

**CARBON FRIENDLY SOLUTIONS INC.**

**Condensed Interim Consolidated Financial Statements**

**For the six months ended December 31, 2011 and 2010**

**CARBON FRIENDLY SOLUTIONS INC.**

**Unaudited Condensed Interim Financial Statements  
December 31, 2011**

**Notice of No Auditor Review of Interim Condensed Financial Statements**

The accompanying unaudited condensed interim financial statements have been prepared by management and approved by the Audit Committee.

The Company's independent auditors have not performed a review of these condensed financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditors.

# CARBON FRIENDLY SOLUTIONS INC.

Condensed Consolidated Statement of Financial Position

(in Canadian dollars)(unaudited)

		December 31,		
	Note	2011	June 30, 2011	July 1, 2010
<b>ASSETS</b>				
<b>Current</b>				
Cash		\$ 62,175	\$ 3,031	\$ 156,840
Receivables	7	93,983	80,607	113,184
Inventory	8	-	-	9,567
Prepaid expenses		57,021	51,924	22,063
		213,179	135,562	301,654
<b>Non-current</b>				
Deposit	10	56,729	56,729	56,729
Property and equipment	9	49,402	50,148	31,666
Coal technology and plant prototype	6	5,377,147	6,268,323	-
Intangibles	12	56,107	60,976	-
Investment in Carbiopel	11	210,000	-	-
<b>Total assets</b>		<b>\$ 5,962,564</b>	<b>\$ 6,571,738</b>	<b>\$ 390,049</b>
<b>LIABILITIES</b>				
<b>Current</b>				
Accounts payable and accrued liabilities		\$ 511,951	\$ 1,791,642	\$ 206,101
Related parties	15	221,909	440,646	8,630
Loans payable	13	1,180,232	2,503,200	-
		1,914,092	4,735,488	214,731
<b>SHAREHOLDERS' EQUITY</b>				
Share capital	14b	9,868,492	8,650,892	5,321,753
Share subscription receivable	14b	-	(352,000)	-
Share-based payment reserve	14f	1,917,534	1,698,955	1,147,344
Deficit		(10,611,173)	(9,703,060)	(6,293,779)
Cumulative other comprehensive income		2,873,619	104,778	-
		4,048,472	399,565	175,318
<b>Non-controlling interest</b>		<b>-</b>	<b>1,436,685</b>	<b>-</b>
<b>Total equity</b>		<b>4,048,472</b>	<b>1,836,250</b>	<b>175,318</b>
<b>Total liabilities and equity</b>		<b>\$ 5,962,564</b>	<b>\$ 6,571,738</b>	<b>\$ 390,049</b>

Approved on behalf of the Board:

"Slawomir Smulewicz"

Director

"Stan Lis"

Director

# CARBON FRIENDLY SOLUTIONS INC.

## Condensed Consolidated Statement of Comprehensive Income

(in Canadian dollars)(unaudited)

	Note	Three months ended December 31, 2011	Three months ended December 31, 2010	Six months ended December 31, 2011	Six months ended December 31, 2010
<b>Revenues</b>					
Carbon credits		\$ -	\$ 8	\$ -	\$ 666
<b>Cost of credits</b>					
		-	-	-	-
		-	8	-	666
<b>Expenses</b>					
Amortization		445,710	2,198	894,282	4,472
Bank charges and interest		972	2,952	2,453	3,774
Consulting fees	15	42,435	68,354	240,834	228,821
Finance and sponsorship fees		-	47,835	852	47,835
Foreign exchange loss (gain) on operations		(4,836)	31,672	(4,978)	32,692
Interest on notes payable		44,949	-	161,773	-
Investor relations		16,513	22,804	34,224	32,014
Management fees	15	204,900	62,233	276,864	146,207
Office and miscellaneous		12,227	31,677	77,216	51,802
Professional fees	15	164,130	89,101	235,745	143,369
Rent		38,455	26,199	79,919	57,063
Share-based compensation		158,979	-	218,579	-
Transfer agent and regulatory fees		7,409	16,366	11,055	19,399
Travel and promotion	15	33,024	23,184	56,736	43,536
Wages and benefits		38,263	18,280	59,244	37,887
Write down of intangible assets		-	1,424	-	55,269
Write down of property and equipment		-	63	-	2,122
		(1,203,130)	(444,342)	(2,344,798)	(906,262)
Loss for the period		(1,203,130)	(444,334)	(2,344,798)	(905,596)
<b>Other comprehensive income</b>					
Exchange gain (loss) arising on translation of foreign operations		90,555	43,266	(37,143)	62,407
Gain on forgiveness of debt		2,805,984	-	2,805,984	-
		2,896,539	43,266	2,768,841	62,407
<b>Total comprehensive income (loss)</b>		\$ 1,693,409	\$ (401,068)	\$ 424,043	\$ (843,189)
<b>Loss for period attributable to:</b>					
Owners of parent		(19,695)	(444,334)	\$ (908,113)	\$ (905,596)
Non-controlling interest		(1,183,435)	-	(1,436,685)	-
		\$ (1,203,130)	\$ (444,334)	\$ (2,344,798)	\$ (905,596)
<b>Total comprehensive income attributable to:</b>					
Owners of parent		\$ 2,876,844	\$ (401,068)	\$ 1,860,728	\$ (843,189)
Non-controlling interest		(1,183,435)	-	(1,436,685)	-
		\$ 1,693,409	\$ (401,068)	\$ 424,043	\$ (843,189)
<b>Loss per share, basic and diluted</b>		\$ 0.04	\$ (0.01)	\$ 0.01	\$ (0.03)

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

# CARBON FRIENDLY SOLUTIONS INC.

## Condensed Consolidated Statements of Cash Flows

(in Canadian dollars)(unaudited)

Note	Three months ended December 31, 2011	Three months ended December 31, 2010	Six months ended December 31, 2011	Six months ended December 31, 2010
<b>Cash provided by (used in):</b>				
<b>Operating Activities</b>				
Net loss (income) for the period	\$ 1,693,409	\$ (401,068)	\$ 424,043	\$ (843,189)
Items not involving cash:				
Amortization	445,710	2,198	894,282	4,472
Share-based compensation	158,979	-	218,579	-
Gain on forgiveness of debt	(2,805,984)	-	(2,805,984)	-
Change in non-cash working capital:				
Receivables	(26,396)	(17,112)	(13,419)	11,434
Prepaid expenses and deposits	(9,144)	(70)	(5,105)	15,591
Accounts payable and accrued liabilities	90,361	184,483	37,601	389,073
Related parties	(12,000)	-	-	-
	(465,065)	(231,569)	(1,250,003)	(422,619)
<b>Investing Activities</b>				
Purchase of property and equipment	-	-	-	(959)
Purchase of equity interest	(40,000)	-	(102,000)	-
	(40,000)	-	(102,000)	(959)
<b>Financing Activities</b>				
Share issuances	-	-	1,099,000	44,850
Issue costs	-	-	(29,900)	-
Share subscriptions	364,500	-	352,000	-
Proceeds of loans	125,000	260,000	125,000	260,000
Loan repayments	(7,258)	-	(137,258)	-
Related parties	(50,707)	-	-	-
	431,535	260,000	1,408,842	304,850
Effect of foreign exchange	(130,939)	201	2,305	12
Increase (decrease) in cash	(204,469)	28,632	59,144	(118,716)
<b>Cash, beginning of period</b>	266,644	9,492	3,031	156,840
<b>Cash, end of period</b>	\$ 62,175	\$ 38,124	\$ 62,175	\$ 38,124
<b>Supplemental cash flow information:</b>				
Non-cash operating, investing and financing activities				
Issuance of shares for investment in Carbiopel (note 11)			\$ 108,000	\$ -

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

**CARBON FRIENDLY SOLUTIONS INC.**

## Condensed Statements of Equity

(unaudited)

(in Canadian dollars)

	Shares	Amount	Share subscriptions	Share-based payment reserves	Deficit	Cumulative other comprehensive income	Non-controlling interest	Total
Balance, July 1, 2010	27,558,427	\$ 5,321,753	\$ -	\$ 1,147,344	\$ (6,293,779)	\$ -	\$ -	\$ 175,318
Share issuance								
Stock options exercised		44,850	-	-	-	-	-	44,850
Property acquisition		-	-	-	-	-	-	-
Fair value of stock options exercised	-	37,266	-	(37,266)	-	-	-	-
Warrants and units issued	-	-	-	-	-	-	-	-
Comprehensive loss	-	-	-	-	(905,595)	62,567	-	(843,028)
Balance, December 31, 2010	27,558,427	5,403,869	-	1,110,078	(7,199,374)	62,567	-	(622,860)
Balance, July 1, 2011	44,183,955	\$ 8,650,892	\$ (352,000)	\$ 1,698,955	(9,703,060)	\$ 104,778	\$ 1,436,685	\$ 1,836,250
Share issuance								
Private placement	5,495,000	1,099,000	(364,500)	-	-	-	-	734,500
Issue costs	-	(29,900)	-	-	-	-	-	(29,900)
Investment in Carbiopel	400,000	108,000	-	-	-	-	-	108,000
Shares for debt	150,000	40,500	-	-	-	-	-	40,500
Share subscription proceeds	-	-	716,500	-	-	-	-	716,500
Share-based compensation	-	-	-	218,579	-	-	-	218,579
Deficit	-	-	-	-	(908,113)	-	-	(908,113)
Non-controlling interest	-	-	-	-	-	-	(1,436,685)	(1,436,685)
Other comprehensive income	-	-	-	-	-	2,768,841	-	2,768,841
Balance, December 31, 2011	50,228,955	\$ 9,868,492	\$ -	\$ 1,917,534	\$ (10,611,173)	\$ 2,873,619	\$ -	\$ 4,048,472

## **1. NATURE OF OPERATIONS AND ABILITY TO CONTINUE AS A GOING CONCERN**

The Company was incorporated on April 6, 1990 under the laws of the Province of British Columbia. The head office, principal address and records office of the Company are located at 2500 - 555 West Hastings Street, Vancouver, British Columbia, Canada, V6B 4N5. The Company's registered address is at the same address.

The Company is in the business of providing solutions for companies, organizations and individuals looking to reduce or offset their global warming impact caused by greenhouse gas emissions, while including the generation of carbon credits for sale in the global Voluntary and Compliance markets from the completion of reforestation, biomass energy and renewable energy technology projects that are independently validated and verified to globally recognized standards and methodologies. Carbon Friendly Solutions Inc., is also providing coal technology using patented technologies to decontaminate and upgrade low-rank coals for use by power utilities

These consolidated financial statements include the accounts of the Company since the effective date of the reverse takeover transaction being September 2008 and the historical accounts of the business of Global CO2. Upon closing the acquisition, the Company legally changed its name to Carbon Friendly Solutions Inc.

These consolidated financial statements are prepared on a basis of accounting principles applicable to a going concern, which assumes the realization of assets and satisfaction of liabilities and commitments in the normal course of business. For the six month period ended December 31, 2011, the Company had a profit of \$424,043 (2011 – loss of \$843,189) and has an accumulated deficit of \$10,611,173 at December 31, 2011 (June 30, 2011 – \$9,598,282) and expects to incur further losses in the development of its business, all of which casts significant doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due. Management has no formal plan in place to address this concern but is considering obtaining additional funds by equity financing to the extent there is a shortfall from operations. While the Company is expending its best efforts to achieve the above plans, there is no assurance that any such activity will generate funds for operations.

The Company's operations to December 31, 2011 have been financed through debt and the issuance of common shares. If further successful commercialization of the Company's carbon credit business and/or coal technology is not achieved, the Company may not have sufficient working capital to sustain operations for the next twelve months.

Although there is no assurance that the Company will be successful in generating future profitable operations, management is confident that the Company will be able to continue as a going concern. Accordingly, these financial statements do not reflect adjustments to the carrying value of assets and liabilities, the reported revenues and expenses and balance sheet classifications used that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

## **2. BASIS OF PREPARATION**

### **(a) Statement of Compliance**

These interim financial statements are unaudited and have been prepared in accordance with IAS 34 'Interim Financial Reporting' ("IAS 34") using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

The policies applied in these interim financial statements are based on IFRS issued and effective for the year ended June 30, 2012. Any subsequent changes to IFRS that are given effect in the annual financial statements for the year ending June 30, 2012 could result in restatement of these interim financial statements, including the transition adjustments recognized on change-over to IFRS.

These are the Company's first IFRS interim financial statements for part of the period covered by the Company's first IFRS annual financial statements for the year ending June 30, 2012. Previously, the Company prepared its annual and interim financial statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The explanation of the effect of the transition to IFRS is set out in note 22.

## 2. BASIS OF PREPARATION continued

As these are the Company's first set of interim financial statements in accordance with IFRS, the Company's disclosures exceed the minimum requirements under IAS 34. The Company has elected to exceed the minimum requirements in order to present the Company's accounting policies in accordance with IFRS and the additional disclosures required under IFRS, which also highlight the changes from the Company's 2011 annual financial statements prepared in accordance with Canadian GAAP. In 2012 and beyond, the Company may not provide the same amount of disclosure in the Company's interim financial statements under IFRS as the reader will be able rely on these and the annual financial statements which will be prepared in accordance with IFRS.

The condensed interim financial statements were authorized for issue by the board of Directors on February 28, 2012.

### (b) Basis of presentation

The financial statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments, which are measured at fair value, as explained in the accounting policies set out in Note 3. The comparative figures presented in these interim consolidated financial statements are in accordance with IFRS. The presentation of the cash flow statement in accordance with IFRS differs from the presentation of the cash flow statement in accordance with Canadian GAAP. The transition from previous GAAP to IFRS has had no effect upon the reported cash flows generated by the Company. The reconciling items between the previous GAAP presentation and the IFRS presentation have no net impact on the cash flows generated.

## 3. SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated financial statements include the accounts of the Company and the following subsidiaries. All significant intercompany transactions and balances have been eliminated.

	Country of incorporation	Ownership - December 31, 2011	Ownership - June 30, 2011	Ownership - July 1, 2010
Global CO2 Reduction Inc. ("Global CO2")	Canada	100%	100%	100%
CO2 Reduction Poland Sp. z. o. o. ("CO2 Reduction")	Poland	100%	100%	100%
MicroCoal Inc. ("MicroCoal")	USA	100%	58.21%	0.0%

### Foreign currency translation

#### Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Canadian dollar, which is the functional and presentation currency of the Company and its Canadian subsidiary. The functional currency for CO2 Reduction is the Polish zloty and for MicroCoal the United States dollar.

#### Translation of accounts of foreign subsidiaries

On consolidation, the financial statements of foreign operations, are translated into Canadian dollar using exchange rate at the end of reporting period for the financial position and average exchange rate over the reporting period for the income statement. Foreign currency translation differences are recognized in other comprehensive income.

#### Transactions in foreign currency

Transactions made in a foreign currency are translated using the currency rate at the time of the translation. Monetary assets and liabilities in foreign currency are measured at the currency rate at the closing date and the translation differences are charged in profit and loss continuously.

### Cash and equivalents

Cash and cash equivalents include cash on deposit and highly liquid short-term interest bearing guaranteed investment certificates that are readily convertible to known amounts of cash.



### 3. SIGNIFICANT ACCOUNTING POLICIES continued

#### Inventory

The Company's inventory is comprised of carbon credit offsets and is stated at lower of cost and net realizable value. Carbon credit offsets are generated through the planting of trees and restoring degraded ecosystems through re-forestation. The planting and re-forestation will generate carbon credits which represent the carbon consumption capability of the planted trees. Directly attributable internally and externally incurred expenditures are allocated on a purchase by purchase basis for each contract and comprises of all production, acquisition and conversion costs. The costs associated with producing inventory are charged to the statement of operations in the same period as the related revenues are recognized. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and selling expense.

Carbon credit offsets are recognized in inventory once the methodologies for quantifying, documenting and reporting CO<sub>2</sub> removals have been validated and/or verified to International standards by accredited third party validation companies such as Rainforest Alliance or TUV SUD or any of their regional affiliates. The Company follows such recognized standards and methodologies as ISO-14064-2, Climate Community Biodiversity Alliance (CCBA) and the Voluntary Carbon Standard (VCS).

#### Property and equipment

Property and equipment are recorded at cost less accumulated amortization and impairment losses. The asset's residual value, useful life and depreciation method are evaluated annually and changes to estimated useful lives, residual values or depreciation methods resulting from such review are accounted for prospectively. The significant classes of depreciable property and equipment is recorded using the following rates and methods:

Assets	Rate	Basis
Computer equipment	45%	Declining-balance
Furniture and equipment	20%	Declining-balance
Leasehold improvements	7 years	Straight-line

#### Coal technology and plant prototype

In connection with the acquisition of MicroCoal, Inc. (note 6), the Company acquired patented coal technology and a plant prototype. The technology and the plant prototype were recorded at determined fair value, resulting in a gross asset of \$7.1 million and accumulated amortization of \$1,682,177 as of December 31, 2011 (\$791,001 to June 30, 2011). The asset is being amortized on a straight-line basis over a period of 5 years.

#### Impairment

The Company's tangible and intangible assets are reviewed for indications of impairment at each statement of financial position date. If indication of impairment exists, the asset's recoverable amount is estimated.

An impairment loss is recognized when the carrying amount of an asset, or its cash-generating unit, exceeds its recoverable amount. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Impairment losses are recognized in profit and loss for the period. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis.

The recoverable amount is the greater of the asset's fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

When an impairment loss reverses in a subsequent period, the carrying amount of the related asset is increased to the revised estimate of recoverable amount to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset previously. Reversals of impairment losses are recognized in the statement of profit or loss in the period the reversals occur.

### 3. SIGNIFICANT ACCOUNTING POLICIES continued

#### Income taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under the liability method, deferred income taxes are recognized to reflect the expected deferred tax consequences arising from temporary differences between the carrying value and the tax bases of the assets and liabilities. Deferred tax assets are only recognized where it is probable that future taxable profits will be available and measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled.

The following temporary differences do not result in deferred tax assets or liabilities:

- the initial recognition of assets or liabilities, not arising in a business combination, that does not affect accounting or taxable profit
- goodwill
- investments in subsidiaries, associates and jointly controlled entities where the timing of reversal of the temporary differences can be controlled and reversal in the foreseeable future is not probable.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

#### Financial instruments

##### Financial assets

Financial assets are classified as into one of the following categories based on the purpose for which the asset was acquired. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

The Company has classified its financial assets as follows:

- Cash is classified as loans and receivables.
- Receivables are classified as loans and receivables.
- Investment in Carbiopel is classified as AFS.

##### Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted on an active market. Such assets are initially recognized at fair value plus any direct attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

##### Available-for-sale ("AFS")

Non-derivative financial assets that do not meet the definition of loans and receivables are classified as available-for-sale and comprise principally the Company's strategic investments in entities not qualifying as subsidiaries or associates. Available-for-sale investments are carried at fair value with changes in fair value recognized in other comprehensive loss/income. If there is no quoted market price in an active market and fair value cannot be readily determined, available-for-sale investments are carried at cost. Where there is a significant or prolonged decline in the fair value of an available-for-sale financial asset (which constitutes objective evidence of impairment), the full amount of the impairment, including any amount previously recognized in other comprehensive loss/income, is recognized in profit or loss.

##### Financial liabilities

##### Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest method. Liabilities in this category include accounts and other payables.

The Company classified its financial liabilities which consisted of accounts payable and accrued liabilities, related parties, and loans payable as other liabilities.

### **3. SIGNIFICANT ACCOUNTING POLICIES continued**

#### **Share-based payments**

The fair value of equity settled stock options awarded to employees defined under IFRS 2 (i.e. employees for legal and tax purpose, directors and certain consultants), determined as of the date of grant, and awarded to non-employees defined under IFRS 2, as of the date of delivery of service, is recognized as share-based compensation expense, included in general and administrative expenses in the statement of comprehensive income, over the vesting period of the stock options based on the estimated number of options expected to vest, with a corresponding increase to equity. The fair value of stock options is determined using the Black-Scholes option pricing model with market related inputs as of the date of grant or the date of delivery of service. Stock options with graded vesting schedules are accounted for as separate grants with different vesting periods and fair values. Changes to the estimated number of awards that will eventually vest are accounted for prospectively.

The Company has a share-based compensation plan. See Note 14d for details with respect to the fair value determination, including assumptions.

#### **Basic and diluted loss per share**

Basic loss per share is computed by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Diluted loss per share reflects the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. Diluted amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share.

#### **Share issue costs**

The Company charges all costs incurred in relation to financing transactions to share capital when the related shares are issued. The transaction costs related to financing transactions that are not completed are expensed.

#### **Related party transactions**

Parties are considered to be related, if one party has the ability, directly or indirectly, to control, jointly control or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources, services or obligations between related parties.

### **4. SIGNIFICANT ACCOUNTING ESTIMATES**

The preparation of financial statements in accordance with IFRS requires management to make certain accounting judgment, estimates and assumptions that affect the reported amounts of assets and liabilities, income and expenses. The estimates and underlying assumptions are based on past experience and other factors perceived to be relevant and probable when the judgments were made. Estimates are reviewed on an ongoing basis and the changes to the accounting estimates are accounted prospectively.

Information regarding critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is covered in note 3 - significant accounting policies.

## **5. FUTURE IFRS STANDARDS AND INTERPETATIONS ISSUED BUT NOT YET EFFECTIVE**

Unless otherwise indicated below, the Company is in the process of assessing whether there will be any significant impact on its consolidated financial statements upon future adoption of these new standards, interpretations, or amendments. At this time, the Company does not plan to early adopt any of these new standards, interpretations, or amendments.

### **Financial instruments**

The IASB intends to replace IAS 39 - Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety with IFRS 9 - Financial Instruments ("IFRS 9") in three main phases. IFRS 9 will be the new standard for the reporting of financial instruments that is principles-based and less complex than IAS 39.

IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact of the new standard on the accounting for the available-for-sale investment.

### **Consolidation**

In May 2011, the IASB issued IFRS 10 - Consolidated Financial Statements ("IFRS 10"), which supersedes SIC 12 and the requirements relating to consolidated financial statements in IAS 27 - Consolidated and Separate Financial Statements. IFRS 10 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances. IFRS 10 establishes control as the basis for an investor to consolidate its investees; and defines control as an investor's power over an investee with exposure, or rights, to variable returns from the investee and the ability to affect the investor's returns through its power over the investee.

In addition, the IASB issued IFRS 12 - Disclosure of Interests in Other Entities ("IFRS 12") which combines and enhances the disclosure requirements for the Company's subsidiaries, joint arrangements, associates and unconsolidated structured entities. The requirements of IFRS 12 include reporting of the nature of risks associated with the Company's interests in other entities, and the effects of those interests on the Company's consolidated financial statements. One of the most significant changes introduced by IFRS 12 is that an entity is now required to disclose the judgments made to determine whether it controls another entity.

Concurrently with the issuance of IFRS 10, IAS 27 and IAS 28 - Investments in Associates ("IAS 28") were revised and reissued as IAS 27 - Separate Financial Statements and IAS 28 - Investments in Associates and Joint Ventures to align with the new consolidation guidance.

### **Interests in joint ventures**

In May 2011, the IASB issued IFRS 11 - Joint Arrangements ("IFRS 11"), which supersedes IAS 31 - Interests in Joint Ventures and SIC-13 - Jointly Controlled Entities - Non-Monetary Contributions by Venturers. IFRS 11 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted under certain circumstances. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures based on the rights and obligations of the parties to the joint arrangements. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement ("joint operators") have rights to the assets, and obligations for the liabilities, relating to the arrangement. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement ("joint venturers") have rights to the net assets of the arrangement. IFRS 11 requires that a joint operator recognize its portion of assets, liabilities, revenues and expenses of a joint arrangement, while a joint venturer recognizes its investment in a joint arrangement using the equity method.

**5. FUTURE IFRS STANDARDS AND INTERPETATIONS ISSUED BUT NOT YET EFFECTIVE continued**

**Fair value measurement**

In May 2011, IASB issued IFRS 13 – Fair Value Measurement. The standard defines fair value and sets out a single framework for measuring fair value and requires disclosure about fair value measurements. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. IFRS 13 requires entities to disclose information about the valuation techniques and inputs used to measure fair value, as well as information about the uncertainty inherent in fair value measurements. The Company does not anticipate the application of IFRS 13 to have a material impact on its consolidated financial statements.

**Financial statement presentation**

In June 2011, the IASB issued amendments to IAS 1 - Presentation of Financial Statements ("IAS 1") that require an entity to group items presented in the other comprehensive income (OCI) on the basis of whether they may be reclassified to profit or loss subsequent to initial recognition. The amendments are effective for annual periods beginning on or after July 1, 2012, with earlier adoption permitted. The Company does not anticipate the application of the amendments to IAS 1 to have a material impact on its consolidated financial statements.

**6. COAL TECHNOLOGY AND PLANT PROTOTYPE**

The Company entered into an agreement to acquire 58.21% of the outstanding share capital of MCI. In accordance with a share purchase agreement and its amendment, all Microcoal shareholders, except for one, exchanged their shares of Microcoal on a pro rata basis for 10,957,778 common shares of the Company at a price of \$ 0.195 per share, as per the share price at the January 31, 2011 closing date, which equals a total of \$2,136,767 (the "Share Exchange").

At the time of acquisition the fair value of the assets and liabilities of Microcoal were:

Cash and cash equivalents	\$ 10,036
Property, plant and equipment	29,632
Coal technology	7,059,324
Accounts payable and accrued liabilities	(842,680)
Loans payable	(2,585,521)
<b>Fair value</b>	<b>3,670,791</b>
<b>Non-controlling interest</b>	<b>(1,534,024)</b>
<b>Consideration (10,957,778 common shares)</b>	<b>\$ 2,136,767</b>

In addition to the Share Exchange the Company is to complete a private placement financing of up to \$6 million (the "Financing") and from such proceeds, the Company is to pay (i) US\$1 million cash to Orica, a creditor/shareholder of MCI, in consideration for the forgiveness of certain outstanding debt owed to such creditor by MCI and for the re-purchase of such creditor's 1,013 MCI shares for cancellation; and (ii) up to US\$85,000 cash to certain other creditors of MCI to settle other outstanding indebtedness owed by MCI. Upon completion of the entire transaction, the Company will own 100% of MicroCoal. This transaction did not occur prior to the agreed closing date, September 30, 2011, however, the acquisition of the remaining 41.79% interest in MCI has been agreed to as follows.

The Company has arranged a purchase of the 41.79% in MicroCoal held by Orica. The Company will pay the sum of \$125,000 USD (paid) and a balance of \$875,000 USD by March 31, 2012. The Company has transferred 200,000 VERS (Verified Emission Reductions) (note 12) for use by Orica where sale proceeds would be subtracted from the balance owing of \$875,000 USD.

MicroCoal is a materials technology company focused on commercializing the use of microwave energy and related process technologies to transform coal and other minerals into higher quality and higher value industrial materials. The Company accounted for the 58.21% acquisition of MicroCoal as an asset acquisition. The balance of the 41.79% interest has been reflected with the elimination of the minority interest of \$1,436,685 and a forgiveness of debt for \$2,805,984.

Carbon Friendly Solutions Inc.  
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For the six months ended December 31, 2011  
(in Canadian dollars)(unaudited)

**7. RECEIVABLES**

	December 31,		
	2011	June 30, 2011	July 1, 2010
GST/HST/VAT recoverable	\$ 93,983	\$ 63,266	\$ 35,351
Payroll tax receivable	-	-	32,833
Trade receivables	-	17,341	45,000
	<b>\$ 93,983</b>	<b>\$ 80,607</b>	<b>\$ 113,184</b>

**8. INVENTORY**

	December 31,		
	2011	June 30, 2011	July 1, 2010
	\$ -	\$ -	\$ 9,567

During the year ended June 30, 2010, the Company wrote-down the value of inventory to its net realizable value and recorded an impairment charge of \$6,867 in the consolidated statement of operations.

**9. PROPERTY AND EQUIPMENT**

Property and equipment	Computer equipment	Furniture and equipment	Leasehold improvements	Total
July 1, 2010	\$ 21,810	\$ 24,660	\$ 8,614	\$ 55,084
Additions	13,857	50,152	-	64,009
Effect of foreign exchange	(255)	(1,043)	-	(1,298)
June 30, 2011	35,412	73,769	8,614	117,795
Additions	-	922	-	922
Effect of foreign exchange	658	2,773	-	3,431
December 31, 2011	\$ 36,070	\$ 77,464	\$ 8,614	\$ 122,148
<b>Accumulated amortization</b>				
July 1, 2010	\$ 12,622	\$ 8,335	\$ 2,461	\$ 23,418
Acquisitions	5,314	27,256	-	32,570
Amortization	5,489	5,208	1,231	11,928
Effect of foreign exchange	341	(610)	-	(269)
June 30, 2011	23,766	40,189	3,692	67,647
Amortization	903	1,773	307	2,983
Effect of foreign exchange	417	1,699	-	2,116
December 31, 2011	25,086	43,661	3,999	72,746
Net book value	\$ 10,984	\$ 33,803	\$ 4,615	\$ 49,402

During the year ended June 30, 2011, the Company recovered \$22,499 as a reduction of costs written off in certain property and equipment it acquired and recorded a \$nil impairment charge in the consolidated statement of operations.

**10. DEPOSIT**

The deposit represents an amount paid in advance for the lease of office premises. See also note 18, commitments.

## 11. INVESTMENT IN CARBIOPEL

The Company executed a share purchase agreement with the shareholders of Carbiopel - Eco Stream Power S.A. ("Carbiopel") pursuant to which the Company can acquire 51% of the issued and outstanding shares of Carbiopel, set out in the amendment to the share purchase agreement (the "Amended Agreement") between the Company and the Carbiopel shareholders dated July 14, 2011. The terms of the agreement provide the Company can purchase 1% of Carbiopel by the issuance of 400,000 shares of the Company and 50% of Carbiopel for cash injections of up to two million zloty to develop a business model in Poland.

Pursuant to terms of the Amendment Agreement the Company purchased 2,000 of the issued and outstanding shares of Carbiopel from the Carbiopel shareholders, representing 1% of Carbiopel, from the issuance of 400,000 common shares in the capital of the Company (market price on the day the shares were issued was \$0.27 per share). The Company is currently renegotiating with Carbiopel.

An advance of \$102,000 was made to Carbiopel to initiate the business plan.

## 12. INTANGIBLE ASSETS

	December 31,		
	2011	June 30, 2011	July 1, 2010
Exclusive sales contract (i)	\$ 111,228	\$ 116,097	\$ -
Impairment charge (i) and (ii)	(55,121)	(55,121)	-
	<b>\$ 56,107</b>	<b>\$ 60,976</b>	<b>\$ -</b>

### (i) Exclusive Sales Contract

During the year ended June 30, 2011 and 2010, the Company entered into additional sales contracts for the exclusive rights to sell carbon credits generated from the bedding and trees growing on plots of land located in Poland. Additional lease payments are conditional on the earlier of the date of certification of validation carbon credits or sale of a carbon credit units generated from the plots of land. The Company has approximately 1,500,000 verified emission reduction credits.

As of June 30, 2011, the Company reviewed the carrying amount of its intangible assets and recognized an impairment charge of \$nil in the consolidated statement of operations. (June 30, 2010 - \$55,121)

## 13. LOANS PAYABLE

	December 31,	
	2011	June 30, 2011
Pursuant to several loan agreements a total of \$385,000 was advanced to the Company. A 20% loan bonus was charged with the loan amount calculated at \$462,000 to be repaid. The interest rate is 8% per annum and the term is one year or shorter if a financing was achieved by the Company. During the period ended December 31, 2011 the Company repaid \$110,000 ( June 30, 2011 - \$202,000).	\$ 150,000	\$ 260,000
Pursuant to a loan agreement a total of \$20,000 was advanced to the Company. The interest rate is at 2% per month. The term is one year or shorter if a financing was achieved by the Company.	-	20,000
Pursuant to a loan agreement a total of \$20,000 was advanced to the Company. The interest rate is at 2% per month. The loan is payable on demand.	-	20,000
Pursuant to a loan agreement a total of \$125,000 was advanced to the Company. The interest rate is at 10% per annum. The loan is payable on or before March 23, 2012.	125,000	-
Pursuant to a loan agreement dated June 2, 2008, MicroCoal received \$2,250,000 USD in periodic payments at a rate of interest at 6.75% per annum. The loan was payable on demand however, as a result of the acquisition agreement where the Company acquired a 58.12% interest in MicroCoal (note 6), there was a provision to limit the liabilities to MicroCoal for a total of \$1,000,000 USD if the Company was to continue to acquire the balance of shares in MicroCoal and provide financing.	905,232	2,203,200
	<b>\$ 1,180,232</b>	<b>\$ 2,503,200</b>

**14. SHARE CAPITAL**

(a) Authorized: 100,000,000 common shares without par value

<b>(b) Issued and Outstanding</b>	<b>Shares</b>	<b>Amount</b>	<b>Share subscriptions</b>
Balance, June 30, 2010	27,558,427	\$ 5,321,753	\$ -
Private placement	5,272,750	1,052,830	-
Share subscriptions	-	-	(352,000)
Stock options exercised (note 14(d))	395,000	84,850	-
Shares issued for acquisition of MicroCoal (note 6)	10,957,778	2,136,767	-
Fair value of stock options exercised	-	54,692	-
Balance, June 30, 2011	44,183,955	8,650,892	(352,000)
Private placement	5,495,000	1,069,100	-
Shares for debt investment in Carbiopel	150,000	40,500	-
Share subscriptions received	-	-	716,500
Share subscriptions	-	-	(364,500)
Balance, December 31, 2011	50,228,955	\$ 9,868,492	\$ -

For the six-month period ended December 31, 2011

A second tranche of a private placement announced on June 21, 2011 raised an additional \$1,099,000. The total financing was comprised of \$2,153,550 in gross proceeds from the subscription of 10,767,750 units. Each unit consisted of one common share and one common share purchase warrant to purchase one common share of the Company at an exercise price of \$0.35 per share for a period of two years. A first tranche was completed at June 30, 2011 with the balance of 5,495,000 units completed in the current quarter. Fees pursuant to the private placement of \$29,900 were incurred.

Fiscal 2011

During the year ended June 30, 2011, a private placement was completed consisting of 5,272,750 units at \$0.20 per unit, each unit consisting of one common share and one share purchase warrant to purchase one common share at \$0.35 per share for a period of two years. Issue costs of \$1,720 were incurred. As at June 30, 2011 \$352,000 remain as share subscriptions, but were collected subsequent to year end.

All proceeds from the above private placements were allocated to share capital with no amounts allocated to the attached warrants.



**14. SHARE CAPITAL continued**

**c) Warrants**

A summary of the status of the warrants outstanding is as follows:

	Number of shares	Exercise Price
Balance, June 30, 2010	9,747,700	0.75
Issued	5,272,750	0.35
Balance, June 30, 2011	15,020,450	0.44
Issued	5,495,000	0.35
Expired	(7,675,200)	0.35
Balance, December 31, 2011	12,840,250	\$ 0.41

The following table summarizes warrants outstanding and exercisable at December 31, 2011:

Warrants Outstanding	Warrants Exercisable	Exercise Price	Expiry Date
2,072,500 *	2,072,500	\$0.75	August 29, 2012
5,272,750	5,272,750	\$0.35	June 30, 2013
5,495,000	5,495,000	\$0.35	September 30, 2013
12,840,250	12,840,250		

\* 2,072,500 warrants with an original expiry date of August 29, 2010 were extended to August 29, 2012. Stock-based compensation related to the warrant extension has been recorded in the amount of \$10,682 for the year ended June 30, 2011.

**d) Stock options**

On December 29, 2010, the Company adopted an incentive share option plan for granting options to directors, employees and consultants, under which the total outstanding options are limited to 10% of the issued and outstanding common shares of the Company. The options vest when granted except for options granted for investor relations activities which vest over a 12 month period with no more than 25% of the options vesting in any three month period.

Stock options outstanding are as follows:

	Number of shares	Weighted Average Exercise Price
Outstanding, June 30, 2010	2,817,500	0.29
Granted	2,321,620	0.20
Cancelled	(912,500)	0.29
Exercised	(195,000)	0.23
Exercised	(200,000)	0.20
Outstanding, June 30, 2011	3,831,620	0.24
Granted	1,420,000	0.22
Cancelled	(230,000)	0.24
Outstanding, December 31, 2011	5,021,620	\$ 0.22

During the six-month period ended December 31, 2011, the Company granted 790,000 options at an exercise price of \$0.14 and 630,000 options at a price of \$0.32 to officers, directors and consultants. The options vested immediately. The Company has adopted a 10% rolling plan.

#### 14. SHARE CAPITAL continued

The following table summarizes stock options outstanding and exercisable at December 31, 2011:

Options Outstanding	Exercise Price	Expiry Date	Options Exercisable
790,000	\$0.14	August 18, 2016	790,000
2,121,620	\$0.20	February 8, 2016	2,121,620
805,000	\$0.23	October 6, 2013	805,000
675,000	\$0.36	December 16, 2014	675,000
630,000	\$0.32	December 22, 2016	630,000
5,021,620			5,021,620

During the six-month period ended December 31, 2011, share-based compensation has been recorded in the amount of \$218,579 (2010 - \$nil) and included in share-based payment reserve. The weighted average life of the options is 3.76 years.

The compensation costs recorded in the consolidated statements of operations and deficit were calculated using the Black-Scholes option pricing model using the following weighted average assumptions:

	2011	2010
Risk free interest rate	2.78%	0.00%
Expected dividend yield	nil%	nil%
Stock price volatility	93.6%	nil%
Expected life of options	3.76	nil%

The weighted average fair value of options granted during the period ended December 31, 2011 is \$0.15.

##### e) Escrow shares

Pursuant to a reverse takeover transaction in October 31, 2007, 6.05 million common shares were subject to TSX Venture Exchange Tier 2 value securities escrow provisions. The escrow provisions contemplate the release of 10 per cent of the escrow shares on the issuance of the TSX-V bulletin and 15 per cent released every six months thereafter, for a total escrow period of 36 months.

As at December 30, 2011 NIL (June 30, 2011 - 907,500) (June 30, 2010 - 2,722,500) common shares remain in escrow.

##### f) Share-based payment reserve

	2011	2010
Balance, beginning of period	\$ 1,698,955	\$ 1,147,344
Stock-based compensation	218,579	-
Fair value of stock options exercised, reclassified to share capital	-	(37,266)
Balance, end of period	\$ 1,917,534	\$ 1,110,078

##### g) Nature and purpose of reserves

The reserves recorded in equity on the Company's Statement of Financial Position include 'Share-based payment reserve', 'Cumulative Other Comprehensive Income' and 'Accumulated Deficit'. 'Share-based payment reserve' is used to recognize the value of stock option grants and share purchase warrants prior to exercise. 'Cumulative Other Comprehensive Income' includes the cumulative translation reserve which records exchange gains and losses on translating overseas operations into the company's Canadian dollar functional currency. 'Accumulated Deficit' is used to record the Company's change in deficit from earnings from year to year.

## 15. RELATED PARTIES

The following expenses were incurred with directors and officers of the Company

	Six months ended December 31, 2011	Six months ended December 31, 2010
<b>Key management personnel remuneration</b>		
Management and directors' fees	\$ 276,864	\$ 119,700
Consulting	12,800	26,000
Automobile allowance (travel and promotion)	19,650	19,200
Professional fees	45,700	32,552
<b>Total</b>	<b>\$ 355,014</b>	<b>\$ 197,452</b>

As at December 31, 2011 accounts payable and accrued liabilities included \$221,909 (June 30, 2011 - \$440,646) owing to officers and directors. The amounts due are unsecured, non-interest bearing and have no fixed terms of repayment.

The amounts charged to the Company for the services provided have been determined by negotiation among the parties and in certain cases, by signed agreements. These transactions were measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

## 16. INCOME TAXES

There is no current or deferred income tax expense in the period due to the losses incurred. At June 30, 2011 the Company had non-capital losses of approximately \$5.933 million to reduce future taxable income expiring between 2027 to 2031. For Polish tax purposes there are approximately \$844,000 in non-capital losses.

No deferred tax asset has been recognized in respect of the losses due to the uncertainty of future profits.

## 17. SEGMENTED INFORMATION

The Company currently operates in one industry segment, being the generation of carbon credits and in the geographic areas as follows.

	Six months ended December 31, 2011		Six months ended December 31, 2010	
<b>Sales for the period</b>				
Canada	\$ -		\$ -	
USA	-		-	
Poland	-		658	
	\$ -		\$ 658	
<b>Property and Equipment</b>				
	December 31, 2011		June 30, 2011	
Canada	\$ 21,439		\$ 21,920	\$ 29,638
USA	26,682		27,120	-
Poland	1,281		1,288	2,025
	\$ 49,402		\$ 50,328	\$ 31,663
<b>Intangible Assets</b>				
Canada	\$ -		\$ -	\$ -
USA	-		-	-
Poland	56,107		60,975	60,975
	\$ 56,107		\$ 60,975	\$ 60,975
<b>Coal technology and plant prototype</b>				
Canada	\$ -		\$ -	\$ -
USA	5,377,147		6,268,323	-
Poland	-		-	-
	\$ 5,377,147		\$ 6,268,323	\$ -

## 18. COMMITMENTS AND CONTINGENCIES

- (a) The Company has two consulting agreements for a period of 3 years commencing July 1, 2010 for \$120,000 per year, and July 1, 2011 for \$84,000 per year respectively. There is an annual increase of 5% per annum. In an event of a change in control, and the officer is terminated within 12 months of such change of control, then the officer will receive a lump sum payment equal to the greater of (1) the compensation remaining for the rest of the period under the terms of engagement and (2) one year's compensation.
- (b) The Company entered into an agreement to lease additional office space for five years as follows:

2012	\$	71,192
2013		94,923
2014		96,714
2015		98,505
2016		-
	\$	<u>361,334</u>

- (c) The Company has acquired the rights to over 100 properties wherein it has the exclusive sale contract rights to sell carbon credits generated from the bedding and trees growing in various plots of lands in Poland until 2040. The Company paid a total of \$111,408 for these exclusive sales contract rights and has right to sell carbon credits into the market place. If sales are found through a carbon credit certification process, further amounts would be paid to the vendors of up to 8,177,216 PLN (approximately \$2.9 million) within 30 days subject to obtaining carbon credit certification or sale of a carbon credit unit from the lands. The Company is not bound to sell any carbon credits at a loss and would only do so on a profitable basis.
- (d) The Company has received demands to pay the sum of \$450,000 USD in regards to an unpaid finders' fee pursuant to the acquisition of MicroCoal. The Company believes the demand is without merit and the finder has already received consideration in full.

## 19. CAPITAL DISCLOSURES

The Company manages its capital structure and makes adjustments based on the funds available in order to support continued operation and future business opportunities. The board of directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company considers its capital to be share capital. The capital management objectives remain the same as for the previous fiscal period.

The Company's operations are currently not generating positive cash flow; as such, the Company is dependent on external financing to fund its activities. In order to carry out potential expansion and to continue operations, and pay for administrative costs, the Company will spend its existing working capital, and raise additional amounts as needed. Companies in this stage typically rely upon equity and debt financing or joint venture partnerships to fund its operations. There is no certainty with respect to the Company's ability to raise capital.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. As at December 31, 2011, cash amounted to \$62,175. During the six month period ended December 31, 2011, the Company raised \$1,069,100 through the issuance of common shares in a private placement. These additional funds were used for working capital requirements.

The Company is not exposed to external requirements by regulatory agencies regarding its capital.

## 20. FINANCIAL INSTRUMENTS AND RISKS

As at December 31, 2011, the Company's financial instruments consist of cash, receivables, accounts payable and accrued liabilities and loans payable. The fair values of these financial instruments approximate their carrying values because of their current nature or adjustments to fair value made at each period end.

### Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, investment fluctuations, and commodity and equity prices. Market conditions will cause fluctuations in the fair values of financial assets classified as held-for-trading and available-for-sale and cause fluctuations in the fair value of future cash flows for assets or liabilities classified as held-to-maturity, loans or receivables and other financial liabilities. The Company is not exposed to significant market risk. The Company is not exposed to significant interest rate risk as the Company has no variable interest debt. The Company's ability to raise capital to fund activities is subject to risks associated with fluctuations in the carbon market. Management closely monitors individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company.

### 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 manages liquidity risk through the management of its capital structure and financial leverage as outlined in note 19.

### Interest rate Risk

The Company is not exposed to significant interest rate risk due to the short-term maturity of its monetary assets and liabilities and amounts owing being non-interest bearing or bearing fixed rates of interest.

### Credit Risk

The Company is not exposed to significant credit risk on its financial assets due to cash being placed with major financial institutions and GST/HST recoverable is due from government agencies.

### Currency Risk

The Company is exposed to foreign currency risk on fluctuations related to cash, receivables and accounts payable and accrued liabilities that are denominated Polish Zloty (PLN) and the United States dollar (USD). Management does not hedge its exposure to foreign exchange risk and does not believe the Company's net exposure to foreign currency risk is significant.

The following table provides an indication of the Company's significant foreign exchange currency exposure:

	United States		Poland	
	December 31, 2011	June 30, 2011	December 31, 2011	June 30, 2011
Cash	14,305	1,987	86	312
Accounts payable and accrued liabilities	(23,673)	(1,310,995)	(79,495)	(71,503)
Related parties	-	(99,715)	(15,188)	(19,045)
Loans payable	(1,034,500)	(2,203,200)	-	-
	(1,043,868)	(3,611,923)	(94,597)	(90,236)

The following exchange rates were applied:

	Six months ended December 31, 2011		Year ended June 30, 2011	
	Average rate	Spot rate	Average rate	Spot rate
Canadian dollars to US dollars	0.9998	1.0345	0.9987	1.0212
Canadian dollars to Zloty	3.0924	2.8345	2.9058	2.8254

### Other Price and Market Risk

The Company's financial instruments are all short term and exposed to other price and market risks should the fair value of future cash flows from financial instruments fluctuate.

The carbon market is a newly developing market and as such there are limited avenues to negate market risk in traditional manners. The Company monitors and understands movements within the market on a regular basis.

## 21. SUBSEQUENT EVENTS

### Private placement

On February 13, 2012 the Company announced it had closed a private placement ("Private Placement") announced on January 24, 2012. The total financing from the Private Placement is comprised of \$1,918,740 in gross proceeds from the subscription to 6,395,800 Units. Each Unit consists of one common share and one non-transferable common share purchase warrant (the "Warrant"). Each Warrant entitles the holder thereof to purchase one common share of the Company at an exercise price of \$0.45 per common share for a period of two years from the closing date of the Private Placement.

### Coal technology and plant prototype

The Company announced that Ameren Corporation (NYSE:AEE) ("Ameren") has signed a Letter of Interest ("LOI") that reflects the intention of Ameren and MicroCoal to negotiate a term sheet and enter into a proposed license agreement relating to the deployment of MicroCoal technology at one of Ameren's coal-fired power plants (the "Nominated Plant") in two main phases. The first phase is proposed to commence in early 2012 and consists of re-configuring MicroCoal's pilot plant in Colorado to determine the design for Ameren's plant in upgrading Powder River Basin (PRB) coal to higher energetic value (BTU rating). The second phase involves the construction and operation of a fully integrated commercial plant, which will be able to treat 250,000 tons of PRB coal per month. This first commercial coal upgrading plant will be located at Ameren's Nominated Plant, located in the State of Missouri. It is a 1,000 Megawatt coal-fired plant and burns approximately 3 million tons of coal annually.

## 22. First Time Adoption of IFRS

For all periods up to and including the year ended June 30, 2011, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles (GAAP). The Company has prepared financial statements which comply with IFRS applicable for periods beginning on or after July 1, 2011 as described in the accounting policies. In preparing these financial statements, the Company's opening statement of financial position was prepared as at July 1, 2010, the Company's date of transition to IFRS.

This note explains the principal adjustments made by the Company in restating its Canadian GAAP statement of financial position as at July 1, 2010 and the GAAP financial statements for the six months period ended December 31, 2010 and the year ended June 30, 2011.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* sets forth guidance for the initial adoption of IFRS. Under IFRS 1 the standards are applied retrospectively at the transitional statement of financial position date with all adjustment to assets and liabilities taken to retained earnings unless certain exemptions are applied.

The Company has applied the following exemptions to its opening statement of financial position dated July 1, 2010:

### (a) Share-based payment transactions

IFRS 1 encourages, but does not require, first-time adopters to apply IFRS 2 Share based Payment to equity instruments that were granted on or before November 7, 2002, or equity instruments that were granted subsequent to November 7, 2002 and vested before the later of the date of transition to IFRS and January 1, 2005. The Company has elected not to apply IFRS 2 to awards that vested prior to July 1, 2010.

### (b) cumulative translation adjustment

The Company elected to transfer the cumulative translation differences, recognized as a separate component of equity, to deficit at July 1, 2010.

### (c) compound financial instruments

The Company elected not to bifurcate compound financial liabilities if the debt portion is no longer outstanding at transition.

### (d) business combinations

Business combinations have not been applied to acquisitions of subsidiaries or of interests in associates and joint ventures that occurred before July 1, 2010.

## 22. First Time Adoption of IFRS continued

### (e) liabilities extinguished for equities

IFRIC 19 requires a gain or loss to be recognized in profit or loss when a liability is settled through the issuance of the entity's own equity instruments. The amount of the gain or loss recognized in profit or loss is the difference between the carrying value of the financial liability and the fair value of the equity instruments issued. The fair value of the existing financial liability is used to measure the gain or loss if the fair value of the equity instruments cannot be reliably measured. The Company elected not to apply this method until July 1, 2010.

IFRS 1 also outlines specific guidelines that a first-time adopter must adhere to under certain circumstances. The Company has applied the following guidelines to its opening statement of financial position dated July 1, 2010:

### (a) Estimates

In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of July 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

IFRS employs a conceptual framework that is similar to Canadian GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed the Company's actual cash flows, it has resulted in changes to the Company's reported financial position and results of operations. In order to allow the users of the financial statements to better understand these changes, the Company's Canadian GAAP statement of operations, statement of comprehensive income and statement of financial position the six months ended December 31, 2010, the year ended June 30, 2011, and the transitional July 1, 2010 statement of financial position have been reconciled to IFRS, with the resulting differences explained.

### (b) Share-based payments

#### *IFRS*

- Each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is amortized over the vesting period of the respective tranches.
- Forfeiture estimates are recognized in the period they are estimated, and are revised for actual forfeitures in subsequent periods.

#### *Canadian GAAP*

- The Company had elected to recognize the fair value of stock-based awards with graded vesting method and/or immediate vesting, which is the same requirement under IFRS.
- Forfeitures of awards are recognized as they occur.

### (c) Impairment

*IFRS* – If indication of impairment is identified, the asset's carrying value is compared to the asset's discounted cash flows. If the discounted cash flows are less than the carrying value, the asset is impaired by an amount equal to the difference between the discounted cash flows and the carrying value.

*Canadian GAAP* – If indication of impairment is identified, the asset's carrying value is compared to the asset's undiscounted cash flows. If the undiscounted cash flows are less than the carrying value, the asset is impaired by an amount equal to the difference between the discounted cash flows and the carrying value. The Company completed an impairment review of its assets at July 1, 2010 and at June 30, 2011 and December 31, 2011, and concluded that the assets were not impaired in accordance with IFRS.

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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of financial positions at July 1, 2010 has been reconciled to IFRS as follows:

	Note	As at July 1, 2010		
		GAAP	Effect of transition to	IFRS
<b>ASSETS</b>				
Current Assets				
Cash and cash equivalents		\$ 156,840	\$ -	\$ 156,840
HST and other receivables		113,184	-	113,184
Inventory		9,567	-	9,567
Prepaid expenses		22,063	-	22,063
		301,654	-	301,654
Deposit		56,729	-	56,729
Property and equipment		31,666	-	31,666
Website development costs	Note 22 - 3	30,519	(30,519)	-
		\$ 420,568	\$ (30,519)	\$ 390,049
<b>LIABILITIES</b>				
Current Liabilities				
Accounts payable and accrued liabilities		\$ 206,101	\$ -	\$ 206,101
Due to related parties		8,630	-	8,630
		214,731	-	214,731
<b>SHAREHOLDERS' EQUITY</b>				
Share capital		5,321,753	-	5,321,753
Subscriptions received		-	-	-
Contributed surplus		1,147,344	(1,147,344)	-
Share-based payment reserve		-	1,147,344	1,147,344
Deficit	Note 22 - 3	(6,263,260)	(30,519)	(6,293,779)
Cumulative other comprehensive income		-	-	-
		205,837	(30,519)	175,318
		\$ 420,568	\$ (30,519)	\$ 390,049



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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of operations for the six months ended December 31, 2010 has been reconciled to IFRS as follows:

	For the six months ended December 31, 2010			
	GAAP	transition to	IFRS	
<b>Revenues</b>				
Carbon credits	\$ 666		\$ 666	
<b>Cost of credits</b>	-		-	
	666		666	
<b>Expenses</b>				
Amortization	Note 22 - 3	9,049	(4,577)	4,472
Bank charges and interest		3,774	-	3,774
Consulting fees		228,821	-	228,821
Finance and sponsorship fees		47,835		47,835
Foreign exchange on operations	Note 22 - 1	-	32,692	32,692
Investor relations		32,014	-	32,014
Loss on disposal of Pacific Briquetters		2,122	-	2,122
Management and director's fees		146,207	-	146,207
Office and general		51,802	-	51,802
Professional fees		143,369	-	143,369
Rent		57,063	-	57,063
Transfer agent and filing fees		19,399	-	19,399
Travel and promotion		43,536	-	43,536
Wages and benefits		37,887	-	37,887
Write down of intangible assets		55,269	-	55,269
<b>Total expenses</b>		<b>878,147</b>	<b>28,115</b>	<b>906,262</b>
<b>Loss before other comprehensive income</b>		<b>(877,481)</b>	<b>(28,115)</b>	<b>(905,596)</b>
<b>Other comprehensive income</b>				
Foreign exchange	Note 22 - 1	29,715	(29,715)	-
Exchange gain (loss) arising on translation of foreign operations		-	62,407	62,407
		29,715	32,692	62,407
<b>Total comprehensive loss for the period</b>		<b>\$ (847,766)</b>	<b>\$ 4,577</b>	<b>\$ (843,189)</b>

Carbon Friendly Solutions Inc.  
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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of operations for the three months ended December 31, 2010 has been reconciled to IFRS as follows:

	For the three months ended December 31, 2010			
	GAAP	transition to	IFRS	
<b>Revenues</b>				
Carbon credits	\$ 8		\$ 8	
<b>Cost of credits</b>				
	8		8	
<b>Expenses</b>				
Amortization	Note 22 - 3	4,486	(2,288)	2,198
Bank charges and interest		2,952	-	2,952
Consulting fees		68,354	-	68,354
Finance and sponsorship fees		47,835		47,835
Foreign exchange on operations	Note 22 - 1	-	31,672	31,672
Investor relations		22,804	-	22,804
Loss on disposal of Pacific Briquetters		63	-	63
Management and director's fees		62,233	-	62,233
Office and general		31,677	-	31,677
Professional fees		89,101	-	89,101
Rent		26,199	-	26,199
Transfer agent and filing fees		16,366	-	16,366
Travel and promotion		23,184	-	23,184
Wages and benefits		18,280	-	18,280
Write down of intangible assets		1,424	-	1,424
<b>Total expenses</b>		<b>414,958</b>	<b>29,384</b>	<b>444,342</b>
<b>Loss before other comprehensive income</b>		<b>(414,950)</b>	<b>(29,384)</b>	<b>(444,334)</b>
<b>Other comprehensive income</b>				
Foreign exchange gain (loss)	Note 22 - 1	11,783	(11,783)	-
Exchange gain (loss) arising on translation of foreign operations		-	43,455	43,455
		11,783	31,672	43,455
<b>Total comprehensive loss for the period</b>		<b>\$ (403,167)</b>	<b>\$ 2,288</b>	<b>\$ (400,879)</b>

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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of financial position as at December 31, 2010 has been reconciled to IFRS as follows:

	As at December 31, 2010		
	GAAP	transition to	IFRS
<b>ASSETS</b>			
Current Assets			
Cash and cash equivalents	\$ 38,124	\$ -	\$ 38,124
HST and other receivables	101,750	-	101,750
Inventory	9,567	-	9,567
Prepaid expenses	6,472	-	6,472
	155,913	-	155,913
Deposit	56,729	-	56,729
Property and equipment	Note 22 - 1 28,142	-	28,142
Website development costs	Note 22 - 3 25,941	(25,941)	-
	\$ 266,725	\$ (25,941)	\$ 240,784
<b>LIABILITIES</b>			
Current Liabilities			
Accounts payable and accrued liabilities	\$ 603,804	\$ -	\$ 603,804
Due to related parties	260,000	-	260,000
	863,804	-	863,804
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	5,403,869	-	5,403,869
Contributed surplus	1,110,078	(1,110,078)	-
Share-based payment reserve	-	1,110,078	1,110,078
Deficit	(7,111,026)	(88,348)	(7,199,374)
Cumulative other comprehensive income	-	62,407	62,407
	(597,079)	(25,941)	(623,020)
	\$ 266,725	\$ (25,941)	\$ 240,784

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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of financial position as at June 30, 2011 has been reconciled to IFRS as follows:

	As at June 30, 2011		
	GAAP	transition to	IFRS
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents	\$ 3,031	\$ -	\$ 3,031
Receivables	80,607	-	80,607
Prepaid expenses	51,924	-	51,924
	135,562	-	135,562
<b>Deposit</b>			
Property and equipment	Note 22 - 1	56,729	-
		50,328	(180)
Coal technology and plant prototype	Note 22 - 2	8,169,126	(1,900,803)
Intangibles	Note 22 - 1	56,287	4,689
Website development costs	Note 22 - 3	21,363	(21,363)
		\$ 8,489,395	\$ (1,917,657)
			\$ 6,571,738
<b>LIABILITIES</b>			
<b>Current</b>			
Accounts payable and accrued liabilities	\$ 1,791,642	\$ -	\$ 1,791,642
Related parties	440,646	-	440,646
Loans payable	2,503,200	-	2,503,200
	4,735,488	-	4,735,488
Future income tax	Note 22 - 4	3,025,474	(3,025,474)
			-
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	8,650,892	-	8,650,892
Share subscription receivable	(352,000)	-	(352,000)
Contributed surplus	1,698,955	(1,698,955)	-
Share-based payment reserve	-	1,698,955	1,698,955
Deficit	(9,269,414)	(433,646)	(9,703,060)
Cumulative other comprehensive income	-	104,778	104,778
	728,433	(328,868)	399,565
Non-controlling interest	Note 22 - 2	-	1,436,685
		\$ 8,489,395	\$ (1,917,657)
			\$ 6,571,738

Carbon Friendly Solutions Inc.  
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**22. First Time Adoption of IFRS continued**

The Canadian GAAP statement of operations for the year ended June 30, 2011 has been reconciled to IFRS as follows:

	For the year ended June 30, 2011			
	GAAP	transition to	IFRS	
<b>Revenues</b>				
Carbon credits	\$ 7,980		\$ 7,980	
<b>Cost of credits</b>	(9,567)		(9,567)	
	(1,587)		(1,587)	
<b>Expenses</b>				
Amortization	Note 22 - 2	763,731	39,197	802,928
Bank charges and interest		8,445	-	8,445
Consulting fees		581,029	-	581,029
Finance and sponsorship fees		2,506	-	2,506
Foreign exchange gain (loss) on operations	Note 22 - 1	-	(5,204)	(5,204)
Gain on disposal of subsidiary		2,246	-	2,246
Interest on notes payable		130,303	-	130,303
Investor relations		13,666	-	13,666
Management fees		488,615	-	488,615
Office and miscellaneous		116,670	-	116,670
Professional fees		305,246	-	305,246
Rent		99,019	-	99,019
Stock-based compensation		606,303	-	606,303
Transfer agent and regulatory fees		10,132	-	10,132
Travel and promotion		207,056	-	207,056
Wages and benefits		134,214	-	134,214
Write down of receivable		1,859	-	1,859
<b>Total expenses</b>		(3,471,040)	(33,993)	(3,505,033)
<b>Loss before other comprehensive income</b>		(3,472,627)	(33,993)	(3,506,620)
<b>Other comprehensive income</b>				
Foreign exchange	Note 22 - 1	105,473	(105,473)	-
Exchange gain arising on translation of foreign operations		-	104,778	104,778
		105,473	(695)	104,778
<b>Loss before income tax</b>				
Future income tax recovery	Note 22 - 4	361,000	(361,000)	-
<b>Total comprehensive loss for the period</b>		\$ (3,006,154)	\$ (395,688)	\$ (3,401,842)
<b>Loss for period attributable to:</b>				
Owners of parent				(3,409,281)
Non-controlling interest	Note 22 - 2			(97,339)
				\$ (3,506,620)
<b>Total comprehensive income attributable to:</b>				
Owners of parent				(3,304,503)
Non-controlling interest	Note 22 - 2			(97,339)
				\$ (3,401,842)

## 22. First Time Adoption of IFRS continued

### Explanation of transition to IFRS

#### 1. Foreign currency translation

Under GAAP, the Company's assessment of its foreign operations as integrated operations required that non-monetary items be translated at historical exchange rates. IFRS, on the other hand, requires that the translation of foreign operation's assets and liabilities for each balance sheet presented be translated at the closing rate at the date of that balance sheet where the functional currency is different from the parent company's functional currency. Revenue and expense items are translated at the average rate of exchange in the period. The functional currency of Carbon Friendly Solutions Inc. is the Canadian dollar, resulting in the Company recognizing cumulative translation adjustments through other comprehensive income (loss) under IFRS. The functional currency of CO2 Reduction is the Polish zloty and MicroCoal is the United States dollar. the resulting cumulative translation adjustment at July 1, 2010 has been reset to zero as permitted an exemption under IFRS.

#### 2. Non-controlling interest

Under GAAP, no non-controlling interest was recognized in respect of the MicroCoal asset acquisition, or its net loss to June 30, 2011, as MicroCoal's book values resulted in a net liability position. In accordance with IFRS 3, on an asset acquisition the Company allocates its purchase consideration to the assets, then notionally grosses up the assets and recognizes the difference as non-controlling interest.

Under IFRS, the non-controlling interest in the equity in a subsidiary not attributable to the parent is presented within equity separately from the equity of the owners of the parent. Similarly total comprehensive income is attributed between the owners of the parent and to the non-controlling interests, even if this results in the non-controlling having a deficit balance.

#### 3. Website development costs

Under IFRS, IAS 38 Development Capitalization Criteria, an intangible asset arising from development (or from the development phase of an internal project) shall be recognized if and only if, an entity can demonstrate all of the following:

- (a) The technical feasibility of completing the intangible asset so that it will be available for use or sale.
- (b) Its intention to complete the intangible asset and use or sell it.
- (c) Its ability to use or sell the intangible asset.
- (d) How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
- (e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- (f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Previously capitalized website development costs have been expensed to profit and loss as they do not meet the criteria for recognition through the probable generation of future economic benefits to the Company

#### 4. Deferred tax

In accordance with IAS 12, the Company reversed recognition of deferred tax liabilities on the purchase of coal technology and plant prototype. Under Canadian GAAP deferred tax liabilities were calculated following the acquisition of these assets, and included in the cost of the assets. IFRS does not allow the recognition of deferred tax liabilities for temporary differences that arise on initial recognition in a transaction other than a business combination that at the time of the transaction affects neither the taxable nor accounting profit or loss. As a result deferred tax liabilities recognized on asset acquisitions under Canadian GAAP have been derecognized under IFRS and reversed out of the asset cost.