign currencies are included in the determination of net loss.

m) *Financial instruments*

The following is a summary of the Company's financial instruments, their classifications and measurement basis:

- Cash and cash equivalents are classified as held-for-trading and are measured at fair value with changes in fair value recognized in net income.
- Accounts receivable and unbilled receivables are classified as loans and receivables and are measured at amortized cost.
- Accounts payable and accrued liabilities and long term debt are classified as other liabilities and are measured at amortized cost.

### **3. CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2008, the Company adopted the following new accounting standards, as issued by the Canadian Institute of Chartered Accountants: Section 1535, Capital Disclosures; Section 3031, Inventories; Section 3862, Financial Instruments – Disclosures; and Section 3863, Financial Instruments - Presentation. These changes in accounting policy were applied in accordance with the transitional provisions contained in each of these sections.

#### *Capital Disclosures*

Section 1535, Capital Disclosures requires the Company to include additional information about its capital and the manner it is managed. Disclosure requirements for this section are contained in note 20 – Capital Risk Management.

#### *Inventories*

Section 3031, Inventories relates to the accounting for inventories and enhances the requirements for assigning costs to inventories. The Company accounts for its system sales using the percentage of completion method and thus is exempt from applying Section 3031 for inventory relating to system sales. Application of the section on the remaining inventory does not have any significant effect.

#### *Financial Instruments*

Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation, provide standards for disclosure and presentation about financial instruments, including disclosures about fair value and the credit, liquidity and market risks associated with financial instruments. Disclosure and presentation requirements for these sections are contained in note 6 – Accounts Receivable, note 18 – Financial Risk Management, and note 19 – Financial Instruments.

### **4. FUTURE ACCOUNTING STANDARDS**

The CICA has issued the following handbook sections:

#### *Goodwill, Intangible Assets and Financial Statement Concepts*

In February 2008, the CICA issued Section 3064 Goodwill and Intangible Assets, replacing Section 3062 Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs. The new Section establishes standards on the recognition, measurement, presentation and disclosure for goodwill and intangible assets subsequent to their initial recognition. The standard, which applies commencing with the Company's 2009 fiscal year, requires retroactive application to prior period financial statements. While the Company is currently assessing the impact of this new standard on its consolidated financial statements, management does not expect the standard to have a significant impact on the Company's consolidated financial results.

#### *International Financial Reporting Standards*

In January 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards for public companies would be required to converge with International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011 with comparative figures presented on the same basis. In February 2008, the CICA AcSB confirmed the effective date of the initial adoption of IFRS. The impact of the transition to IFRS on the Company's consolidated financial statements has not yet been determined.

**5. CASH AND CASH EQUIVALENTS**

	<u>2008</u>	<u>2007</u>
Cash (overdraft)	\$ 7,167,897	\$ (614,005)
Short term investments	11,429,436	31,417,994
	<u>\$ 18,597,333</u>	<u>\$ 30,803,989</u>

Overdraft is a result of outstanding cheques being in excess of cash held.

Short term investments consist of investments in short term banker's acceptances, short term deposits and money market mutual funds.

Included in short-term investments are term deposits totalling US \$222,000 that have been pledged as security to our bank for letters of credit required for bid bonds on certain system installations.

**6. ACCOUNTS RECEIVABLE**

	<u>2008</u>	<u>2007</u>
Accounts receivable, trade	\$ 1,094,940	\$ 3,832,802
Commodity taxes receivable	91,784	223,115
Interest receivable	21,656	57,336
	<u>\$ 1,208,380</u>	<u>\$ 4,113,253</u>

The carrying value of the Company's trade accounts receivable is as noted above. The Company has not provided an allowance for doubtful accounts.

As at December 31, 2008, trade accounts receivable of \$268,516 were past due but not impaired. The aging of these trade accounts receivable are as follows:

	<u>Current</u>	<u>1 to 30 days past due</u>	<u>31 to 60 days past due</u>	<u>&gt; 90 days past due</u>
Accounts receivable, trade	\$ 826,424	\$ 268,516	\$Nil	\$Nil

There are no impairments relating to accounts receivable. There are no amounts past due other than those relating to trade accounts receivable.

**7. INVENTORY**

	<u>2008</u>	<u>2007</u>
Materials	\$ 2,146,319	\$ 2,177,701
Work in progress	39,964	469,400
	<u>\$ 2,186,283</u>	<u>\$ 2,647,101</u>

During the year ended December 31, 2008, the Company recorded inventory write-downs of \$80,000 (2007 - \$Nil).

## 8. PROPERTY, PLANT, AND EQUIPMENT

	<u>Cost</u>	<u>2008 Accumulated Amortization</u>	<u>Net book value</u>	<u>Cost</u>	<u>2007 Accumulated Amortization</u>	<u>Net book value</u>
Computer software	\$ 222,945	\$ 139,421	\$ 83,524	\$ 185,337	\$ 74,284	\$ 111,053
Computer equipment	619,888	378,454	241,434	428,277	218,383	209,894
Office furnishings & equipment	495,013	230,998	264,015	405,950	135,408	270,542
Assembly & test equipment	7,306,945	1,748,233	5,558,712	2,198,615	892,523	1,306,092
Demonstration suite & tradeshow equipment	840,792	326,063	514,729	827,777	158,866	668,911
Leasehold improvements	335,190	130,601	204,589	204,415	68,374	174,041
Assets under capital lease	32,091	14,441	17,650	32,091	8,022	24,069
	<u>\$ 9,852,864</u>	<u>\$ 2,968,211</u>	<u>\$ 6,884,653</u>	<u>\$ 4,320,462</u>	<u>\$ 1,555,860</u>	<u>\$ 2,764,602</u>

## 9. PATENTS

	<u>2008</u>	<u>2007</u>
Cost	\$ 484,080	\$ 484,080
Accumulated amortization	(160,119)	(115,434)
	<u>\$ 323,961</u>	<u>\$ 368,646</u>

During the year ended December 31, 2008, amortization of \$44,685 (2007 - \$44,684) relating to the patents was charged to operations.

## 10. LONG TERM DEBT

The long-term loan under the NRC Industrial Research Assistance Program results from a refundable contribution in the amount of \$495,000 under which the NRC contributed to funding certain research and development activities. The loan facility is unsecured, is non-interest bearing, and is repayable quarterly as to principal only until January 31, 2015 at a rate of 1% of the Company's gross revenues for the preceding quarter. The debt was repaid during 2008.

## 11. OBLIGATION UNDER CAPITAL LEASE

The following schedule details the future minimum lease payments relating to the capital lease together with the balance of the obligation:

2009	\$ 8,862
Less amount representing interest	(238)
	(8,624)
Less current portion	(8,624)
	<u>\$ -</u>

The obligation under capital lease is secured by the asset to which the capital lease relates. The lease expires in September 2009 and includes an implicit interest rate of 6.6%. This rate is approximately equal to what the Company could be expected to currently negotiate in the market, as such the carrying value approximates the fair value of the debt. During the year ended December 31, 2008, the Company paid interest expense on the obligation under capital lease of \$958 (2007 - \$1,647).

## 12. CAPITAL STOCK

### a) Authorized

The Company's share capital consists of an unlimited number of common shares and an unlimited number of preferred shares.

### b) Issued and outstanding

The issued share capital of the Company is as follows:

Common Shares	Number of Shares	Consideration
Issued and outstanding as at December 31, 2006	14,943,986	\$ 18,107,332
Shares issued upon exercise of warrants (i)	3,108,818	3,093,264
Shares issued May 17, 2007 for cash (ii)	2,222,221	5,000,000
Shares issued June 6, 2007 for cash (iii)	219,547	493,981
Shares issued June 29, 2007 for cash (iv)	81,510	183,398
Shares issued June 29, 2007 for cash (v)	35,264	79,344
Shares issued September 24, 2007 for cash (vi)	70,000	77,700
Allocation of the Company's capital dividend account balance on November 1, 2007 (vii)	-	3,220,000
Shares issued November 2, 2007 for cash (viii)	6,666,667	35,730,601
Issued and outstanding as at December 31, 2007	27,348,013	\$ 65,985,620
Stock options exercised (ix)	4,500	7,200
Issued and outstanding as at December 31, 2008	27,352,513	\$ 65,992,820

- i) On May 17, 2007 certain investors exercised 3,108,818 of their warrants to purchase common shares for consideration of \$0.965 per common share for total cash proceeds of \$3,000,000. As a result of the transaction \$93,264 was transferred from warrants to share capital.
- ii) On May 17, 2007 the Company issued 2,222,221 common shares for \$2.25 per common share for total cash proceeds of \$5,000,000.
- iii) On June 6, 2007 the Company issued 219,547 common shares for \$2.25 per common share for total cash proceeds of \$493,981.
- iv) On June 29, 2007 the Company issued 81,510 common shares to employees for \$2.25 per common share for total cash proceeds of \$183,398.
- v) On June 29, 2007 the Company issued 35,264 common shares to employees for \$2.25 per common share for total cash proceeds of \$79,344.
- vi) On September 24, 2007 pursuant to an option exercise, the Company issued 70,000 common shares to an employee for \$0.97 per common share for cash consideration of \$67,900. In addition to the cash consideration, \$9,800 was transferred from contributed surplus to share capital.

**12. CAPITAL STOCK (continued)**

- vii) On November 1, 2007 the Company increased the paid up capital of the common shares of IMRIS in the amount of \$3,220,000 pursuant to the allocation of the balance in the Company's capital dividend account. The impact of the deemed dividend was an increase in both the share capital and the deficit of the Company by \$3,220,000.
- viii) On November 2, 2007 the Company closed an initial public offering of its common shares raising gross proceeds of \$40,000,002, through the issuance of 6,666,667 common shares at a price of \$6.00 per share. The costs relating to the offering were \$4,269,401 and were netted against the proceeds as a reduction of share capital.
- ix) Pursuant to option exercises, during 2008, the Company issued 4,500 common shares to employees for cash consideration of \$6,285. In addition to the cash consideration, \$915 was transferred from contributed surplus to share capital.

There are no preferred shares outstanding.

c) *Stock-based compensation plan*

On May 20, 2005 the Company established a stock option plan (the "Plan") for the employees, directors, officers and consultants of the Company and any of its subsidiaries which govern all options granted under the Plan. Under the Plan, options to purchase common shares of the Company may be granted by the Board of Directors. The exercise price of the options granted is established by the Board of Directors based on the fair market value of the common shares as at the date of the grant. The maximum number of common shares which may be issued pursuant to options granted under the Plan is equal to 15% of the common shares of the Company outstanding at any time.

Options granted under the Plan generally vest over a four year period and may be exercised in whole or in part as to any vested options prior to the expiry time as follows: 25% on or after the first anniversary of the grant date increasing 6.25 percent per quarter thereafter until fully vested after four years. Options expire six years after the date of the grant. The vesting of options granted under the plan ceases upon the death or the termination of employment of the participant or the participant ceases to be a director, and the participant thereafter has 90 days to exercise any vested and unexpired options, failing which any unexercised options shall lapse. The Board of Directors, at their discretion, may accelerate the vesting period of individual grants as deemed appropriate.

The Board of Directors may accelerate the vesting of all unvested options in the event of certain change of control transactions, including without limitation a take over bid, merger or other structured acquisition; and may further force the exercise of any and all vested options, and/or may cancel or replace any unvested options in any manner as the Board deems reasonable in its unfettered discretion.

The outstanding options and the activity relating to these options are as follows:

	2008		2007	
	Number of <u>options</u>	Weighted average exercise <u>price</u>	Number of <u>options</u>	Weighted average exercise <u>price</u>
Outstanding, beginning of year	3,399,300	\$2.75	2,270,300	\$1.58
Granted	485,051	4.63	1,326,500	4.49
Exercised	(4,500)	1.40	(70,000)	0.97
Forfeited	(182,625)	4.78	(127,500)	1.09
Outstanding, end of year	3,697,226	\$2.90	3,399,300	\$2.75

**12. CAPITAL STOCK (continued)**

*c) Stock-based compensation plan (continued)*

The following table summarizes the options outstanding at December 31, 2008:

<u>Year granted</u>	<u>Number of options outstanding</u>	<u>Exercise price range</u>	<u>Weighted average exercise price</u>	<u>Number of options exercisable</u>	<u>Weighted average exercise price</u>	<u>Expiry date</u>
2005	927,800	\$0.97	\$0.97	773,175	\$0.97	2011
2006	1,165,125	1.71 to 2.25	2.18	698,313	2.17	2012
2007	1,222,250	2.25 to 6.00	4.53	481,281	4.38	2013
2008	382,051	2.40 to 5.00	4.54	-	-	2014
	<u>3,697,226</u>	<u>\$0.97 to \$6.00</u>	<u>\$2.90</u>	<u>1,952,769</u>	<u>\$2.24</u>	

The company recorded an expense of \$653,044 related to stock options during the year ended December 31, 2008 (2007 - \$444,989) with a corresponding credit to contributed surplus. The fair value of option grants issued was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2008	2007
Risk-free interest rate	2.96%	4.14%
Dividend yield	0%	0%
Expected life of the options	4.2 years	4.2 years
Expected volatility of the underlying stock	51.3%	13.0%

Prior to the Company becoming a public enterprise, the minimum value method was utilized, which does not take into account the expected volatility of the underlying stock. For options issued on or after November 2, 2007, an expected volatility rate was used.

The estimated fair value of the options is expensed on a straight-line basis over the option's vesting period.

The weighted average fair value of stock options granted during the year ended December 31, 2008, under the Black-Scholes option pricing model, and using the above assumptions was \$2.00 (December 31, 2007 - \$0.96).

*d) Contributed Surplus*

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 576,065	\$ 140,876
Stock based compensation expense for the year	653,044	444,989
Amount credited to share capital related to options exercised during the year	(916)	(9,800)
<u>Balance, end of year</u>	<u>\$ 1,228,193</u>	<u>\$ 576,065</u>

*e) Diluted loss per share*

There were no adjustments to the weighted number of shares outstanding for the purposes of calculating diluted loss per share because to do so would be anti-dilutive. Employee stock options totaling 3,697,226 (December 31, 2007 - 3,399,300) could dilute the loss per share.

**13. INCOME TAXES**

*a) Income tax expense*

Income tax expense differs from the amount that would be computed by applying the statutory income tax rates to loss before income taxes. A reconciliation of income taxes calculated at the statutory rates to the actual tax provision is as follows:

	<u>2008</u>	<u>2007</u>
Statutory federal and provincial tax rates	33.00%	36.12%
Expected tax recovery at statutory rate	\$ (5,597,755)	\$ (5,262,754)
Permanent differences and other	201,895	(50,015)
Change in future Canadian tax rates	921,770	1,956,650
Non taxable foreign exchange gains	(56,493)	(101,119)
Expiry of non-capital losses	320,437	978,441
Benefit of future tax assets not recognized	4,210,146	2,478,797
Income tax expense	\$ -	\$ -

*b) Future income taxes*

The Company has not recorded any future income tax assets in these financial statements because a valuation allowance has been provided against the full amount of the future income tax assets. The balances of future income taxes as at December 31, 2008 and December 31, 2007 represent the future benefit of unused tax losses and temporary differences between the tax and accounting bases of assets and liabilities. The major items giving rise to future income tax assets and liabilities are presented below:

	<u>2008</u>	<u>2007</u>
Non-capital losses carried forward	\$ 6,697,240	\$ 6,224,235
Capital assets	(135,208)	421,300
Intangible assets	(50,669)	(55,361)
Research and development expenditures	3,431,893	2,208,566
Reserves not taken for tax purposes	5,710,349	1,388,346
Total future income assets	15,653,604	10,187,086
Valuation allowance	(15,653,604)	(10,187,086)
Net future income tax asset	\$ -	\$ -

*c) Non-capital losses*

As at December 31, 2008, Company had non-capital loss carry forwards of approximately \$23,510,000 available to reduce the taxable income of future years which expire as follows:

2014	\$ 670,000
2025 and beyond	22,840,000

**13. INCOME TAXES (continued)**

*d) Scientific Research and Experimental Development*

The company has deductible Scientific Research and Experimental Development expenditures applicable to future years in the amount of approximately \$12,710,000. These expenditures have been included in the calculation of future income taxes in note 13 (b) and have no expiry date.

The Company also has unutilized federal and provincial scientific research and experimental development investment tax credits of approximately \$3,000,000 and \$3,600,000 respectively. The tax benefit of these investment tax credits has not been recognized in the financial statements. These credits expire in the following years:

2014	\$ 200,000
2015	500,000
2016	500,000
2017	800,000
2018	1,600,000
2022	400,000
2023	300,000
2024	100,000
2025 and beyond	2,200,000

**14. COMMITMENTS**

As at December 31, 2008 the Company had commitments under operating leases requiring future minimum annual lease payments as follows:

2009	\$ 577,195
2010	439,170
2011	203,365
2012	23,820
	<u>\$ 1,243,550</u>

**15. SEGMENTED INFORMATION**

The Company operates as one business segment that develops, assembles and installs surgical imaging systems used in medical applications as well as providing ancillary products and services and extended maintenance services.

Revenue attributable to geographic locations, based on the location of the customer, is as follows:

	<u>2008</u>	<u>2007</u>
North America	\$ 15,304,756	\$ 16,713,800
Asia Pacific	7,647,730	731,258
	<u>\$ 22,952,486</u>	<u>\$ 17,445,058</u>

During the year ended December 31, 2008, revenues from five individual customers totalled \$20,168,831 which represents 88% of the total revenue (2007 – four individual customers accounted for \$15,893,674 or 92 % of revenues). The revenues from each of those customers, individually accounted for more than 10% of the total revenue for the years ended December 31, 2008 and 2007.

Substantially all of the capital assets and the entire goodwill balance are attributable to the Company's operations located in Canada.

## 16. RELATED PARTY TRANSACTIONS

The Company leases air travel time from a company which is wholly owned by a significant shareholder of IMRIS Inc. The amount charged to travel expenses during the year ended December 31, 2008 totaled \$319,832 (December 31, 2007 – \$640,654) and the amount charged to share issuance costs totaled \$Nil (December 31, 2007 - \$35,799). The transactions were priced using an estimated third party comparable cost and were recorded at the exchange amount. The payable balance owing as at December 31, 2008 was \$41,580 (December 31, 2007 - \$88,466).

The Company contracts consulting services from a company which is controlled by a director of IMRIS Inc. The amount charged to professional fees during the year ended December 31, 2008 totaled \$96,000 (December 31, 2007 – \$16,000). The transactions were priced using arms length pricing and were recorded at the exchange amount. The payable balance owing as at December 31, 2008 was \$Nil (December 31, 2007 - \$Nil).

## 17. DEFINED CONTRIBUTION EMPLOYEE PENSION PLAN

The Company began a defined contribution Employee Pension Plan for all its employees on March 1, 2008. Contributions to this Plan are expensed as incurred. The Company makes a matching contribution equal to 50% of the employee's contribution, to a maximum of 3% of the employee's annual remuneration (subject to regulatory maximums). These Employer contributions vest immediately with the employee. The expense for the defined contribution plan during the year ended December 31, 2008 totaled \$157,426 (December 31, 2007 - \$Nil).

## 18. FINANCIAL RISK MANAGEMENT

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk; fair value interest rate risk; cash flow interest rate risk); credit risk and liquidity risk. The overall risk management efforts focus on the unpredictability of financial markets and seek to minimize potential adverse effects on financial performance. The finance department identifies and evaluates financial risks in close cooperation with management. The finance department is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated.

### a) *Market Risk*

#### i. Foreign exchange risk

The Company operates internationally and is exposed to foreign exchange risk from various currencies, primarily US dollars. Foreign exchange risk arises from future sales and purchase transactions as well as recognized financial assets and liabilities denominated in foreign currencies. The Company's main objective in managing its foreign exchange risk is to preserve gross margins and reduce variations in performance. While the Company sells in most foreign markets in US dollars, the Company also sources a significant portion of the components it delivers in US dollars. In addition, the Company incurs nearly all of its sales expenses in US dollars. As a result of this natural hedge, the Company's foreign exchange risk is significantly reduced. The Company does not currently enter into any foreign exchange contracts, but may consider doing so in the future.

The balances in foreign currencies at December 31, 2008 are as follows:

	<u>US Dollars</u>
Cash and cash equivalents	\$ 7,236,534
Accounts receivables	898,965
Unbilled receivables	1,636,248
Accounts payable and accrued liabilities	(724,779)
	<u>\$ 9,046,968</u>

## 18. FINANCIAL RISK MANAGEMENT (continued)

Based on the above net exposures as at December 31, 2008, and assuming that all other variables remain constant a 10% depreciation of the Canadian dollar or a 10% appreciation of the Canadian dollar against the US dollar would result in increases/(decreases) in net earnings as follows:

Canadian dollar depreciates 10%	\$ 1,101,920
Canadian dollar appreciates 10%	(1,101,920)

### ii. Cash flow and fair value interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents includes short-term highly liquid investments that earn interest at market rates. Financial assets and financial liabilities that bear interest at fixed rates are subject to fair value interest rate risk. The Company's short-term investments are the only financial assets bearing fixed interest rates while the capital lease obligation is the only financial liability bearing a fixed interest rate. The Company manages its interest rate risk by minimizing financing costs on its borrowings and maximizing the interest incomes earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company's investment policy limits the investing of excess funds to Bankers Acceptances, Canadian Chartered bank term deposits, and short term highly liquid money market mutual funds sponsored by Canadian Chartered banks.

### b) Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The maximum exposure to credit risk of the Company at period end is the carrying value of its financial assets. The Company manages its credit risk on cash and cash equivalents by dealing solely with reputable banks and financial institutions. The Company's North American customers are large credit worthy medical hospitals and thus there is very little exposure to credit risk. When selling internationally, the Company uses irrevocable letters of credit to reduce its exposure to credit risks. The Company reviews the collectability of its accounts receivable and would record an allowance for doubtful accounts receivable if accounts were determined to be doubtful. The loss would be recognized in the income statement within 'Administrative expense'. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the account receivable is uncollectible. For the year ended December 31, 2008, revenues from five individual customers totalled \$20,168,831 which represents 88% of the total revenue. (December 31, 2007; four customers represented 92% of the total revenue). The Company's December 31, 2008 receivables include balances owing from five individual customers who respectively account for 24%, 17%, 15%, 14% and 14% of the combined accounts receivable and unbilled receivables balances.

### c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. The following are the contractual maturities of the undiscounted cash flows of financial liabilities as at December 31, 2008:

	Less than 3 <u>months</u>	3 to 6 <u>months</u>	6 to 9 <u>months</u>	9 months <u>to 1 year</u>	Over 1 <u>year</u>
Accounts payable and accrued liabilities	\$ 4,953,113	\$ 317,741	\$ 274,374	\$ 133,796	\$ 548,962

## **19. FINANCIAL INSTRUMENTS**

### Fair values

The carrying amounts of cash and cash equivalents, accounts receivable, unbilled receivables and accounts payable and accrued liabilities are a reasonable estimate of their fair values because of the short-term maturity of these instruments. As at December 31, 2008, the effective rate of return on short-term investments is approximately 1.44% (December 2007 – 4.35%).

## **20. CAPITAL RISK MANAGEMENT**

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the overall cost of capital.

In the management of capital, the Company includes shareholders' equity, debt and customer deposits in the definition of capital.

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets.

To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets and adjust the amount of cash and short-term investment balances.

During 2007, the Company completed its Initial Public Offering in accordance with its capital objectives.

## **21. COMPARATIVE FIGURES**

Certain prior period figures have been reclassified to conform to the current period's presentation.