Consolidated Financial Statements

(Expressed in thousands of United States (U.S.) dollars)

(Prepared in accordance with generally accepted accounting principles used in the United States of America (U.S. GAAP))

# CARDIOME PHARMA CORP.

Periods ended September 30, 2010 and 2009

(Unaudited)

# CARDIOME PHARMA CORP.

Consolidated Balance Sheets
(Unaudited)
(Expressed in thousands of U.S. dollars, except share amounts)
(Prepared in accordance with U.S. GAAP)

| | As at | |
|---|---|---|
| | September 30, 2010 | December 31, 2009 (Adjusted- notes 2(a) & (c)) |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 53,432 | $ 47,270 |
| Accounts receivable (note 9(a)) | 30,630 | 1,428 |
| Prepaid expenses and other assets | 729 | 495 |
| | 84,791 | 49,193 |
| Property and equipment | 2,201 | 2,646 |
| Intangible assets | 1,672 | 1,666 |
| | $ 88,664 | $ 53,505 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities (note 5) | $ 5,493 | $ 7,618 |
| Deferred revenue | - | 35,197 |
| Current portion of deferred leasehold inducement | 214 | 212 |
| | 5,707 | 43,027 |
| Deferred leasehold inducement | 538 | 696 |
| Long-term debt (note 6) | 25,000 | - |
| | 31,245 | 43,723 |
| Stockholders' equity: | | |
| Common stock | 261,545 | 256,711 |
| Authorized - unlimited number with no par value | | |
| Issued and outstanding - 61,051,878 (2009 – 60,513,911) | | |
| Additional paid-in capital | 29,671 | 29,669 |
| Deficit | (251,982) | (294,783) |
| Accumulated other comprehensive income | 18,185 | 18,185 |
| | 57,419 | 9,782 |
| | $ 88,664 | $ 53,505 |

Related party transactions (note 10)

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

/s/ Peter W. Roberts
Director

/s/ Harold H. Shlevin
Director

# CARDIOME PHARMA CORP.

Consolidated Statements of Operations and Comprehensive Income (Loss)
(Unaudited)
(Expressed in thousands of U.S. dollars, except share and per share amounts)
(Prepared in accordance with U.S. GAAP)

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | September 30, 2010 | September 30, 2009 (Adjusted- notes 2(a) & (c)) | September 30, 2010 | September 30, 2009 (Adjusted- notes 2(a) & (c)) |
| Revenue: | | | | |
| Licensing fees (note 9(a)) | $ 30,000 | $ 19,110 | $ 65,146 | $ 26,121 |
| Research collaborative fees | 221 | 88 | 544 | 642 |
| | 30,221 | 19,198 | 65,690 | 26,763 |
| Expenses: | | | | |
| Research and development | 3,486 | 9,290 | 10,922 | 20,828 |
| General and administration | 3,505 | 4,193 | 10,135 | 11,739 |
| Amortization | 291 | 301 | 890 | 868 |
| | 7,282 | 13,784 | 21,947 | 33,435 |
| Operating income (loss) | 22,939 | 5,414 | 43,743 | (6,672) |
| Other income and expenses: | | | | |
| Interest income (expense) | (565) | 2 | (1,412) | 17 |
| Other income | 187 | 44 | 534 | 97 |
| Foreign exchange gain (loss) | 207 | (5,232) | (64) | (3,190) |
| | (171) | (5,186) | (942) | (3,076) |
| Net income (loss) for the period | 22,768 | 228 | 42,801 | (9,748) |
| Other comprehensive income for the period: | | | | |
| Foreign currency translation adjustment | - | 1,620 | - | 2,232 |
| Comprehensive income (loss) for the period | $ 22,768 | $ 1,848 | $ 42,801 | $ (7,516) |
| Basic and diluted income (loss) per common share (note 7) | $ 0.37 | $ 0.00 | $ 0.70 | $ (0.15) |
| Weighted average common shares outstanding during the period | | | | |
| Basic | 60,985,176 | 64,107,616 | 60,733,543 | 63,889,446 |
| Diluted | 61,740,580 | 66,550,664 | 61,343,530 | 63,889,446 |

See accompanying notes to the consolidated financial statements.

# CARDIOME PHARMA CORP.

Consolidated Statements of Stockholders' Equity
(Unaudited)
(Expressed in thousands of U.S. dollars)
(Prepared in accordance with U.S. GAAP)
For the three and nine months ended September 30, 2010

| **For the three months ended September 30, 2010** | Common stock | Preferred stock | Additional paid-in capital | Deficit | Accumulated other comprehensive income | Total stockholders' equity |
|---|---|---|---|---|---|---|
| **Balance at June 30, 2010** | $ 260,264 | $ - | $ 29,686 | $ (274,750) | $ 18,185 | $ 33,385 |
| Net income | - | - | - | 22,768 | - | 22,768 |
| Common stock issued upon exercise of options | 715 | - | - | - | - | 715 |
| Reallocation of additional paid-in capital arising from stock-based compensation related to exercise of options | 566 | - | (566) | - | - | - |
| Stock option expense recognized | - | - | 551 | - | - | 551 |
| **Balance at September 30, 2010** | $ 261,545 | $ - | $ 29,671 | $ (251,982) | $ 18,185 | $ 57,419 |

| **For the nine months ended September 30, 2010** | Common stock | Preferred stock | Additional paid-in capital | Deficit | Accumulated other comprehensive income | Total stockholders' equity |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2009 – Adjusted Notes 2(a) & (c)** | $ 256,711 | $ - | $ 29,669 | $ (294,783) | $ 18,185 | $ 9,782 |
| Net income | - | - | - | 42,801 | - | 42,801 |
| Common stock issued upon exercise of options | 2,359 | - | - | - | - | 2,359 |
| Reallocation of additional paid-in capital arising from stock-based compensation related to exercise of options | 2,475 | - | (2,475) | - | - | - |
| Stock option expense recognized | - | - | 2,477 | - | - | 2,477 |
| **Balance at September 30, 2010** | $ 261,545 | $ - | $ 29,671 | $ (251,982) | $ 18,185 | $ 57,419 |

See accompanying notes to the consolidated financial statements.

# CARDIOME PHARMA CORP.

Consolidated Statements of Stockholders' Equity
(Unaudited)
(Expressed in thousands of U.S. dollars)
(Prepared in accordance with U.S. GAAP)
For the three and nine months ended September 30, 2009

| **For the three months ended September 30, 2009** (Adjusted- notes 2(a) & (c)) | Common stock | Preferred stock | Additional paid-in capital | Deficit | Accumulated other comprehensive income | Total stockholders' equity |
|---|---|---|---|---|---|---|
| **Balance at June 30, 2009** | $ 255,968 | $ 24,698 | $ 22,721 | $ (307,113) | $ 21,556 | $ 17,830 |
| Net loss | - | - | - | 228 | - | 228 |
| Common stock issued upon exercise of options | 1,521 | - | - | - | - | 1,521 |
| Reallocation of additional paid-in capital arising from stock-based compensation related to exercise of options | - | - | - | - | - | - |
| Stock option expense recognized | - | - | 1,623 | - | - | 1,623 |
| Foreign currency translation adjustment | - | - | - | - | 1,620 | 1,620 |
| **Balance at September 30, 2010** | $ 257,489 | $ 24,698 | $ 24,344 | $ (306,885) | $ 23,176 | $ 22,822 |

| **For the nine months ended September 30, 2009** (Adjusted- notes 2(a) & (c)) | Common stock | Preferred stock | Additional paid-in capital | Deficit | Accumulated other comprehensive income | Total stockholders' equity |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2008** | $ 255,657 | $ 24,698 | $ 22,112 | $ (297,137) | $ 20,944 | $ 26,274 |
| Net loss | - | - | - | (9,748) | - | (9,748) |
| Common stock issued upon exercise of options | 1,797 | - | - | - | - | 1,797 |
| Reallocation of additional paid-in capital arising from stock-based compensation related to exercise of options | 35 | - | (35) | - | - | - |
| Stock option expense recognized | - | - | 2,267 | - | - | 2,267 |
| Foreign currency translation adjustment | - | - | - | - | 2,232 | 2,232 |
| **Balance at September 30, 2009** | $ 257,489 | $ 24,698 | $ 24,344 | $ (306,885) | $ 23,176 | $ 22,822 |

See accompanying notes to the consolidated financial statements.

# CARDIOME PHARMA CORP.

Consolidated Statements of Cash Flows
(Unaudited)
(Expressed in thousands of U.S. dollars)
(Prepared in accordance with U.S. GAAP)

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | September 30, 2010 | September 30, 2009 (Adjusted- notes 2(a) & (c)) | September 30, 2010 | September 30, 2009 (Adjusted- notes 2(a) & (c)) |
| Cash flows from operating activities: | | | | |
| Net income (loss) for the period | $ 22,768 | $ 228 | $ 42,801 | $ (9,748) |
| Add items not affecting cash: | | | | |
| Amortization | 291 | 301 | 890 | 868 |
| Stock-based compensation | 551 | 1,623 | 2,477 | 2,267 |
| Deferred leasehold inducement | (50) | (25) | (156) | (83) |
| Unrealized foreign exchange (gain) loss | (119) | 5,127 | (23) | 3,089 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable (note 9(a)) | (29,502) | (6,037) | (29,196) | (6,234) |
| Prepaid expenses and other assets | (28) | 777 | (234) | 691 |
| Accounts payable and accrued liabilities | 1,080 | 2,231 | (2,060) | (279) |
| Deferred revenue | - | 2,353 | (35,197) | 52,942 |
| Net cash provided by (used in) operating activities | (5,009) | 6,578 | (20,698) | 43,513 |
| Cash flows from investing activities: | | | | |
| Purchase of property and equipment | (73) | (51) | (216) | (85) |
| Purchase of intangible assets | (78) | (72) | (242) | (160) |
| Net cash used in investing activities | (151) | (123) | (458) | (245) |
| Cash flows from financing activities: | | | | |
| Issuance of common stock upon exercise of stock options | 715 | 1,521 | 2,359 | 1,797 |
| Deferred costs relating to tender offer (note 8(c)) | - | (702) | | (702) |
| Proceeds from draws of long-term debt | - | - | 25,000 | - |
| Net cash provided by financing activities | 715 | 819 | 27,359 | 1,095 |
| Effect of foreign exchange rate changes on cash and cash equivalents | 170 | 1,011 | (41) | 3,956 |
| Increase (decrease) in cash and cash equivalents during the period | (4,275) | 8,285 | 6,162 | 48,319 |
| Cash and cash equivalents, beginning of period | 57,707 | 70,529 | 47,270 | 30,495 |
| Cash and cash equivalents, end of period | $ 53,432 | $ 78,814 | $ 53,432 | $ 78,814 |
| Supplemental cash flow information: | | | | |
| Interest paid | 573 | 4 | 1,423 | 10 |
| Interest received | 6 | 3 | 10 | 30 |

See accompanying notes to the consolidated financial statements.

**1. Basis of presentation:**

These unaudited interim consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles used in the United States of America (U.S. GAAP) and are presented in U.S. dollars. These policies are consistent with Canadian generally accepted accounting principles (Canadian GAAP) in all material respects for the Company, except as described in note 12. Cardiome Pharma Corp (the Company) issued its audited annual consolidated financial statements for the year ended December 31, 2009 in accordance with Canadian GAAP in Canadian dollars and also provided a reconciliation of the differences between Canadian GAAP and U.S. GAAP in note 19 to those audited annual consolidated financial statements. The change in generally accepted accounting principles as well as changes in the Company's functional and reporting currencies is described in note 2 below. These unaudited interim consolidated financial statements do not include all note disclosures required by U.S. GAAP on an annual basis, and therefore should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2009 filed with the appropriate securities commissions. The results of operations for the three and nine months ended September 30, 2010 and 2009 are not necessarily indicative of the results for the full year.

The Company has financed its cash requirements primarily from share issuances, payments from research collaborators, licensing fees and credit facilities. The Company's ability to realize the carrying value of its assets is dependent on successfully bringing its technologies to market and achieving future profitable operations, the outcome of which cannot be predicted at this time.

**2. Changes affecting fiscal 2010 consolidated financial statements:**

(a) Change in generally accepted accounting policies

The Company historically prepared its consolidated financial statements in conformity with Canadian GAAP and provided a supplemental reconciliation to U.S. GAAP. Effective January 1, 2010, the Company adopted U.S. GAAP as the reporting standard for its consolidated financial statements. These consolidated interim financial statements, including related notes, have therefore been prepared in accordance with U.S. GAAP. All comparative financial information contained herein has been recast to reflect the Company's results as if the Company had historically reported in accordance with U.S. GAAP. These adjustments resulted in an increase in deficit of $13,748, a decrease in intangible assets of $13,855, an increase in common share capital of $446, an increase in additional paid-in capital of $80, and a decrease in accumulated other comprehensive income of $633, at January 1, 2010. These differences are outlined in our annual audited consolidated financial statements for the year ended December 31, 2009 in note 19. A reconciliation of the differences from U.S GAAP to Canadian GAAP is contained in note 12.

**2. Changes affecting fiscal 2010 consolidated financial statements (continued):**

(b) Change in functional currency

The functional currency of the Company and its subsidiaries changed to U.S. dollars from Canadian dollars on January 1, 2010 based on management's analysis of the primary economic environment in which the Company and its wholly owned subsidiaries operate. The change in functional currency is accounted for prospectively from January 1, 2010 and prior year financial statements have not been restated for the change in functional currency. As a result of this change, the Company's foreign operations have been translated to U.S. dollars using the temporal method on a prospective basis. Monetary assets and liabilities are translated into U.S. dollars using the exchange rate in effect at the end of the period, and non-monetary assets and liabilities are translated into U.S. dollars using the exchange rate in effect at the date of the transaction. Revenues and expenses are translated at the average rate during the period. Foreign exchange gains and losses are included in the consolidated statement of operations and comprehensive income (loss).

(c) Change in reporting currency

The Company elected to adopt U.S. dollars as its reporting currency effective January 1, 2010 to better reflect its business and to improve comparability of its financial information with other publicly traded businesses in the life sciences industry. Prior year financial statements and all comparative financial information contained herein have been recast to reflect the Company's results as if they had been historically reported in U.S. dollars. All revenues, expenses and cash flows for each period were translated into the reporting currency using average rates for the period, or the rates in effect at the date of the transaction for significant transactions. Assets and liabilities were translated using the exchange rate at the end of the period and stockholders' equity was translated at historical rates. The resulting translation adjustment was recorded as accumulated foreign currency translation adjustment in accumulated other comprehensive income.

The cumulative impact of the change in reporting currency was to increase accumulated other comprehensive income by $18,185 as at December 31, 2009.

**3. Future changes in accounting policies:**

(a) International Financial Reporting Standards:

In February 2010, the U.S. Securities and Exchange Commission (SEC) approved a new timeline regarding the potential use of International Financial Reporting Standards (IFRS) by SEC issuers. Under this timeline, the earliest date SEC issuers could be required to prepare financial statements under IFRS is fiscal 2015. The Company expects to adopt IFRS as its reporting standard when the SEC requires its domestic registrants in the U.S. to transition to IFRS. The SEC will make a determination in 2011 regarding the mandatory adoption of IFRS. The Company has not assessed the impact of this potential change on its consolidated financial statements.

(b) Multiple-Deliverable Revenue Arrangements:

In October 2009, the Financial Accounting Standards Board (FASB) provided amendments to the criteria for separating consideration in multiple-deliverable arrangements, established a selling price hierarchy for determining the selling price of a deliverable, and eliminated the residual method of allocation of consideration by requiring that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. FASB also requires expanded disclosures related to multiple-deliverable revenue arrangements, including information about the significant judgments made and changes to those judgments, as well as how the application of the relative selling-price method affects the timing and amount of revenue recognition. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We do not expect the adoption of the amendments to have a material impact on the Company's financial position, results of operations or cash flows.

(c) Milestone method of revenue recognition:

In April 2010, FASB published guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. Milestones should be considered substantive in their entirety and may not be bifurcated. An arrangement may contain both substantive and nonsubstantive milestones that should be evaluated individually. The amendments are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the impact of adoption of the amendments on the Company's financial position, results of operations and cash flows.

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

## 4. Financial instruments:

The fair values of cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate carrying values because of their short-term nature.

## 5. Accounts payable and accrued liabilities:

Accounts payable and accrued liabilities comprise of:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Trade accounts payable | $ 171 | $ 920 |
| Accrued contract research | 2,633 | 4,400 |
| Employee-related accruals | 869 | 893 |
| Other accrued liabilities [1] | 1,820 | 1,405 |
| | $ 5,493 | $ 7,618 |

[1] Included in other accrued liabilities at September 30, 2010 is an amount of $384 (December 31, 2009 - $162) owing to a related party (note 10).

## 6. Long-term debt:

Pursuant to a collaboration and license agreement with Merck & Co., Inc. (Merck), Merck has granted the Company an interest-bearing credit facility of up to $100 million, secured by a first priority interest to the Company’s patents and all associated proceeds. This credit facility can be accessed in amounts of up to $25 million annually, subject to certain minimums, from January 1, 2010 to December 31, 2013, with each advance to be fully repaid six years after the year of the advance on December 31st. Interest accrues at LIBOR plus 8% per annum and is payable at the end of each calendar quarter.

The Company borrowed $25 million under this facility in the nine month period ended September 30, 2010. The Company may at its option, repay all or a portion of the advance from time to time without premium or penalty. This advance must be repaid in full by December 31, 2016.

The long-term debt has been recorded at amortized cost. Based on current market borrowing rates, the carrying value of the Company’s long-term debt approximates its fair value.

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

**7. Basic and diluted income (loss) per share:**

Basic income (loss) per share is calculated using the weighted average number of common shares outstanding during the period.

Diluted income (loss) per share is calculated using the weighted average number of common shares outstanding during the period, adjusted to include the number of incremental common shares that would have been outstanding if all dilutive potential common shares had been issued. The incremental common shares related to stock options are calculated using the treasury stock method, whereby the potential proceeds from the exercise of dilutive stock options are used to purchase the Company's common shares at the average market price during the period.

Of the 5,690,006 stock options outstanding at September 30, 2010 (2009 - 6,757,410), the number of potentially dilutive common shares excluded from the income per share calculation due to their anti-dilutive effect for the three and nine months ended September 30, 2010 was 2,929,596 and 3,594,193 options, respectively (three months ended September 30, 2009 - 6,407,410 options). As the Company incurred a loss for the nine months ended September 30, 2009, all stock options and convertible preferred shares were anti-dilutive and were excluded from the diluted weighted average shares outstanding for that period.

Reconciliations of the income (loss) and weighted average number of common shares used in the calculations are set forth below:

| | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Income (loss) available to common stockholders | 22,768 | 228 | 42,801 | (9,748) |
| Weighted average number of common shares for basic income (loss) per share | 60,985,176 | 64,107,616 | 60,733,543 | 63,889,446 |
| Dilutive effect of options | 755,404 | 170,321 | 609,987 | - |
| Dilutive effect of conversion of preferred shares (note 8(c)) | - | 2,272,727 | - | - |
| Diluted weighted average number of common shares for diluted income (loss) per share | 61,740,580 | 66,550,664 | 61,343,530 | 63,889,446 |
| Basic and diluted income (loss) per share | 0.37 | 0.00 | 0.70 | (0.15) |

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

## 8. Stockholders' equity:

(a) Stock options:

On May 26, 2010, the shareholders approved amendments to the 2001 Stock Option Plan. These amendments (i) permit the cashless exercise of options without payment of cash consideration, where the option holder receives the intrinsic value of the exercised options in the form of common shares issued from treasury, and (ii) provide option holders, at the discretion of the Board of Directors or Chief Executive Officer, with a cash surrender right which entitles the holder to surrender options and receive the intrinsic value of the surrendered options in cash.

Details of the stock option transactions for the nine months ended September 30, 2010 are summarized as follows:

| | Number of stock options outstanding | Weighted average exercise price (CAD$) |
|---|---|---|
| Balance, December 31, 2009 | 6,339,031 | $ 7.45 |
| Options granted | 242,200 | 8.10 |
| Options exercised[1] | (767,829) | 5.86 |
| Options forfeited | (93,396) | 7.26 |
| Options expired | (30,000) | 7,52 |
| Balance, September 30, 2010 | 5,690,006 | $ 7.70 |

[1] During the three and nine months ended September 30, 2010, the Company issued 12,124 and 95,273 shares, respectively, in exchange for 49,435 and 324,435 stock options, respectively, in cashless exercise transactions.

At September 30, 2010, stock options to executive officers and directors, employees and consultants, which expire at various dates from October 1, 2010 and September 26, 2015, were outstanding as follows:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices (CAD$) | Number of common shares issuable | Weighted average remaining contractual life (years) | Weighted average exercise price (CAD$) | Number of common shares issuable | Weighted average exercise price (CAD$) |
| $4.15 - $6.24 | 2,651,690 | 3.30 | $ 4.68 | 943,193 | 4.65 |
| $6.29 - $8.95 | 1,199,720 | 1.16 | 8.48 | 1,100,095 | 8.47 |
| $8.98 - $11.15 | 936,292 | 2.13 | 10.14 | 855,392 | 10.15 |
| $11.26 - $14.50 | 902,304 | 1.91 | 12.98 | 879,179 | 13.01 |
| | 5,690,006 | 2.44 | $ 7.70 | 3,777,859 | $ 8.95 |

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

**8. Stockholders' equity (continued):**

(a) Stock options (continued):

A summary of the Company's non-vested stock option activity and related information for the nine months ended September 30, 2010 is as follows:

| Non-vested options | Number of options | Weighted average grant-date fair value (U.S.$) |
|---|---|---|
| Non-vested at December 31, 2009 | 2,567,398 | 2.82 |
| Granted | 242,200 | 3.87 |
| Vested | (831,542) | 3.78 |
| Forfeited | (65,909) | 2.71 |
| Non-vested at September 30, 2010 | 1,912,147 | 2.53 |

As of September 30, 2010, there is $1,895 of total unrecognized compensation cost related to non-vested stock options. That cost is expected to be recognized over a weighted average period of 1.4 years.

The aggregate intrinsic value of stock options outstanding at September 30, 2010 is $4,062.

The aggregate intrinsic value of the vested and exercisable stock options at September 30, 2010 is $1,472.

The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2010 was $1,914 (2009 - $525)

The aggregate fair value of vested options during the nine months ended September 30, 2010 was $3,144 (2009 - $3,941).

The weighted average remaining contractual life of vested and exercisable stock options at September 30, 2010 is 2.0 years.

Cash received during the nine months ended September 30, 2010 related to the exercise of stock options was $2,359.

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

**8. Stockholders' equity (continued):**

(b) Conversion of preferred shares:

On July 25, 2008, the Company closed a non-brokered private placement of 2,272,727 Series A convertible preferred shares at a price of U.S.$11.00 per share for gross proceeds of $25,000 to CR Intrinsic Investments, LLC. On October 6, 2009, the 2,272,727 Series A preferred shares were converted into common shares of the Company on a one-to-one basis at the option of CR Intrinsic Investments, LLC. No Series A preferred shares remain outstanding subsequent to the conversion.

(c) Tender offer:

On October 16, 2009, in connection with its modified “Dutch Auction” tender offer (the Offer), the Company announced it accepted 6,470,588 of its common shares for purchase and cancellation at a purchase price of $4.25 per share, for an aggregate purchase price of $27.5 million. As of September 30, 2009, the Company incurred total legal and professional fees of $702 relating to the Offer, which were recorded as other assets and were applied against share capital upon completion of the repurchase of shares.

(d) Stock-based compensation:

The estimated fair value of options granted from December 1, 2002 to officers, directors, employees and consultants is amortized over the vesting period. Compensation expense is recorded in research and development expenses and general and administration expenses as follows:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Research and development | $ 214 | $ 450 | $ 840 | $ 667 |
| General and administration | 337 | 1,173 | 1,637 | 1,600 |
| Total | $ 551 | $ 1,623 | $ 2,477 | $ 2,267 |

(Expressed in thousands of U.S. dollars except share and per share amounts and where otherwise indicated)

**8. Stockholders' equity (continued):**

(d) Stock-based compensation (continued):

The weighted average fair value of stock options granted during the three and nine months ended September 30, 2010 was $3.54 and $3.87 per option respectively (three and nine months ended September 30, 2009 - $2.02 per option). The estimated fair value of the stock options granted was determined using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| | September 30, 2010 | September 30, 2009 | September 30, 2010 | September 30, 2009 |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| Expected volatility | 61.8% | 64.6% | 62.5% | 64.6% |
| Risk-free interest rate | 1.9% | 2.0% | 2.4% | 2.0% |
| Expected average life of the options | 4.1 years | 3.4 years | 4.1 years | 3.4 years |

The Company estimates forfeitures for unvested options as a percentage of stock-based compensation. For the period ended September 30, 2010, the Company applied an estimated percentage of 13.9%, which management considered to be a reasonable estimate of actual forfeitures.

There is no dividend yield as the Company has not paid, and does not plan to pay, dividends on its common shares. The expected volatility is based on the historical share price volatility of the Company's daily share closing prices over a period equal to the expected life of each option grant. The risk-free interest rate is based on yields from Canadian government bond yields with a term equal to the expected term of the options being valued. The expected life of options represents the period of time that the options are expected to be outstanding based on the contractual term of the options and on historical data of option holder exercise and post-vesting employment termination behaviour.

**9. Collaborative and license agreements:**

(a) Merck & Co., Inc

Under the terms of the April 8, 2009 collaboration and license agreement with Merck & Co., Inc. for the development and commercialization of vernakalant, the Company is entitled to milestone payments based on achievements of certain development and approval milestones associated with vernakalant products. On September 2, 2010 the Company achieved the milestone of $30 million relating to the marketing approval in Europe of vernakalant (iv), which was recorded as revenue for the period and included in accounts receivable at September 30, 2010.

**9. Collaborative and license agreements (continued):**

(b) Artesian Therapeutics, Inc

Under the terms of the October 21, 2005 acquisition of Artesian Therapeutics, Inc (Artesian), the Company initially had an obligation to advance the development of at least one drug candidate by October 21, 2007 and subsequently continue its development. On October 19, 2007, the Company amended its Stock Purchase Agreement with Artesian Therapeutics Inc. to extend this period to March 31, 2009, otherwise the Company would be required to transfer ownership to or license the acquired intellectual property to the former shareholders of Artesian. The Company did not meet the obligation of drug advancement and in March 2010, the former shareholders of Artesian exercised their right to reclaim the acquired intellectual property assets.

**10. Related party transactions:**

The Company has incurred expenses for services provided by a law firm in which an officer is a partner. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the nine months ended September 30, 2010, the Company has incurred legal fees of $448 for services provided by the law firm relating to general corporate matters. For the nine months ended September 30, 2009, the Company incurred legal fees of $1,019 for services provided by the law firm relating to general corporate matters and review of partnership opportunities. Included in accounts payable and accrued liabilities at September 30, 2010 is an amount of $384 (December 31, 2009 - $162) owing to the legal firm.

**11. Accounting for tax uncertainties:**

The Company recognizes interest and penalties related to income taxes in interest income (expense). To date, the Company has not incurred any significant interest and penalties.

**12. Reconciliation of Generally Accepted Accounting Principles:**

The Company prepares its consolidated financial statements in accordance with U.S. GAAP which, as applied in these consolidated financial statements, conform in all material respects to Canadian GAAP, except as summarized below:

### 12. Reconciliation of Generally Accepted Accounting Principles (continued):

I. Reconciliation of consolidated balance sheets:

As at September 30, 2010 (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ 53,432 | $ - | | $ 53,432 |
| Accounts receivable | 30,630 | - | | 30,630 |
| Prepaid expenses and other assets | 729 | - | | 729 |
| | 84,791 | - | | 84,791 |
| Property and equipment | 2,201 | - | | 2,201 |
| Intangible assets | 1,672 | 12,207 | a & b | 13,879 |
| | $ 88,664 | $ 12,207 | | $ 100,871 |
| **Liabilities & Stockholders' Equity** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | 5,493 | - | | 5,493 |
| Current portion of deferred leasehold inducement | 214 | - | | 214 |
| | 5,707 | - | | 5,707 |
| Deferred leasehold inducement | 538 | - | | 538 |
| Long-term debt | 25,000 | - | | 25,000 |
| | 31,245 | - | | 31,245 |
| Stockholders' equity: | | | | |
| Common stock | 261,545 | (751) | c, d(ii) | 260,794 |
| Additional paid-in capital | 29,671 | 244 | d(i), d(ii) | 29,915 |
| Deficit | (251,982) | 12,081 | a,b,c & d(i) | (239,901) |
| Accumulated other comprehensive income | 18,185 | 633 | a & b | 18,818 |
| | 57,419 | 12,207 | | 69,626 |
| | $ 88,664 | $ 12,207 | | $ 100,871 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

I. Reconciliation of consolidated balance sheets (continued):

December 31, 2009 (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP | Stated in accordance with Canadian GAAP and in CAD$ |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $ 47,270 | $ - | | $ 47,270 | $ 49,680 |
| Accounts receivable | 1,428 | - | | 1,428 | 1,501 |
| Prepaid expenses and other assets | 495 | - | | 495 | 521 |
| | 49,193 | - | | 49,193 | 51,702 |
| Property and equipment | 2,646 | - | | 2,646 | 2,782 |
| Intangible assets | 1,666 | 13,855 | a & b | 15,521 | 16,312 |
| | $ 53,505 | $ 13,855 | | $ 67,360 | $ 70,796 |
| **Liabilities & Stockholders' Equity** | | | | | |
| Current liabilities: | | | | | |
| Accounts payable and accrued liabilities | $ 7,618 | $ - | | $ 7,618 | $ 8,007 |
| Deferred revenue | 35,197 | - | | 35,197 | 36,992 |
| Current portion of deferred leasehold inducement | 212 | - | | 212 | 223 |
| | 43,027 | - | | 43,027 | 45,222 |
| Deferred leasehold inducement | 696 | - | | 696 | 732 |
| | 43,723 | - | | 43,723 | 45,954 |
| Stockholders' equity: | | | | | |
| Common stock | 256,711 | (446) | c | 256,265 | 322,329 |
| Additional paid-in capital | 29,669 | (80) | d(i) | 29,589 | 33,192 |
| Deficit | (294,783) | 13,748 | a,b,c,& d(i) | (281,035) | (330,679) |
| Accumulated other comprehensive income | 18,185 | 633 | a & b | 18,818 | - |
| | 9,782 | 13,855 | | 23,637 | 24,842 |
| | $ 53,505 | $ 13,855 | | $ 67,360 | $ 70,796 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

II. Reconciliation of consolidated statements of operations and comprehensive income (loss):

For the three months ended September 30, 2010:
(in thousands of U.S. dollars, except share and per share amounts)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP |
|---|---|---|---|---|
| Revenue: | | | | |
| Licensing fees | $ 30,000 | $ - | | $ 30,000 |
| Research collaborative fees | 221 | - | | 221 |
| | 30,221 | - | | 30,221 |
| Expenses: | | | | |
| Research and development | 3,486 | 75 | a & d(i) | 3,561 |
| General and administration | 3,505 | (8) | d(i) | 3,497 |
| Amortization | 291 | 447 | a & b | 738 |
| Write-down of intangible asset (note 13) | - | 58 | | 58 |
| | 7,282 | 572 | | 7,854 |
| Operating income | 22,939 | (572) | | 22,367 |
| Other income and expenses: | | | | |
| Interest expense | (565) | - | | (565) |
| Other income | 187 | - | | 187 |
| Foreign exchange loss | 207 | - | | 207 |
| | (171) | - | | (171) |
| Net income | $ 22,768 | $ (572) | | $ 22,196 |
| Basic and diluted income (loss) per common share | $ 0.37 | $ (0.01) | | $ 0.36 |
| Weighted average number of common shares outstanding | | | | |
| Basic | 60,985,176 | | | 60,985,176 |
| Diluted | 61,740,580 | | | 61,740,580 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

II. Reconciliation of consolidated statements of operations and comprehensive income (loss):

For the nine months ended September 30, 2010:
(in thousands of U.S. dollars, except share and per share amounts)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP |
|---|---|---|---|---|
| Revenue: | | | | |
| Licensing fees | $ 65,146 | $ - | | $ 65,146 |
| Research collaborative fees | 544 | - | | 544 |
| | 65,690 | - | | 65,690 |
| Expenses: | | | | |
| Research and development | 10,922 | 267 | a & d(i) | 11,189 |
| General and administration | 10,135 | (6) | d(i) | 10,129 |
| Amortization | 890 | 1,348 | a & b | 2,238 |
| Write-down of intangible asset (note 13) | - | 58 | | 58 |
| | 21,947 | 1,667 | | 23,614 |
| Operating income | 43,743 | (1,667) | | 42,076 |
| Other income and expenses: | | | | |
| Interest expense | (1,412) | - | | (1,412) |
| Other income | 534 | - | | 534 |
| Foreign exchange loss | (64) | - | | (64) |
| | (942) | - | | (942) |
| Net income | $ 42,801 | $ (1,667) | | $ 41,134 |
| Income per common share | | | | |
| Basic | $ 0.70 | $ (0.02) | | $ 0.68 |
| Diluted | $ 0.70 | $ (0.03) | | $ 0.67 |
| Weighted average number of common shares outstanding | | | | |
| Basic | 60,733,543 | | | 60,733,543 |
| Diluted | 61,343,530 | | | 61,343,530 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

II. Reconciliation of consolidated statements of operations and comprehensive loss (continued):

For the three months ended September 30, 2009:
(in thousands of U.S. dollars, except share and per share amounts)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP | Stated in accordance with Canadian GAAP and in CAD$ |
|---|---|---|---|---|---|
| Revenue: | | | | | |
| Licensing fees | $ 19,110 | - | | $ 19,110 | $ 20,972 |
| Research collaborative fees | 88 | - | | 88 | 97 |
| | 19,198 | - | | 19,198 | 21,069 |
| Expenses: | | | | | |
| Research and development | 9,290 | 72 | a & d(i) | 9,362 | 10,275 |
| General and administration | 4,193 | 51 | d(i) | 4,244 | 4,657 |
| Amortization | 301 | 436 | a & b | 737 | 809 |
| | 13,784 | 559 | | 14,343 | 15,741 |
| Operating income | 5,414 | (559) | | 4,855 | 5,328 |
| Other income and expenses: | | | | | |
| Interest income | 2 | - | | 2 | 3 |
| Other income | 44 | - | | 44 | 47 |
| Foreign exchange gain | (5,232) | - | | (5,232) | (5,742) |
| | (5,186) | - | | (5,186) | (5,692) |
| Net income (loss) | 228 | (559) | | (331) | (364) |
| Other comprehensive income | | | | | |
| Foreign currency translation adjustment | 1,620 | 1,147 | a & b | 2,767 | - |
| Comprehensive income (loss) | $ 1,848 | 588 | | $ 2,436 | $ (364) |
| Loss per common share | | | | | |
| Basic | 0.00 | (0.01) | | (0.01) | (0.01) |
| Diluted | 0.00 | (0.01) | | (0.01) | (0.01) |
| Weighted average number of common shares outstanding | | | | | |
| Basic | 64,107,616 | | | 64,107,616 | 64,107,616 |
| Diluted | 66,550,664 | | | 64,107,616 | 64,107,616 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

II. Reconciliation of consolidated statements of operations and comprehensive loss (continued):

For the nine months ended September 30, 2009:
(in thousands of U.S. dollars, except share and per share amounts)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP | Stated in accordance with Canadian GAAP and in CAD$ |
|---|---|---|---|---|---|
| Revenue: | | | | | |
| Licensing fees | $ 26,121 | $ - | | $ 26,121 | $ 29,154 |
| Research collaborative fees | 642 | - | | 642 | 761 |
| | 26,763 | - | | 26,763 | 29,915 |
| Expenses: | | | | | |
| Research and development | 20,828 | 160 | a & d(i) | 20,988 | 24,328 |
| General and administration | 11,739 | 86 | d(i) | 11,825 | 13,764 |
| Amortization | 868 | 1,236 | a & b | 2,104 | 2,457 |
| | 33,435 | 1,482 | | 34,917 | 40,549 |
| Operating loss | (6,672) | (1,482) | | (8,154) | (10,634) |
| Other income and expenses: | | | | | |
| Interest income | 17 | - | | 17 | 22 |
| Other income | 97 | - | | 97 | 110 |
| Foreign exchange gain | (3,190) | - | | (3,190) | (3,337) |
| | (3,076) | - | | (3,076) | (3,205) |
| Net loss | (9,748) | (1,482) | | (11,230) | (13,839) |
| Other comprehensive income | | | | | |
| Foreign currency translation adjustment | 2,232 | 1,765 | a & b | 3,997 | - |
| Comprehensive loss | (7,516) | $ 283 | | $ (7,233) | $ (13,839) |
| Basic and diluted loss per common share | (0.15) | (0.02) | | (0.17) | (0.22) |
| Weighted average number of common shares outstanding - basic and diluted | 63,889,446 | | | 63,889,446 | 63,889,446 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

III. Reconciliation of consolidated statements of cash flows:

For the three months ended September 30, 2010 (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income for the period | $ 22,768 | $ (572) | | $ 22,196 |
| Add items not affecting cash: | | | | |
| Amortization | 291 | 447 | a & b | 738 |
| Stock-based compensation | 551 | (11) | d(i) | 540 |
| Deferred leasehold inducement | (50) | - | | (50) |
| Write-down of intangible asset (note 13) | - | 58 | | 58 |
| Unrealized foreign exchange loss | (119) | - | | (119) |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (29,502) | - | | (29,502) |
| Prepaid expenses and other assets | (28) | - | | (28) |
| Accounts payable and accrued liabilities | 1,080 | - | | 1,080 |
| Deferred revenue | - | - | | - |
| Net cash used in operating activities | (5,009) | (78) | | (5,087) |
| Cash flows from investing activities: | | | | |
| Purchase of property and equipment | (73) | - | | (73) |
| Purchase of intangible assets | (78) | 78 | a | - |
| Net cash provided by (used in) investing activities | (151) | 78 | | (73) |
| Cash flows from financing activities: | | | | |
| Issuance of common stock upon exercise of stock options | 715 | - | | 715 |
| Proceeds from draws of long-term debt | - | - | | - |
| Net cash provided by financing activities | 715 | - | | 715 |
| Effect of foreign exchange rate changes on cash and cash equivalents | 170 | - | | 170 |
| Decrease in cash and cash equivalents during the period | (4,275) | - | | (4,275) |
| Cash and cash equivalents, beginning of period | 57,707 | - | | 57,707 |
| Cash and cash equivalents, end of period | $ 53,432 | $ - | | $ 53,432 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

III. Reconciliation of consolidated statements of cash flows:

For the nine months ended September 30, 2010 (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Net income for the period | $ 42,801 | $ (1,667) | | $ 41,134 |
| Add items not affecting cash: | | | | |
| Amortization | 890 | 1,348 | a & b | 2,238 |
| Stock-based compensation | 2,477 | 19 | d(i) | 2,496 |
| Deferred leasehold inducement | (156) | - | | (156) |
| Write-down of intangible asset (note 13) | - | 58 | | 58 |
| Unrealized foreign exchange loss | (23) | - | | (23) |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (29,196) | - | | (29,196) |
| Prepaid expenses and other assets | (234) | - | | (234) |
| Accounts payable and accrued liabilities | (2,060) | - | | (2,060) |
| Deferred revenue | (35,197) | - | | (35,197) |
| Net cash used in operating activities | (20,698) | (242) | | (20,940) |
| Cash flows from investing activities: | | | | |
| Purchase of property and equipment | (216) | - | | (216) |
| Purchase of intangible assets | (242) | 242 | a | - |
| Net cash provided by (used in) investing activities | (458) | 242 | | (216) |
| Cash flows from financing activities: | | | | |
| Issuance of common stock upon exercise of stock options | 2,359 | - | | 2,359 |
| Proceeds from draws of long-term debt | 25,000 | - | | 25,000 |
| Net cash provided by financing activities | 27,359 | - | | 27,359 |
| Effect of foreign exchange rate changes on cash and cash equivalents | (41) | - | | (41) |
| Increase in cash and cash equivalents during the period | 6,162 | - | | 6,162 |
| Cash and cash equivalents, beginning of period | 47,270 | - | | 47,270 |
| Cash and cash equivalents, end of period | $ 53,432 | $ - | | $ 54,432 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

III. Reconciliation of consolidated statements of cash flows:

For the three months ended September 30, 2009: (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP | Stated in accordance with Canadian GAAP and in CAD $ |
|---|---|---|---|---|---|
| Cash flows from operating activities: | | | | | |
| Net income (loss) for the period | 228 | (559) | | (331) | (364) |
| Add items not affecting cash: | | | | | |
| Amortization | 301 | 436 | a & b | 737 | 809 |
| Stock-based compensation | 1,623 | 51 | d(i) | 1,674 | 1,836 |
| Deferred leasehold inducement | (25) | - | | (25) | (27) |
| Unrealized foreign exchange gain | 5,127 | - | | 5,127 | 5,627 |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | (6,037) | - | | (6,037) | (7,276) |
| Prepaid expenses and other assets | 777 | - | | 777 | 843 |
| Accounts payable and accrued liabilities | 2,231 | - | | 2,231 | 3,503 |
| Deferred revenue | 2,353 | - | | 2,353 | 2,582 |
| Net cash provided by (used in) operating activities | 6,578 | (72) | | 6,506 | 7,533 |
| Cash flows from investing activities: | | | | | |
| Purchase of property and equipment | (51) | - | | (51) | (56) |
| Purchase of intangible asset | (72) | 72 | a | - | - |
| Net cash provided by (used in) investing activities | (123) | 72 | | (51) | (56) |
| Cash flows from financing activities: | | | | | |
| Issuance of common stock upon exercise of stock options | 1,521 | - | | 1,521 | 1,669 |
| Deferred costs relating to tender offer (note 8(c)) | (702) | - | | (702) | (771) |
| Net cash provided by financing activities | 819 | - | | 819 | 898 |
| Effect of foreign exchange rate changes on cash and cash equivalents | 1,011 | - | | 1,011 | (6,014) |
| Increase in cash and cash equivalents during the period | 8,285 | - | | 8,285 | 2,361 |
| Cash and cash equivalents, beginning of period | 70,529 | - | | 70,529 | 82,025 |
| Cash and cash equivalents, end of period | 78,814 | - | | 78,814 | 84,386 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

III. Reconciliation of consolidated statements of cash flows:

For the nine months ended September 30, 2009: (in thousands of U.S. dollars)

| | Stated in accordance with U.S. GAAP | Adjustments from U.S. to Canadian GAAP | Note | Stated in accordance with Canadian GAAP | Stated in accordance with Canadian GAAP and in CAD $ |
|---|---|---|---|---|---|
| Cash flows from operating activities: | | | | | |
| Net loss for the period | (9,748) | (1,482) | | (11,230) | (13,839) |
| Add items not affecting cash: | | | | | |
| Amortization | 868 | 1,236 | a & b | 2,104 | 2,457 |
| Stock-based compensation | 2,267 | 86 | d(i) | 2,353 | 2,656 |
| Deferred leasehold inducement | (83) | - | | (83) | (98) |
| Unrealized foreign exchange gain | 3,089 | - | | 3,089 | 3,236 |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | (6,234) | - | | (6,234) | (7,522) |
| Prepaid expenses and other assets | 691 | - | | 691 | 711 |
| Accounts payable and accrued liabilities | (279) | - | | (279) | 508 |
| Deferred revenue | 52,942 | - | | 52,942 | 61,626 |
| Net cash provided by (used in) operating activities | 43,513 | (160) | | 43,353 | 49,735 |
| Cash flows from investing activities: | | | | | |
| Purchase of property and equipment | (85) | - | | (85) | (96) |
| Purchase of intangible asset | (160) | 160 | a | - | - |
| Net cash provided by (used in) investing activities | (245) | 160 | | (85) | (96) |
| Cash flows from financing activities: | | | | | |
| Issuance of common stock upon exercise of stock options | 1,797 | - | | 1,797 | 1,991 |
| Deferred costs relating to tender offer (note 8(c)) | (702) | - | | (702) | (771) |
| Net cash provided by financing activities | 1,095 | - | | 1,095 | 1,220 |
| Effect of foreign exchange rate changes on cash and cash equivalents | 3,956 | - | | 3,956 | (3,615) |
| Increase in cash and cash equivalents during the period | 48,319 | - | | 48,319 | 47,244 |
| Cash and cash equivalents, beginning of period | 30,495 | - | | 30,495 | 37,142 |
| Cash and cash equivalents, end of period | 78,814 | - | | 78,814 | 84,386 |

**12. Reconciliation of Generally Accepted Accounting Principles (continued):**

IV. Reconciliation of U.S. GAAP to Canadian GAAP - Notes:

(a) Patents

Under U.S. GAAP, patent costs related to internally generated assets developed from research activities are capitalized and amortized on a straight line basis over the estimated useful life of the patent. Under Canadian GAAP, these costs are expensed as incurred.

(b) In-process research and development:

Under U.S. GAAP, the Company's acquired license for a clinical-stage drug candidate is classified as in-process research and development and written off immediately as it has no alternative use. Under Canadian GAAP, in-process research and development is amortized over its estimated useful life.

(c) Preferred shares:

Under U.S. GAAP, the Series A convertible preferred shares contain an embedded beneficial conversion feature of $446 in favor of CR Intrinsic Investments, LLC (the holder). The beneficial conversion feature represents the difference between the conversion price and the fair value of the Company's common stock on the commitment date, which was also the issuance date. Under U.S. GAAP, the beneficial conversion feature was measured at its intrinsic value at the date of issuance of the shares and was recognized as a return to the preferred shareholders through a charge to deficit, over the period from the date of issuance to October 25, 2008, which was the earliest date when the conversion became exercisable by the holder. The beneficial conversion feature of $446 was fully amortized in 2008.

(d) Stock-based compensation:

(i) The amount of stock-based compensation expense for U.S. GAAP purposes differs from the amount for Canadian GAAP purposes, representing the impact of estimated employee award forfeitures. Under U.S. GAAP, the Company estimates forfeitures for unvested options as a percentage of stock-based compensation. Under Canadian GAAP, no estimate forfeitures of unvested options are made. Instead, forfeitures are recorded when they occur.

(ii) Under U.S. GAAP, cashless exercises of stock options have been recorded in share capital at their grant-date fair value. Under Canadian GAAP, the Company accounted for the 229,861 shares not issued on exercise of the options as a deemed re-purchase of these shares at the market value on the date of exercise and recognized $305, being the excess of their carrying value over the deemed cost, as a debit to contributed surplus.

**13. Subsequent event:**

On November 4, 2010, the Company elected to terminate an exclusive licensing agreement relating to a pre-clinical stage asset under which the Company is responsible for milestone payments of up to U.S. $7.3 million based on certain pre-defined clinical and regulatory approval milestones and has an obligation to pay royalties based on future net product income. The termination will become effective as of December 4, 2010, at which point the Company will have to return the asset to the licensor. The acquired license was classified as in-process research and development and expensed at the date of acquisition. Under Canadian GAAP, the license which was being amortized over its useful life was written off at September 30, 2010, resulting in a write-down of intangible asset of $58 as included in note 12.