CONSOLIDATED FINANCIAL STATEMENTS
AND MANAGEMENT'S DISCUSSION AND ANALYSIS

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

December 31, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2008

This Management's Discussion and Analysis has been prepared as of March 23, 2009.

Napier Environmental Technologies Inc. (the "**Company**" or "**Napier**") is a manufacturer and distributor of highly effective, safe and environmentally friendly chemicals for stripping paints and coatings, surface preparation, as well as a complete line of wood restoration and protective products. These products are cost effective, safe and easy to use, and are formulated and designed to be environmentally benign, which is important given today's environmental awareness. We distribute products both domestically and internationally through a network of distribution channels in the "Industrial" as well as "Consumer" markets.

Primary industrial uses for our products are paint stripping, concrete etching, rust or adhesive removal, asbestos removal and containment, and lead abatement. The products are applied to a range of surfaces including metal, concrete, and wood. Typical surface preparation applications include aircraft, industrial plants, ships, bridges, storage tanks, oil refineries, railcars, concrete floors, and buildings. In the industry there is limited reliance on a particular market sector due to the diversity of product application. Market demand for the products is highly project driven. As well, most applications occur outdoors, so weather plays a major factor. Napier products have not yet been introduced and adopted for all possible applications.

Consumer uses for the products are a large part of our business. The products and uses are similar to industrial uses with the main difference being a smaller scale project. We have been successful in this market segment through our private label business with some of the world's largest paint and coatings producers who have recognized our unique formulas and have leveraged their respective distribution abilities to position many of our products onto major retailers' shelves. Additionally, Napier has a successful retail network, distributing wood renovation products including cleaners, surface preparation products and a variety of coatings products. We have undertaken initiatives to form licensing agreements, which will allow our products to service customers we would otherwise be unable to service because of volume and distribution requirements. More recently, we have searched offshore markets in an effort to identify a company with significant size and prominence to utilize the Company's products and leverage from their existing relationships. This search identified Freeworld Global (pty) Limited ("Freeworld") with whom the Company has conclude an agreement to acquire all of the IP of the Company and have the rights to manufacture such IP in territories outside of the USA, Canada and Mexico ("NAFTA").

Competitive alternatives to our product offerings include products that are not environmentally benign and other surface preparation methods including sand blasting. In the wood coatings sector of the business, there are a number of competitive products. No one competitor offers the same broad range of products or has the same level of global product acceptance. Competitors tend to be found on a regional or national level and in some instances are tied to one market sector. Our competitive advantage is that our products are environmentally benign, cost effective, safe and easy to use. A number of products are patented and supported by our Research and Development expertise.

Shareholder value for this industry is generated through distribution, product diversity and acceptance. Our vision is to be a leader in environmentally friendly "green" surface preparation, wood restoration, lawn and garden and home cleaning products. Our people, distribution channels, product profitability, product development, brand awareness, infrastructure and working capital will drive performance. We continue to optimize our capabilities and resources in each of these areas.

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2008 has been prepared to give shareholders and other stakeholders an assessment of what the Company achieved last year as well as an indication of initiatives underway and planned for this year to improve shareholder value. This MD&A should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the years ending December 31, 2008 and December 31, 2007.

Disclosure Controls and Internal Controls over Financial Reporting

Management has determined that there have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

Overview

The year ended December 31, 2008 was another challenging one for Napier. The focus was the continued rebuilding of relationships with customers with the ultimate goal of increasing sales.

Results of Operations

For the year ended December 31, 2008, we recorded a net income of $2,961,554 ($0.02 per common share) as compared to a net loss of $1,822,051 ($0.01 per common share) for the year ended December 31, 2007.

The increased net income in 2008 is primarily due to the proceeds of $5,150,000 from the sale of intellectual property ("IP") to Freeworld Coatings Global (JSE: FWD) ("Freeworld") together with an option granting Freeworld the rights to the North American sales, marketing and manufacturing operations of Napier. Of these proceeds, $4,650,000 has been received and the balance of $500,000 is being held in escrow, to be released over the next two years.

Should Freeworld exercise its option to proceed with the operations within North America, Napier will receive further proceeds for inventory, machinery and goodwill for certain customers outside of North America. If Freeworld does not exercise its option with respect to the North American sales, marketing and manufacturing operations of Napier, the IP for North America will be transferred back to Napier in return for a refund of the deposit of $100,000 to Freeworld.

Upon completion of the transaction with Freeworld, the Company intends to continue with its current manufacturing operations in Canada, servicing its current customers within North America and outside of North America. Conditional upon Freeworld deciding to exercise the Option, the Company will transfer its operations to Freeworld. Notwithstanding such occurrence, the Company will retain the proposed licensing arrangement with a major paint company in the United States for the sale of products using the IP. This proposed licensing arrangement would provide a royalty, based on net sales, to the Company for each of the next 10 years. In addition, the Company will retain its losses for income tax purposes. It would be the intention of the Company to ensure that the remaining assets of the Company are exploited to their fullest potential and that overhead would be reduced commensurate with the remaining operations.

We recorded a net loss of $279,711 during the last three months of 2008 as compared to a loss of $662,348 during the last three months of 2007. With the fourth quarter being the industry's slowest period of the year, our loss is traditionally larger in this period compared to the first three quarters of the year.

Sales

Sales for the year ended December 31, 2008 totaled $2,066,147 as compared to $2,558,686 for the year ended December 31, 2007. The decrease in overall sales of 19.2% resulted from the combination of a number of factors varying from external forces such as foreign exchange, weather and changes in our methods of distribution. In one particular case we shifted the supply of one of our larger customers to a distribution agreement that allows us to take a passive approach by shipping to distribution centers as opposed to shipping to stores directly. It is important to note that despite a

decrease in overall sales, we earned royalty revenue during the year which has no direct associated costs.

We recorded sales of $279,767 during the last three months of 2008 as compared to $177,043 for the last three months of 2007. The increase of $102,724 is attributable to increased order activity from our customer base as our customers show a continuously increasing level of confidence in our ability to produce and deliver effective product.

Cost of Sales

Cost of sales for the year ended December 31, 2008 was $1,958,581 (94.79% of sales) compared to $2,234,696 (87.34% of sales) for the year ended December 31, 2007. The decrease in gross margin earned in the year ended December 31, 2008, as compared to the year ended December 31, 2007, is a result of a combination of two key factors. First, the lower volume results in lower gross margins as the absorption of overhead rate of overhead costs changes. Second, our change in distribution method results in lower gross margins on certain products.

The impact of this lower level of production was particularly obvious in the fourth quarter, where the cost of sales, which included an allocation of fixed overhead, exceeded the sales for the same period. We recorded cost of sales totaling $381,921 in the fourth quarter resulting in a gross margin of $(102,154) as compared to cost of sales and a gross margin of $330,211 and $(153,168) respectively, for the three months ended December 31, 2007.

Expenses

General and administrative expenses were $1,802,537 for the year ended December 31, 2008 compared to $860,799 for the year ended December 31, 2007, an increase of $941,738. The increase in costs is primarily attributable to the bonus accrual related to a compensation agreement with the Company's Chairman and legal fees related to our licensing agreement and the sale of intellectual property. General and administrative expenses for the three months ended December 31, 2008 totaled $67,493 as compared to $197,317 for the three months ended December 31, 2007. The decrease of $129,824 is primarily due to the current management team's efforts to control expenditures.

Selling expenses for the year ended December 31, 2008 were $310,054 as compared to $740,396 for the year ended December 31, 2007. The decrease of $430,342 is the result of an overall reduction of expenses within the sales and marketing area. Selling expenses for the three months ended December 31, 2008 were $17,019 as compared to $139,190 for the three months ended December 31, 2007. The decrease of $122,171 is the result of an overall reduction of expenses noted above.

Interest and finance costs decreased to $323,381 during the year ended December 31, 2008 as compared to $398,946 during the year ended December 31, 2007. The decrease of $75,565 is primarily the result of repayment of $3,300,000 of loans payable and long term debt. Interest and finance costs for the three months ended December 31, 2008 were $101,664 as compared to $106,213 for the three months ended December 31, 2007 and is primarily due to the loan repayment noted above.

Research and development costs for the year ended December 31, 2008 were consistent at $150,286 compared to $150,420 for the year ended December 31, 2007. Our emphasis on research and development has not changed. Research and development expenditures have remained constant, in order to maintain product quality and integrity and ensure that our product development remains current. Research and development costs for the three months ended December 31, 2008 were $32,679 as compared to $37,791 for the three months ended December 31, 2007.

Foreign exchange gain totaled $21,520 for the year ended December 31, 2008 as compared to foreign exchange loss of $60,199 for the year ended December 31, 2007. The Company's foreign exchange gain is primarily due to the fluctuations of the US dollar. In particular, we saw a fairly dramatic shift in the US dollar immediately before the start of the fourth quarter of 2008. The impact of this shift was realized in the fourth quarter.

Selected Financial Information

The following financial information has been prepared in accordance with Canadian generally accepted accounting principles. It should be read in conjunction with the audited consolidated financial statements of the Company, the notes thereto and the Auditors' Report thereon for the years ended December 31, 2008, 2007 and 2006 respectively.

The following table sets forth selected consolidated financial information for each of the three most recently completed years ended December 31 (audited; in thousands of dollars, except the loss per share figures):

	December 31		
	2008	**2007**	**2006**
Sales…………………………………….................	2,066	2,558	2,855
Gross profit………………………………...........	108	324	476
Loss before other items……………………….…	(2,479)	(1,827)	(1,901)
Gain on sale of intellectual property................	5,150	-	-
Royalty and other income………………………	269	65	-
Net Income (loss)…………………………………	2,962	(1,822)	(1,899)
Gain (loss) per share, basic and fully-diluted	0.02	(0.01)	(0.03)
Total assets……………………………………...........	1,527	1,143	1,916
Long-term financial liabilities……………………	376	685	900

Summary of Quarterly Results

The following table sets forth selected consolidated financial information for each of our last eight quarters. The table has been derived from our unaudited interim consolidated financial statements for those periods and is stated in thousands of dollars except for the earnings (loss) per share figures. These results are not necessarily indicative of results for future periods and should not be used or relied upon to predict our future performance.

(in thousands $ except per share data)

	Dec 31	**Sept 30**	**June 30**	**March 31**	**Dec 31**	**Sept 30**	**June 30**	**March 31**
	2008	2008	2008	2008	2007	2007	2007	2007
Sales	279	643	746	398	177	721	1,183	477
Operating income (loss) before other items	(322)	(1,335)	(486)	(336)	(633)	(475)	(216)	(503)
Net income (loss)	(279)	3,891	(348)	(302)	(757)	(478)	(88)	(499)
Earnings (loss) per share,								
Basic	(0.002)	0.030	(0.003)	(0.002)	(0.006)	(0.004)	(0.001)	(0.005)
Fully diluted	(0.002)	0.030	(0.003)	(0.002)	(0.006)	(0.004)	(0.001)	(0.005)

Liquidity and Capital Resources

At December 31, 2008, our cash on hand was $196,234 together with Funds held trust of $500,000 to be released in 2009 and 2010, as compared to $4,413 at December 31, 2007.

At December 31, 2008, we had accounts receivable of $150,548 as compared to $240,990 at December 31, 2007. This decrease of $90,442 is primarily due to the current management and accounting team's efforts for collection.

The Company remains principally dependant on the continued support of its related party lenders, 6408753 Canada Corporation, 6408788 Canada Corp. and I.C.T.C. Holdings Corporation (see below).

If the option is exercised, the company will move to a 100% royalty based company over a longer term. If the option is not exercised the company will continue to explore royalty arrangements for the North American rights.

In the opinion of management, the royalty income is sufficient to support the Company's normal operating requirements on an ongoing basis. However, taking into consideration the Company's negative working capital and cash flow from operating activities, volatile equity markets, global uncertainty in the capital markets and increasing cost pressures, the Company is continually reviewing expenditures in order to ensure adequate liquidity and flexibility to support its operations.

Transactions with Related Parties

We have entered into a management services agreement (the "Management Services Agreement"), a sublease (the "Sublease") and a Sales Services Agreement (the Sales Services Agreement") with I.C.T.C. Holdings Corporation ("I.C.T.C."), a company that is controlled by Anthony Traub, Napier's Chairman, CFO and Secretary, and Steve Balmer, Napier's President and Chief Operating Officer.

Pursuant to the Management Services Agreement, effective September 1, 2005, we reimburse I.C.T.C. for certain costs incurred on Napier's behalf. We pay a variable monthly amount to I.C.T.C. under this agreement based on the actual costs incurred by I.C.T.C. At December 31, 2008, Napier experienced a recovery through this agreement for services performed for I.C.T.C. in the amount of $66,199 (2007 charge: $167,230) for services under this agreement.

The Sublease with I.C.T.C. is for half of the premises at 720 Eaton Way, Delta, British Columbia. The Sublease commenced on November 1, 2005 and is based on half of the financial exposure of Napier under its lease commitment.

Pursuant to the Sales Services agreement, effective January 9, 2007 we pay a commission to I.C.T.C. based on successful sales to its retail customers which were managed by the I.C.T.C. Sales and Marketing Staff. There were no commissions incurred during the year (2007- $227,627).

Effective July 1, 2006 the Company's chairman accepted a revised compensation agreement resulting in nominal annual compensation in return for a bonus based on the net income of the Company. This bonus is cumulative and payable at the lesser of 75% of net income or the cumulative bonus entitlement. To the extent that the bonus is not paid on an annual basis, an additional 15% will be added to it and compounded annually. The Company accrued $983,938 related to this bonus as at December 31, 2008 (2007 –nil).

Anthony Traub controls 6408753 Canada Corporation and Steve Balmer controls 6408788 Canada Corp., the companies that have collectively completed two separate financing transactions consisting of term loans totaling $1,500,000, of which $600,000 is outstanding at December 31, 2008, and revolving loans of which $500,000 is outstanding at December 31, 2008. The initial advances of these financing transactions were made on July 14, 2005 in the aggregate amount of $3,000,000 and were used to pay fees and costs related to the loan transactions and satisfy all amounts owing by Napier to its secured, preferred, unsecured and post filing creditors as of July 14, 2005 as approved by the Supreme Court of British Columbia in Bankruptcy. Total interest accrued in respect of these loans was $323,381 (2007: $398,946).

Outstanding Share Data

There are currently 129,921,742 common shares (the "Common Shares") of Napier issued and outstanding. In addition, there are currently options outstanding to purchase 2,013,000 Common Shares at prices at $0.04 and $0.15 per share, expiring between February 2, 2009 and May 31, 2012.

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires that we make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are developed based on the best available information and are believed to be reasonable under the existing circumstances. New events or additional information may result in the revision of these estimates over time. Significant accounting policies are described in Note 3 of the annual audited financial statements. The following discussion outlines what we believe to be the most critical accounting policies involving the use of significant estimates and assumptions.

Accounts Receivable, Allowance for Doubtful Accounts and Product Returns

The allowance for doubtful accounts is based on historical trends. We regularly review the age of the accounts receivable in detail by customer and follow up on delinquent accounts directly with the customer. Based on discussions with the customer, independent credit reports and past collection history, we estimate an appropriate allowance for doubtful accounts. A significant portion of sales is to a number of large customers with higher quality credit. This subjects Napier to a greater exposure to any one particular customer. If the estimate of the allowance is understated, this could result in a charge to earnings in the future, should the account ultimately not be collectable.

The provision for product returns is estimated based on historic experience for particular products and customers taking into account, among other things, obsolescence, age and demand. If the estimate for product returns is understated, this could result in a charge to future earnings should the actual experience for returns be greater than estimated.

Property, Plant and Equipment/Depreciation and Amortization

The estimated useful lives of assets are determined based on historical experience with comparable assets, technological obsolescence and asset utilization. If our estimates of useful lives of assets are incorrect, we could experience increased or decreased charges to depreciation and amortization in the future.

Income Taxes

We follow the liability method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying amounts of assets and liabilities reported in the financial statements and their respective tax basis. Future income tax assets are comprised of

temporary differences between the carrying amount and the tax basis of assets and liabilities as well as tax losses carried forward. In valuing the future income tax assets, consideration is given to the timing of reversal of the temporary differences, the tax rate enacted for the reversal period and the results of future operations. The value of future tax assets is based on the likelihood of realization of future taxable income against which the tax losses can be applied.

The determination of the income tax assets and liabilities is an inherently complex process requiring the interpretation of continually changing regulations and making certain judgments. While income tax filings are subject to audits and reassessments, we believe the tax assets have been adequately provided. However, changes in the interpretations or judgments may result in increases or decreases to Napier's future income tax asset.

Based on our loss history, we do not have, at this time, reasonable assurance of sufficient taxable income and a valuation allowance has been made equal to the full value of the future income tax assets.

Risk Factors

Risks and uncertainties that face our business are common to other manufacturers operating in an international economy in the industrial and consumer sectors. We must deal with business risks associated with product infringement, technological change, increased market penetration into established supply lines, locating and penetrating new markets, foreign currency fluctuations, unavailable raw materials as well as increasing costs, and economic conditions affecting existing and potential customers and suppliers, to name a few of the normal but significant factors affecting our day to day operations. To minimize some of these risks going forward, we continue to nurture relationships with key customers and suppliers. Open, honest and straightforward communication has retained their loyalty and continued commitment to Napier. Our business is seasonal with the third and fourth quarters delivering a lower level of sales than the first and second quarters. Efforts to offset this seasonality continue by targeting less seasonal businesses, with a variety of products that Napier have available. On July 14, 2005, we successfully renegotiated Napier's unsecured debt obligations. While the reduction of its unsecured debt obligations and additional financing should assist us in the future, our continued existence is dependent upon Napier's ability to restore and maintain profitable operations and to receive continued support from our lenders. At the time of advancement and at December 31, 2008, the lenders acknowledge that the margin requirements required under these loans were not met.

International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed January 1, 2011 as the date IFRS will replace current Canadian generally accepted accounting principles ("Canadian GAAP") for publicly accountable enterprises. This will result in the Company reporting under IFRS starting with the interim period ending March 31, 2011, with restatement for comparative purposes of amounts reported under Canadian GAAP.
The conversion to IFRS will likely impact the Company's statement of financial position and results of operations. To transition to IFRS, changes may be required to the Company's information technology and data systems, internal control over financial reporting, disclosure controls and procedures, financial reporting expertise and training requirements, and business activities, such as compensation programs, debt covenants and other contractual arrangements.
The Company will be establishing a project team to manage the conversion process and, complete a high-level impact assessment to identify key areas that will be affected by the conversion. The Company will continuously monitor changes in IFRS leading up to the changeover date, and will update its conversion plan as required.

Cautionary Note Regarding Forward-Looking Statements

This MD&A contains "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. In certain cases, forward-looking statements can be

identified by the use of words such as “plans”, “expects” or “does not expect”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates” or “does not anticipate”, or “believes”, or variations of such words and phrases or statements that certain actions, events or results “may”, “could”, “would”, “might” or “will be taken”, “occur” or “be achieved”. Forward-looking statements involve known and unknown risks and uncertainties and other factors, which may cause the actual results, performance and achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to the going concern status of Napier, historical losses and cash flows, the future need for capital and the uncertainty of additional financing being available, the potential dilution to shareholders, the historical lack of dividend payments, competition, dependence on key personnel, the influence of economic conditions, dependence on key customers and licensees, weather, seasonality, raw materials, the retail industry, foreign exchange rate fluctuations and conflicts of interest. Although Napier has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements.

Additional Information

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

This MD&A has been prepared by management and reviewed by the Company’s board of directors.

"Steve Balmer"

Steve Balmer
President and Chief Operating Officer
March 23, 2009

Deloitte.

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AUDITORS' REPORT

The Shareholders,
Napier Environmental Technologies Inc.

We have audited the consolidated balance sheets of Napier Environmental Technologies Inc. as at December 31, 2008 and 2007 and the consolidated statements of income, comprehensive income and deficit and cash flows for the years then ended. These 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.

Deloitte & Touche LLP

Chartered Accountants
March 17, 2009

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Napier Environmental Technologies Inc. are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management conforming to accounting principles generally accepted in Canada. These statements include some amounts that are based on best estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects.

The company maintains a system of internal control, which provides management with reasonable assurance that assets are safeguarded and that reliable financial records are maintained.

The Board of Directors meets periodically with management, as well as the external auditors, to review the financial statements and to satisfy itself that each party is properly discharging its responsibilities.

The external auditors, Deloitte & Touche LLP, have been appointed by the shareholders to render their opinion on the financial statements. The auditors have full and free access to The Board of Directors and their report is included herein.

"Steve Balmer"

President and COO

"Anthony Traub"

Secretary and CFO

March 17, 2009

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

CONSOLIDATED BALANCE SHEETS

December 31

		2008		2007
Assets				
Current				
Cash	**$**	**196,234**	$	4,413
Funds held in trust (Note 4)		**250,000**		-
Accounts receivable		**150,548**		240,990
Inventory (Notes 4 and 6)		**417,880**		437,613
Prepaid expenses		**27,138**		36,093
		1,041,800		719,109
Deferred leasehold inducements (Note 5)		**100,791**		193,830
Funds held in trust (Note 4)		**250,000**		-
Property and equipment (Notes 4 and 7)		**134,908**		230,443
	$	**1,527,499**	$	1,143,382
Liabilities				
Current				
Loans payable (Note 8)	**$**	**500,000**	$	3,500,000
Accounts payable (Note 5)		**1,121,025**		1,379,270
Bonus payable (Note 5)		**983,938**		-
Deposit (Note 4)		**100,000**		-
Deferred revenue		**8,333**		116,904
Current portion of long term debt (Note 9)		**300,000**		300,000
		3,013,296		5,296,174
Deferred revenue		**76,390**		84,723
Long term debt (Note 9)		**300,000**		600,000
		3,389,686		5,980,897
Shareholders' deficiency				
Capital stock (Note 10)		**24,819,578**		24,819,578
Contributed surplus (Note 11)		**412,015**		398,241
Deficit		**(27,093,780)**		(30,055,334)
		(1,862,187)		(4,837,515)
	$	**1,527,499**	$	1,143,382

Going concern (Note 1) and Commitments (Note 15)

The accompanying notes are an integral part of these financial statements

Approved by the Directors:

"Stephen C. Balmer"

Stephen C. Balmer

"Anthony Traub"

Anthony Traub

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF INCOME, COMPREHENSIVE INCOME AND DEFICIT

Years ended December 31

		2008		2007
Sales	$	**2,066,147**	$	2,558,686
Cost of sales		**1,958,581**		2,234,696
Gross profit		**107,566**		323,990
		5.21%		12.66%
Expenses				
General and administrative (Schedule)		**1,802,537**		860,799
Selling and marketing (Schedule)		**310,054**		740,396
Interest and financing costs		**323,381**		398,946
Research and development		**150,286**		150,420
		2,586,258		2,150,561
Loss before other items		**(2,478,692)**		(1,826,571)
Other items				
Gain on sale of intellectual property (Note 4)		**5,150,000**		-
Royalty and other income		**268,726**		64,719
Foreign exchange gain (loss)		**21,520**		(60,199)
		5,440,246		4,520
Net income (loss) and comprehensive income (loss) for the year		**2,961,554**		(1,822,051)
Deficit at beginning of the year		**(30,055,334)**		(27,771,283)
Change in accounting policy (Note 2)		**-**		(462,000)
Deficit at end of the year	$	**(27,093,780)**	$	(30,055,334)
Weighted average shares outstanding		**129,921,742**		123,169,383
Net income (loss) per share, basic and fully-diluted	$	**0.02**	$	(0.01)

The accompanying notes are an integral part of these financial statements

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31

	2008	2007
Operating activities		
Net income (loss) for the year	**$ 2,961,554**	$ (1,822,051)
Items not involving cash		
Amortization of property and equipment	**96,485**	96,363
Amortization of deferred leasehold inducements	**93,039**	93,039
Deferred revenue	**(116,904)**	201,627
Gain on disposal of intellectual property	**(5,150,000)**	-
Stock based compensation	**13,774**	21,467
	(2,102,052)	(1,409,555)
Change in non-cash operating working capital		
Accounts receivable	**90,442**	(55,616)
Inventory	**19,733**	169,637
Prepaid expenses	**8,955**	(7,684)
Accounts payable	**(258,245)**	977,501
Bonus payable	**983,938**	-
	844,823	1,083,838
	(1,257,229)	(325,717)
Financing activities		
Proceeds on issuance of share capital	**-**	410,769
Proceeds from loans payable and long term debt	**-**	300,000
Repayment of loans payable and long term debt	**(3,300,000)**	(400,000)
	(3,300,000)	310,769
Investing activities		
Purchase of property and equipment	**(950)**	(210)
Sale of the intellectual property	**5,150,000**	-
Increase in funds held in trust	**(500,000)**	-
Deposit received	**100,000**	-
	4,749,050	(210)
Change in cash during the year	**191,821**	(15,158)
Cash at the beginning of the year	**4,413**	19,571
Cash at the end of the year	**$ 196,234**	$ 4,413

The accompanying notes are an integral part of these financial statements

1. Continuing operations

The Company is governed by the *Business Corporations Act* (British Columbia) and is primarily involved in the manufacturing, distribution and licensing of a wide range of products created through environmentally advanced technology. These include coating removal and wood restoration products.

The consolidated financial statements of the Company have been prepared on the basis of accounting principles applicable to a going concern. The Company continues to incur operating losses, does not meet margin requirements required under its operating loans and long term debt and has negative working capital and a shareholders' deficiency. Under the terms of an asset sale agreement entered into during the year ended December 31, 2008, the Company's manufacturing operations will cease if the purchaser exercises an option to acquire the North American operations of the Company (Note 4). In addition, during the year ended December 31, 2008 the Company was delisted from the Toronto Stock Exchange for failure to meet certain listing requirements. The company's ability to continue as a going concern remains dependant on the continued cooperation and support of its lenders and to attain positive cash flow from operations.

If the going concern assumption were not appropriate for these consolidated financial statements, adjustments would be necessary to the carrying values of assets and liabilities, the reported net income and the balance sheet classifications used.

2. Changes in accounting policies

2008

Effective January 1, 2008, the Company adopted the following recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook:

Capital disclosures

The Company adopted the recommendations of CICA Handbook Section 1535, Capital Disclosures. This Section requires the disclosure of information about an entity' objectives, policies and processes for managing capital and quantitative data about what the entity regards as capital. It also requires disclosure of the nature of externally imposed capital requirements and how those requirements are incorporated into the management of capital, whether the entity has complied with those requirements and when the entity has not complied with those requirements, the consequences of such non-compliance. The required disclosures are included in Note 13.

Inventories

The Company adopted the recommendations of CICA Handbook Section 3031, Inventories, which provides guidance on the determination of cost of inventories and its subsequent recognition as an expense, and includes additional disclosure requirements. The new Section also requires to account for the reversal of write-downs previously recognized when there is a subsequent increase in the value of inventories. The adoption of this Section had no impact on the consolidated financial statements other than the additional disclosures provided in Note 6.

2. Change in accounting policies (continued)

2008 (continued)

Financial instruments

The Company adopted the recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments - Presentation. Section 3862 requires the disclosure of information about: a) the significance of financial instruments for the entity's financial position and performance and b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 contains standards for presentation of financial instruments and non-financial derivatives. The adoption of this Section had no impact on the consolidated financial statements other than the additional disclosures provided in Note 13.

2007

Effective January 1, 2007, the Company adopted the new recommendations of The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3251: Equity; Section 1530: Comprehensive Income; and Section 3855: Financial Instruments - Recognition and Measurement, and Section 3861: Financial Instruments – Disclosure and Presentation, retroactively, without restatement. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition, measurement, presentation and disclosure of financial instruments. The adoption of this standard had no significant impact on net loss and net loss per share for the year ended December 31, 2007.

In accordance with Section 3855, the Company adopted a policy to expense debt financing fees as incurred resulting in an increase to opening deficit as at January 1, 2007 of $462,000 to eliminate the deferred financing costs that were capitalized and amortized under the Company's previous accounting policy

3. Basis of presentation and significant accounting policies

Basis of presentation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. Inter-company balances and transactions are eliminated upon consolidation.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the revenues and expenses during the reporting period. These estimates specifically relate to allowance for doubtful customer accounts, inventory valuation, property and equipment amortization policies, accrued liabilities and stock based compensation. Actual results could differ from those estimates.

Inventory

Raw materials, work in process and finished goods are valued at the lower of cost and net realizable value. Cost is determined on the first in, first out basis. The cost of work in process and finished goods includes the cost of raw materials and the applicable share of the cost of labour and fixed and variable production overheads. Net realizable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale.

3. Basis of presentation and significant accounting policies (continued)

Property and equipment

Property and equipment are recorded at cost and the Company provides for amortization computed using the following methods and annual rates:

Machinery and equipment	5 – 10 years straight line
Furniture and fixtures	2 - 5 years straight line
Leasehold improvements	Straight line over lease term

Impairment of long-lived assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

Revenue recognition

Revenue is recognized when persuasive evidence of an arrangement exists, goods are shipped, price is fixed and determinable, and collection is reasonably assured. Initial non-refundable licensing fees are deferred and recognized over the term of the licensing agreement. Royalty fees are recognized as the licensee sells the licensed product.

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 reverse. Future income tax assets are recognized to the extent it is more likely than not they will be realized.

Deferred leasehold inducements

Leasehold inducements related to the sublease outlined in Note 5 are deferred and amortized to rent expense over 51 months from the commencement date of the sublease. As at December 31, 2008 there are 13 months remaining in the amortization period.

Stock based compensation

The Company uses the fair value method to account for stock based compensation and other stock based payments. This method consists of expensing the fair value of stock based awards over the vesting period of the options granted. Upon exercise of the stock options, consideration received together with amounts previously recognized in contributed surplus is recorded as an increase in share capital.

Foreign currency translation

The functional currency of the Company's operations is the Canadian dollar. Monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the historical rates. Revenues and expenses are translated at the average rates for the year except for amortization that is translated at historical rates. Translation gains or losses are included in earnings.

3. Basis of presentation and significant accounting policies (continued)

Earnings per share

Earnings per share is calculated based on the weighted average number of shares outstanding during the period. Potentially dilutive items are described in Note 10. Diluted loss per share is the same as basic loss per share as the average market price of the common shares during the period did not exceed the exercise price of the options.

Financial instruments

Fair value

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments.

Classification

Asset/liability	**Category**	**Measurement**
Cash	Held for trading	Fair value
Funds held in trust	Held-to-maturity	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable	Other liabilities	Amortized cost
Loans payable	Other liabilities	Amortized cost
Long term debt	Other liabilities	Amortized cost

Recent accounting pronouncements

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

3. Basis of presentation and significant accounting policies (continued)

International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian Generally Accepted Accounting Principles ("GAAP") with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that the year 2011 is the changeover date for publicly listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company is currently evaluating the impact the adoption of IFRS will have on its consolidated financial statements.

4. Sale of intellectual property

On July 29, 2008 the Company completed the sale of its intellectual property ("IP") to Freeworld Coatings Global (Pty) Ltd. ("Freeworld") together with an option granting Freeworld the rights to the North American sales, marketing and manufacturing operations of the Company, for aggregate consideration of $5,150,000. Of these proceeds, $4,650,000 has been received and the balance of $500,000 is being held in escrow, to be released $250,000 in 2009 and $250,000 in 2010, subject to certain indemnifications made to the purchaser. The Company is not aware of any potential indemnification claims which would reduce the future payments to be received from the escrow account. The balance of the proceeds being held in escrow is recorded on the balance sheet as funds held in trust at December 31, 2008.

Should Freeworld exercise its option to proceed with the operations within North America, the Company will receive further proceeds for net book value of inventory and certain machinery and equipment. If Freeworld does not exercise its option with respect to the North American sales, marketing and manufacturing operations of the Company, the IP for North America will be transferred back to the Company in return for a refund of the deposit of $100,000 to Freeworld. The option for Freeworld to purchase the North American operations of the Company expires April 30, 2009.

If Freeworld exercises their option to purchase the North American operations of the Company, the manufacturing operations of the Company will cease.

5. Related party transactions

On September 1, 2005, the Company entered into a management services agreement with I.C.T.C. Holdings Corporation ("I.C.T.C."), a company that is controlled by 6408753 Canada Corporation and 6408788 Canada Corp ., companies controlled by directors and officers of the Company. Pursuant to the agreement, the Company reimburses I.C.T.C., at their cost, for personnel expenditures incurred on the Company's behalf. During the year the Company earned a recovery of $66,199 (2007: incurred cost of $167,230) related to the management services agreement. These transactions are in the normal course of business and are recorded at the exchange amount.

On October 31, 2005, the Company entered into a sublease agreement whereby half of the Company's premises have been subleased to I.C.T.C until January 31, 2010. As a condition of this agreement, the Company incurred $395,413 for leasehold inducements related to I.C.T.C.'s relocation costs and costs associated with the cancellation of I.C.T.C's existing lease.

During the year ended December 31, 2005 the Company obtained financing, described in notes 8 and 9, from 6408753 Canada Corporation and 6408788 Canada Corp. Total interest accrued during the year ended December 31, 2008 on these loans was $323,381 (2007 - $398,946).

Effective July 1, 2006 the Company's chairman accepted a revised compensation agreement resulting in nominal annual compensation in return for a bonus based on the net income of the company. This bonus is cumulative and payable at the lesser of 75% of net income or the cumulative entitled bonus. To the extent that the bonus is not paid on an annual basis, an additional 15% will be added to it and compounded annually. The Company accrued $983,938 related to this bonus as at December 31, 2008 (2007 – nil).

On January 9, 2007, the Company entered into a sales services agreement with I.C.T.C. Pursuant to the agreement, the company pays a commission to I.C.T.C. based on successful sales to its retail customer base that is managed by the I.C.T.C. Sales and Marketing staff. During the 2008 fiscal year the Company did not incur any costs (2007: $227,627) related to the sales services agreement. These transactions are in the normal course of business and are measured at the exchange amount.

Included in accounts payable is $949,954 (2007 - $990,205) due to 6408753 Canada Corporation and 6408788 Canada Corp.

6. Inventory

Inventory is comprised of:

		2008		**2007**
Raw materials	**$**	**285,240**	**$**	**316,815**
Finished goods		**132,640**		**120,798**
	$	**417,880**	**$**	**437,613**

During the year ended December 31, 2008 inventory totalling $ 1,918,474 has been charged to cost of sales including an obsolescence recovery of $ 26,859.

7. Property and equipment

						2008
		Cost		Accumulated amortization		Net book value
Machinery and equipment	$	1,034,421	$	969,970	$	64,451
Furniture and fixtures		213,837		179,716		34,121
Leasehold improvements		277,544		241,208		36,336
	$	1,525,802	$	1,390,894	$	134,908

						2007
		Cost		Accumulated amortization		Net book value
Machinery and equipment	$	1,033,471	$	922,361	$	111,110
Furniture and fixtures		213,837		164,383		49,454
Leasehold improvements		277,544		207,665		69,879
	$	1,524,852	$	1,294,409	$	230,443

8. Loans payable

Loans payable consist of loan facilities, to a maximum of $1,750,000 from each of 6408753 Canada Corporation and 6408788 Canada Corp. (see Note 5) secured as outlined in Note 9. The term of each loan is 364 days and is renewable for successive 364-day terms by giving notice to the lenders and obtaining their consent, at least 90 days prior to the expiry. Interest is payable on the last day of each month at a rate of prime plus 2%.

These loans are subject to the following margins: (i) 50% of the aggregate amount of eligible inventory minus the aggregate amount of accounts payable plus (ii) 75% of the aggregate amount of eligible accounts receivable.

At the time of advancement and at December 31, 2008 and 2007, the lenders acknowledged that the Company did not meet the margin requirements required under these loans, and accordingly these loans are repayable upon demand. Strict compliance was waived by the lender in connection with the period ended December 31, 2008 and 2007.

9. Long term debt

Long term debt consists of term loans, originally in the amount of $1,500,000, of which $600,000 is outstanding at December 31, 2008, $300,000 payable to each of 6408753 Canada Corporation and 6408788 Canada Corp. (see Note 5). The term of each loan was originally five years and interest is payable monthly at a rate of prime plus 2%. Annual principal repayments of $300,000 in aggregate are required on each of the anniversary dates of the loans until maturity on July 14, 2010. As a condition of these loans, share purchase warrants were issued to the lenders on August 30, 2005 (Note 10). Long term debt and the loans payable (Note 8) are secured by a general security agreement and an assignment of general insurance.

10. Capital stock

Authorized:

Unlimited common shares

Issued:

	2008		2007	
	Number of shares	**$**	Number of shares	$
Beginning of the year	**129,921,742**	**24,819,578**	88,844,892	24,093,809
Issued on exercise of warrants	**-**	**-**	41,076,850	410,769
Financing costs related to warrants excercised	**-**	**-**	-	315,000
End of the year	**129,921,742**	**24,819,578**	129,921,742	24,819,578

During the year ended December 31, 2007 the Company issued 41,076,850 common shares upon conversion of 41,076,850 warrants for proceeds of $410,769. Financing costs of $315,000 related to warrants exercised have been reclassified from contributed surplus.

Stock options

Under the terms of the Company's incentive stock option plan, options are granted to employees and directors upon approval by the Board of Directors and the exercise price of each option is determined by reference to the market price of the Company's stock. Options are normally exercisable within 5 years from the date of grant or an alternate period as determined by the Board and within 30 days of termination of employment. Options normally vest over a period of five years.

The following table summarizes the status and changes in stock options outstanding at December 31, 2008 and 2007:

	2008		2007	
	Number	**Weighted average price**	Number	Weighted average price
Outstanding, beginning of year	**2,213,000**	**$0.05**	3,095,000	$0.07
Granted	**-**	**-**	100,000	0.08
Cancelled / expired	**(200,000)**	**(0.10)**	(982,000)	(0.11)
Outstanding, end of year	**2,013,000**	**0.04**	2,213,000	0.05
Exercisable, end of year	**1,770,400**	**$0.04**	1,667,800	$0.04
Options reserved for issuance, under stock option plan	**9,750,000**		2,407,000	

10. Capital stock (continued)

Stock options (continued)

The following table summarizes information about stock options outstanding at December 31, 2008:

Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price
$0.04 - $0.12	2,000,000	1.9 years	$0.04
$0.15	13,000	0.1 years	$0.15
	2,013,000	1.9 years	$0.04

Stock-based compensation

During the year ended December 31, 2007, 100,000 stock options were issued. The fair value of these options was determined to be $7,010. No stock options were issued during 2008.

The Black-Scholes option-pricing model assumptions used to compute the fair value of options granted in 2007 are as follows:

Dividend yield	**0%**
Expected volatility	**132%**
Expected life	**5 yrs**
Risk free rate of return	**4.0%**
Weighted average fair value of options granted	**$0.07**

During the year ended December 31, 2008, the Company recorded compensation expense, with a corresponding credit to contributed surplus of $13,774 (2007 - $21,467) relating to the stock options that vested during the year.

As a condition of obtaining the loans described in Note 8 and 9, the Company granted the lenders warrants entitling the lenders to purchase, from treasury, up to 30% each of the common shares of the Company, calculated on a fully-diluted basis, upon payment of $0.01 per share at any time up to August 31, 2010. During the year ended December 31, 2007, all outstanding warrants were exercised for proceeds of $410,769.

11. Contributed surplus

		2008		2007
Beginning of the year	**$**	**398,241**	$	691,774
Stock based compensation		**13,774**		21,467
Warrants exercised		**-**		(315,000)
End of the year	**$**	**412,015**	$	398,241

12. Income taxes

The approximate tax effect of temporary differences and income tax loss carry-forwards that give rise to the Company's future income taxes are as follows:

		2008		2007
Property and equipment	**$**	**673,000**	$	1,393,000
Other		**(26,000)**		(52,000)
Tax loss carryforwards		**2,803,000**		3,675,000
		3,450,000		5,016,000
Less valuation allowance		**3,450,000**		5,016,000
	$	**-**	$	-

The income tax expense (recovery) and change in valuation allowance differs from the amounts computed by applying Canadian statutory rates to net income (loss) for the year before income taxes. The reasons for this difference and the related tax effects are as follows:

		2008		2007
Canadian basic statutory rate		**31%**		34.12%
Expected income tax expense (recovery)	**$**	**918,000**	$	(622,000)
Non-taxable portion of gain on sale		**(492,000)**		-
Change in future enacted tax rates		**208,000**		409,000
Expiry of tax loss carryforwards		**930,000**		680,000
Other		**2,000**		3,000
Change in valuation allowance		**(1,566,000)**		(470,000)
Income tax expense	**$**	**-**	**$**	**-**

The Company has loss carry-forwards available for income tax purposes as follows:

Expiry date		Amount
December 31, 2009	**$**	**1,017,000**
December 31, 2010		**1,478,000**
December 31, 2014		**1,752,000**
December 31, 2015		**2,428,000**
December 31, 2026		**1,619,000**
December 31, 2027		**1,415,000**
December 31, 2028		**743,000**
	$	**10,452,000**

Management's estimate of the Company's non-capital losses and other deductible temporary differences and the Company's tax filings are subject to review and assessment by the applicable tax authorities.

13. Financial instruments and risk management

(a) Classification of financial instruments and fair value

The following table summarizes information relating to the Company's financial instruments for the years ending December 31, 2008 and 2007.

Class of Financial Instruments	Consolidated Balance Sheet Categories Included	Carrying Amount	
		2008	2007
Held for trading financial assets	Cash	**$ 196,234**	$ 4,413
Held to maturity financial assets	Funds held in trust	**500,000**	-
Loans and receivables	Accounts receivable	**150,548**	240,990
Other liabilities	Accounts payable, bonus payable, loans payable, long-term debt	**3,204,963**	5,779,270

The carrying values of cash, accounts receivable, accounts payable and bonus payable approximate their fair market values due to their short-term maturities. The loans payable and long-term debt bear interest at current market rates and as a result their carrying values approximate their fair values.

13. Financial instruments and risk management (continued)

(b) Risks and risk management

Financial instruments may expose the Company to a number of financial risks, including market risk (interest rate risk and currency risk), credit risk and liquidity risk. The Company's overall risk management program seeks to mitigate these risks and reduce the volatility that may otherwise affect its financial performance.

The risks associated with the Company's financial instruments and the Company's policies for minimizing these risks are detailed below.

(i) Market risk

a) Interest rate risk

Interest rate risk refers to the risk that the fair value of a financial instrument or the future cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company's interest rate risk arises primarily from its loans payable and long term debt which bear interest at variable rates which exposes the Company to changes in its debt servicing cash flows.

A sensitivity analysis for interest rate risk has been performed for the year ending December 31, 2008 assuming the prime rate changed by 1%. For every 1% increase in the prime rate, with all other variables held constant, the Company's net income and comprehensive income would have decreased by $ 42,000. A decrease in the bank prime rate would have the opposite effect.

b) Currency risk

Currency risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in foreign currency exchange rates.

The Company has significant sales denominated in U.S. dollars, which exceeds the natural hedge provided by the purchase of products denominated in U.S. dollars, and is therefore exposed to financial risk resulting from fluctuations in foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to rate changes.

A sensitivity analysis has been performed assuming the foreign exchange rate changes by 5% as at December 31, 2008. For every 5% weakening of the U.S. dollar against the Canadian dollar, with all other variables held constant, net income and comprehensive income would decrease by $ 7,000. A strengthening of the U.S. dollar against the Canadian dollar would have the opposite effect.

(ii) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The carrying amounts of cash, funds held in trust and accounts receivable on the consolidated balance sheet represent the Company's maximum exposure to credit risk.

The Company's credit risk is primarily attributable to its accounts receivable. Accounts receivable is disclosed on the balance sheet net of provision for bad debts, estimated by management based on prior experience and its assessment of the current economic environment. The Company believes that the credit risk of accounts receivable is limited because of management's ongoing credit evaluations of customers.

13. Financial instruments and risk management (continued)

(ii) Credit risk (continued)

Accounts receivable with one specific customer represents approximately 19% of the balance of accounts receivable as at December 31, 2008 (December 31, 2008 – two customers represented approximately 30% of accounts receivable). It is the opinion of management that these accounts do not represent a significant credit risk.

The credit risk associated with the Company's cash and funds held in trust is limited because these financial assets are held through large Canadian financial institutions with a high investment grade rating.

The Company's aging of accounts receivable is as follows:

		2008		2007
Trade receivables				
Current	**$**	**70,284**	$	141,781
Aged between 31 - 60 days		**35,514**		43,662
Aged between 61 - 90 days		**12,513**		11,894
Aged greater than 90 days		**7,038**		21,387
		125,349		218,724
Other receivables		**28,879**		39,822
Allowance for doubtful accounts		**(3,680)**		(17,556)
	$	**150,548**	$	240,990

Changes in the Company's allowance for doubtful accounts are as follows:

		2008		2007
Opening balance	**$**	**17,556**	$	18,695
Write-offs		**(2,320)**		-
Recovered		**(11,556)**		(1,139)
Closing balance	**$**	**3,680**	$	17,556

(iii) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company monitors its cash balances and cash flows generated from operations to meet its requirements.

13. Financial instruments and risk management (continued)

(iii) Liquidity risk (continued)

The Company's contractual maturities of its financial liabilities as at December 31, 2008 are as follows:

	Carrying amount	0 to 6 Months	6 to 12 Months	12 to 24 Months
Accounts payable	$ 1,121,025	$ 1,121,025	$ -	$ -
Bonus payable	983,938	983,938		
Loans payable	500,000	500,000	-	-
Long-term debt	600,000	-	300,000	300,000
	$ 3,204,963	$ 2,604,963	$ 300,000	$ 300,000

The Company manages its liquidity risk through limiting its financing to advances from related parties. As disclosed in Notes 5, 8, and 9, the loans payable and long-term debt and a significant portion of its accounts payable are due to related parties.

(iv) Capital risk management

The Company's capital consists of its share capital, loans payable and long-term debt. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and working capital requirements. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, or acquire or dispose of assets.

In order to facilitate the management of its capital requirements, the Company prepares annual budgets that are updated as necessary. The annual and updated budgets are approved by the Board of Directors.

The Company does not use financial ratios to manage its capital and is not subject to externally imposed requirements which have an impact on its management of capital except for the margin requirements of its loan payable (Note 8).

14. Segmented information

The Company operates in one industry segment, which is the manufacture and distribution of coatings removal products and restoration products in Canada and internationally. Within this general industry segment the Company distributes to both retail or consumer and industrial sectors. All of the Company's property and equipment are located in Canada.

		2008		2007
Sales by region				
Canadian	**$**	**847,626**	$	1,134,798
U.S. and International		**1,218,521**		1,423,888
	$	**2,066,147**	$	2,558,686
Sales by sector				
Consumer	**$**	**1,394,946**	$	2,156,415
Industrial		**671,201**		402,271
	$	**2,066,147**	$	2,558,686

15. Commitments

The Company leases its premises under an operating lease. The aggregate minimum rental payments, including operating costs, remaining under this lease are approximately:

2009	$413,540
2010	34,462

NAPIER ENVIRONMENTAL TECHNOLOGIES INC.
CONSOLIDATED SCHEDULES
Years ended December 31

	2008	2007
General and administrative		
Salaries and wages	**$ 141,697**	$ 294,267
Bonus	**983,938**	-
Professional fees	**304,395**	88,861
Insurance	**102,454**	127,286
Regulatory, filing and investor relations	**63,262**	45,141
Amortization	**53,761**	52,610
Occupancy	**46,762**	86,293
Consulting and director fees	**38,285**	52,250
Office	**37,192**	72,723
Travel	**15,751**	24,139
Telecommunications	**15,040**	17,229
	$ 1,802,537	$ 860,799

	2008	2007
Selling and marketing		
Salaries and wages	**$ 182,853**	$ 182,758
Management services and consulting	**55,588**	188,428
Marketing	**37,241**	85,544
Commissions	**21,815**	258,958
Travel and entertainment	**17,598**	17,152
Communications and other	**5,144**	7,556
Bad debt expense (recovery)	**(10,185)**	-
	$ 310,054	$ 740,396

The accompanying notes are an integral part of these financial statements