



2007 ANNUAL REPORT

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PsiNaptic is a technology company that develops and markets middleware software based on open standards to address the growing need to connect small, low-power wired or wireless devices without human intervention, configuration or set up.

Our Company is driven by the need to reduce complexity in computing networking, and to improve the human experience regarding data consumption in a mobile world. Our vision of the world is one in which billions of small embedded devices, all offering services and information, are connected to a network – a world where mobile devices such as cell phones and PDAs communicate with these and other devices to consume services and information with minimum human intervention. Management believes that PsiNaptic's technology and products play an important role in enabling this seamless communication between mobile and embedded devices.

PsiNaptic solutions operate on multiple platforms, across various networks and in all environments. With PsiNaptic's small-footprint adaptive networking technologies, networks of intelligent objects – from servers to embedded processors and Bluetooth® chips – can dynamically exchange information and services where and when needed, on a single protocol, independent of how the underlying hardware or software is configured and/or managed.

PsiNaptic software products, JMatos® and CMatos, are commercially available. Both add dynamic networking capabilities to Java and non-Java embedded processors, revolutionizing the way devices interact. PsiNaptic software solutions are less than 100k standards-based Java/Jini software which can discover any application, driver or 'service' and move Java byte code between wired or wireless devices.

PsiNaptic's products are particularly applicable to companies developing solutions for handsets, vending machines, home automation, telematics, medical and other vertical markets.

PSINAPTIC PRODUCTS

JMatos®

JMatos is an implementation of the Jini Lookup Service and related protocols that enable very small, embedded processors to offer Java-based services. Fully Jini Network Technology compliant, JMatos' less than 100KB footprint enables resource-constrained devices to find each other and spontaneously offer or consume services on a network.

JMatos extends Jini Network functionality to devices on the edge of the net, making possible an end-to-end pervasive computing solution based on an open standard protocol.

CMatos

Fully Jini Network Technology compliant, CMatos' less than 60KB footprint lookup and discovery protocol enables resource constrained devices to find each other, interconnect and spontaneously offer or consume services on a network or any computing device that acts as a Jini client.

CMatos extends the reach of Java into non-Java devices and enables legacy devices to become Jini network capable. CMatos is available in even smaller footprints for devices that do not need to register external services.

JCopia

In 2005, PsiNaptic commenced development on JCopia to address data and entertainment transmission in the home arena. Devices such as a set-up boxes or appliances brought into the home will auto deploy, find a network, and download initial services such as digital content or an intelligent meter. Automatic updates are managed by JCopia to load, swap and discard services or applications autonomously and efficiently.

Letter to the Shareholders

2007 was a challenging year for PsiNaptic.

Our inability to generate revenue forced the Company to terminate the majority of its employees and to look for alternative funding to keep the company operative. In July 2007 the company signed a letter of intent with Innovative Products for Life Inc. ("IPL") a private company based in Calgary which if approved by PsiNaptic shareholders would result in restructuring the Company's equity, add to its business and add an injection of new capital into the Company. This transaction has yet to be concluded.

However, in spite of its financial difficulties the Company continued to aggressively market its products and technology on the world marketplaces and I am happy to report that these efforts are beginning to show results.

On January 24, 2008 we announced the signing of a memorandum of understanding with a company in India whereby PsiNaptic will license its technology and provide Java applications to that company. This opportunity gives management reason to be optimistic that 2008 will be a year where PsiNaptic will show meaningful revenue.

I want to take this opportunity to thank members of the board of directors who continue to work hard on behalf of all shareholders as well as to the Company employees for their dedication to see that PsiNaptic will prosper.

I am looking forward to providing you with positive news on the Company's growth throughout 2008 and beyond.

Sincerely,

A handwritten signature in blue ink that reads "A. Dagan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Aaron Dagan

President and Chief Executive Officer

Management's Discussion and Analysis

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited financial statements of PsiNaptic Inc. ("PsiNaptic" or "the Corporation") as of September 30, 2007. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A is prepared as of February 8, 2008.

Highlights for the 2007 Fiscal Year

Financial Highlights

<u>For the Years ended September 30</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Revenue	\$ -	\$ -	\$ 43,110
Net earnings (loss)	\$ (639,122)	\$ (787,189)	\$ (736,638)
per share – basic	\$ (0.0179)	\$ (0.0262)	\$ (0.0348)
Cash flow from operations	\$ (265,336)	\$ (761,450)	\$ (707,603)
Working capital	\$ (171,338)	\$ 222,711	\$ 300,359
Total assets	\$ 3,301	\$ 290,780	\$ 382,285
Capital expenditures	\$ -	\$ 5,208	\$ 4,077
Long-term debt	\$ -	\$ -	\$ -
Shareholders' equity (deficiency)	\$ (171,338)	\$ 250,646	\$ 339,314
Weighted average shares outstanding basic	35,903,250	30,075,031	21,177,086
Shares outstanding at period end	37,886,812	33,886,812	23,786,812

FORWARD – LOOKING STATEMENTS

This MD&A contains forward-looking statements, including the Corporation's expectations as to the success of its research and development programs related to JMatos® and CMatos, which involve known and unknown risks and uncertainties, and which could cause the Corporation's actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, among others, the availability of funds and resources to successfully commercialize JMatos® and CMatos. Investors are cautioned against placing undue reliance on forward-looking statements. The Corporation does not undertake to update these forward-looking statements unless required under securities laws.

Comparison of the years ended September 30, 2007 and 2006

HIGHLIGHTS

2007

PsiNaptic downsizes to minimal staff.

Products continue to be marketed to selected potential customers.

2006

PsiNaptic markets energy management demonstration program.

PsiNaptic and a major automotive tier one supplier collaborate to integrate mobile devices with car radios.

PsiNaptic makes JCopia software available for the remote management of IP (Internet protocol) connected devices.

RESULTS OF OPERATIONS

PsiNaptic incurred an operating loss of \$641,421 in the year ended September 30, 2007, which compares to an operating loss of \$798,571 in the year ended September 30, 2006. The net loss was \$639,122 for the year ended September 30, 2007 compared to net loss of \$787,189 for the year ended September 30, 2006. This reduction reflects scaling back operations which took place in the fiscal third quarter.

OPERATING EXPENSES

Total operating expenses decreased to \$641,421 in the year ended September 30, 2007 from \$798,571 in the year ended September 30, 2006. Salaries, including consultants, and benefits were \$410,300 in the year ended September 30, 2007 compared to \$458,600 in the year ended September 30, 2006. Of the amount for this year \$200,000 was paid by shares in lieu of cash. Other general and administrative expenses decreased to \$183,103 in the year ended September 30, 2007 from \$239,914 in the year ended September 30, 2006. This decrease is largely due to PsiNaptic severely reducing all of its overhead expenses commencing in the fiscal third quarter.

Marketing expenses decreased to \$20,565 in the year ended September 30, 2007 from \$76,953 in the year ended September 30, 2006. PsiNaptic continued to market its software in England, France, and Israel and expanded its efforts to include India.

RECOVERIES AND OTHER INCOME

PsiNaptic has not generated any licensing revenue in either 2007 or 2006.

In addition, PsiNaptic has not recorded any consulting revenue in either 2007 or 2006.

FINANCIAL CONDITION

Funds used in operations were \$265,336 in the year ended September 30, 2007, compared to \$761,450 used in the year ended September 30, 2006.

PsiNaptic relied on funding (\$13,999 principal by way of 8% convertible notes) from its directors and interest free advances (\$6,500) from a shareholder during fiscal 2007.

Funding activities during the year ended September 30, 2006 resulted in gross proceeds of \$700,000 - \$400,000 from the private placement of 8,000,000 Class A common shares at \$0.05 (net proceeds, after financing costs of \$17,430 were \$382,570) and \$300,000 from the private placement of 2,000,000 Class A common shares at \$0.15 (net proceeds, after financing costs of \$4,728 were \$295,272).

Comparison of the three months ended September 30, 2007 and 2006

HIGHLIGHTS

2007

Products continue to be selectively marketed; results in Memorandum of Understanding announced in January 2008.

2006

On September 21, 2006 PsiNaptic announced that it collaborated with a major automotive tier one supplier to successfully integrate mobile devices with car radios.

On September 25, 2006 PsiNaptic announced that JCopia software is now available for the remote management of IP (Internet Protocol) connected devices.

RESULTS OF OPERATIONS

PsiNaptic incurred an operating loss of \$119,114 in the quarter ended September 30, 2007, which compares to an operating loss of \$205,092 in the quarter ended September 30, 2006. The net loss was \$119,114 for the quarter ended September 30, 2007 compared to net loss of \$202,020 for the quarter ended September 30, 2006.

OPERATING EXPENSES

Total operating expenses decreased to \$119,114 in the quarter ended September 30, 2007 compared to \$205,092 in the quarter ended September 30, 2006. Salaries, including consultants, and benefits were \$39,000 in the quarter ended September 30, 2007 compared to \$105,649 in the quarter ended September 30, 2006. These salaries remain outstanding. Other general and administrative expenses decreased to \$60,823 in the quarter ended September 30, 2007 from \$72,222 in the quarter ended September 30, 2006. This decrease reflects the reduction in overhead expenses.

No out-of-pocket marketing expenses were incurred in the quarter ended September 30, 2007 compared to an expenditure of \$22,032 in the quarter ended September 30, 2006, primarily due to promotion and travel expenses.

RECOVERIES AND OTHER INCOME

PsiNaptic earned net interest income of nil in the quarter ended September 30, 2007 compared to \$3,072 in the quarter ended September 30, 2006.

FINANCIAL CONDITION

Funds used in operations were \$24,397 in the current quarter compared to an outflow of funds of \$184,279 in the quarter ended September 30, 2006. This was due to the Company increasing its liabilities and reducing its expenditure of cash.

During fiscal 2007, the Company's issuance of 8% convertible notes to its directors and receipt of advances from a shareholder are considered transactions with related parties. During fiscal 2006, the Company did not engage in any transactions with related parties.

HISTORICAL FINANCIAL INFORMATION

	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Year ended September 30, 2007:				
Research and consulting	\$ -	\$ 9,143	\$ 37,827	\$ 28,460
Marketing	\$ -	\$ 2,733	\$ 112,724	\$ 25,836
General & administrative	\$ 99,823	\$ 84,742	\$ 160,225	\$ 53,972
Depreciation	\$ 2,427	\$ 2,150	\$ 2,172	\$ 2,323
Asset impairment	\$ 16,864	-	-	-
Total revenue (interest)	<u>\$ -</u>	<u>\$ (15)</u>	<u>\$ (535)</u>	<u>\$ (1,749)</u>
Net Loss	<u>\$119,114</u>	<u>\$ 98,753</u>	<u>\$ 312,413**</u>	<u>\$108,842</u>
Net Loss per share	\$ 0.0031	\$ 0.0026	\$ 0.0092	\$0.0032
Year ended September 30, 2006:				
Research and consulting	\$ 33,631	\$ 39,328	\$ 36,289	\$ 31,369
Marketing	\$ 59,238	\$ 82,165	\$ 46,133	\$ 65,414
General & administrative	\$108,201	\$ 112,021	\$ 85,909	\$ 81,565
Depreciation	\$ 4,022	\$ 4,265	\$ 4,499	\$ 4,523
Total revenue (interest)	<u>\$ (3,072)</u>	<u>\$ (4,556)</u>	<u>\$ (2,339)</u>	<u>\$ (1,416)</u>
Net Loss	<u>\$205,092</u>	<u>\$ 237,779</u>	<u>\$ 172,830</u>	<u>\$182,871</u>
Net Loss per share	\$ 0.0060	\$ 0.0083	\$ 0.0059	\$0.0076

** reflects issuance of shares in lieu of cash with a market value of \$200,000.

Loss per share has been calculated using the weighted average number of Class A common shares outstanding during the year of 35,903,250 (2006 - 30,075,031, 2005 -21,177,086).

Diluted loss per share is not disclosed in these financial statements as the exercise of the stock options is anti-dilutive.

LIQUIDITY AND CAPITAL RESOURCES

Management believes there is substantial doubt about our ability to continue as a going concern.

Subsequent to September 30, 2007 we continued to rely on additional proceeds from the issuance of convertible notes to directors and non-interest bearing advances from a shareholder and also from Innovative Products for Life, Inc. ("IPL"). The previously announced reverse take-over ("RTO") is conditional on completion of a private placement financing which would have generated sufficient working capital for us to continue in a stable manner. The RTO has taken a prolonged period to be concluded. We continue to seek alternative sources of capital or convertible financing in order to fund future operations. If successful, it is the intention of the Company to continue to pursue the licensing opportunity with a company based in India, as was announced January 24, 2008.

There can be, however, no certainty that such new financing will be available or be available on reasonable terms or that the licensing opportunity in India will transpire. To the extent that financing is not available or not available on reasonable terms, the Company may not be able to continue as a going concern.

Changes in Accounting Policies including Initial Adoption

On October 1, 2006, the Company was required to adopt new accounting standards issued by the Canadian Institute of Chartered Accountants, in Sections 1530 "Comprehensive Income", 3855 "Financial Instruments - Recognition and Measurement", and 3861 "Financial Instruments - Disclosure and Presentation".

Under the new standards, financial assets and financial liabilities are initially recognized at fair value on the balance sheet. Subsequent measurement of the financial instruments is based on their classification as either: loans and receivables, held-to-maturity financial assets, available-for-sale financial assets, held-for-trading financial assets and liabilities, and other financial liabilities. Held-for-trading and available-for-sale financial instruments are revalued each reporting period at fair value, with gains and losses recognized in net income and other comprehensive income, respectively. All other categories of financial instruments are recognized at amortized cost using the effective interest rate method.

The Company will be required to adopt Sections 3862 "Financial Instruments - Disclosures" and Section 3863 "Financial Instruments - Presentation" on October 1, 2007. It is expected the effect on the Company financial statements will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

As at October 1, 2008, the Company will also be required to adopt Section 1535 "Capital Disclosures" which requires entities to disclose their objectives, policies and processes for managing capital and whether the Company has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard and anticipates that the main impact will be additional financial statement note disclosure.

ADDITIONAL INFORMATION

Additional information relating to PsiNaptic can be located on SEDAR at www.sedar.com.

Management's Responsibility for Financial Statements

The accompanying audited financial statements and all of the information included in this annual report have been prepared by and are the responsibility of management and have been recommended by the audit committee for approval by the Board of Directors. The annual financial statements have been prepared in accordance with generally accepted accounting principles and reflect management's best estimates and judgements based on current information. The significant accounting policies which management believes are appropriate for the Company are described in Note 3 of the annual financial statements.

The Company has developed and maintains an appropriate system for internal controls in order to ensure, on a reasonable and cost-effective basis, that relevant and reliable financial information is produced.

The Audit Committee is appointed by the Board and consists of two independent Directors and the President. To discharge its duties the Audit Committee meets regularly with management and Deloitte & Touche LLP to discuss internal controls, accounting and financial reporting processes, audit plans and financial matters.

Deloitte & Touche LLP is responsible for auditing the financial statements and expressing their opinion thereon and their report is presented separately. The external auditors have full and free access to meet with management, the Audit Committee and the independent members thereof.

Aaron Dagan
President and Chief Executive Officer

Morris Bleviss
Chief Financial Officer

February 8, 2008

Auditors' Report

To the Shareholders of PsiNaptic Inc.:

We have audited the balance sheets of PsiNaptic Inc. as at September 30, 2007 and 2006 and the statements of loss and deficit and cash flows for the years ended September 30, 2007 and 2006 and cumulative from inception on December 16, 1999. 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 financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2007 and 2006 and the results of its operations and its cash flows for the years ended September 30, 2007 and 2006 and cumulative from inception on December 16, 1999 in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
January 29, 2008

DELOITTE & TOUCHE LLP
Chartered Accountants

PSINAPTIC INC.

Statements of Loss and Deficit

*Years Ended September 30, 2007 and 2006 and
Cumulative From Inception on December 16, 1999*

	September 30, 2007 \$	September 30, 2006 \$	Cumulative From Inception on December 16, 1999 \$
REVENUE			
Licensing	-	-	17,856
Consulting	-	-	43,659
	-	-	61,515
EXPENSES			
Depreciation and amortization	9,072	17,309	279,321
Impairment of assets	16,864	-	16,864
General and administrative	398,532	387,695	2,452,423
Marketing	141,293	252,950	1,775,572
Research and consulting	75,430	140,617	2,247,795
	641,421	798,571	6,771,975
LOSS BEFORE OTHER INCOME	(641,421)	(798,571)	(6,710,460)
OTHER INCOME			
Interest income	2,299	11,382	123,067
IRAP expense recovery	-	-	211,197
SR&ED tax credits	-	-	620,152
	2,299	11,382	954,416
NET LOSS	(639,122)	(787,189)	(5,756,044)
DEFICIT, BEGINNING OF YEAR	(5,116,922)	(4,329,733)	-
DEFICIT, END OF YEAR	(5,756,044)	(5,116,922)	(5,756,044)
LOSS PER SHARE (Note 9)	(0.0179)	(0.0262)	-

PSINAPTIC INC.

Balance Sheets

As at September 30, 2007 and 2006

	2007 \$	2006 \$
ASSETS		
CURRENT		
Cash	1,484	13,909
Short-term investments	-	229,969
Accounts receivable	1,817	3,472
Prepaid expenses	-	15,495
	<u>3,301</u>	<u>262,845</u>
Capital assets (Note 4)	-	25,648
Intellectual property (Note 5)	-	2,287
	<u>3,301</u>	<u>290,780</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	153,697	40,134
Convertible notes (Note 10)	14,442	-
Shareholder advances	6,500	-
	<u>174,639</u>	<u>40,134</u>
SHAREHOLDERS' DEFICIENCY		
Share capital (Note 6)		
Common Shares	5,466,256	5,266,256
Contributed Surplus	118,450	101,312
	<u>5,584,706</u>	<u>5,367,568</u>
Deficit	(5,756,044)	(5,116,922)
	<u>(171,338)</u>	<u>250,646</u>
	<u>3,301</u>	<u>290,780</u>

APPROVED ON BEHALF OF THE BOARD

"Stuart M. Olley"
..... Director

"Aaron Dagan"
..... Director

PSINAPTIC INC.

Statements of Cash Flows

*Years Ended September 30, 2007 and 2006 and
Cumulative From Inception on December 16, 1999*

	September 30, 2007 \$	September 30, 2006 \$	Cumulative From Inception on December 16, 1999 \$
OPERATING			
Net Loss	(639,122)	(787,189)	(5,756,044)
Adjustments for:			
Depreciation and amortization	9,072	17,309	279,321
Impairment of assets	16,864	-	16,864
Non-cash salary/consulting expense (Note 12)	200,000	-	300,000
Stock-based compensation	17,138	10,679	29,701
	(396,048)	(759,201)	(5,130,158)
Changes in non-cash working capital:			
Accounts receivable	1,655	954	(1,817)
Prepaid expenses	15,495	(366)	-
Accounts payable and accrued liabilities	113,562	(2,837)	153,696
	(265,336)	(761,450)	(4,978,279)
INVESTING			
Redemption of short-term investments	229,969	80,618	-
Sale (purchase) of capital assets	2,000	(5,208)	(240,483)
Protection of intellectual property	-	(1,081)	(74,220)
SR&ED recovery on capital assets	-	-	18,518
	231,969	74,329	(296,185)
FINANCING			
Issuance of shares, net of expenses	-	687,842	5,255,006
Issuance of convertible notes (inc. interest)	14,442	-	14,442
Shareholder advances	6,500	-	6,500
	20,942	687,842	5,275,948
NET (DECREASE) INCREASE IN CASH	(12,425)	721	1,484
CASH, BEGINNING OF YEAR	13,188	13,188	-
CASH, END OF YEAR	1,484	13,909	1,484

Notes to the Financial Statements

Years Ended September 30, 2007 and 2006

1. BASIS OF PRESENTATION AND GOING CONCERN ASSUMPTION

At September 30, 2007, PsiNaptic Inc. ("the Company") had a deficit of \$5,756,044, and a working capital deficiency of \$156,337. The future success of the Company is dependent upon obtaining the continuing support of its unsecured creditors, convertible note holders, directors and shareholders and obtaining additional financing to satisfy these creditors.

These financial statements have been prepared using Canadian generally accepted accounting principles and are presented on a liquidation basis. At September 30, 2007, the assets have been adjusted to their net realizable amounts. Management has used its best estimate to determine the net realizable amounts for all assets. Accounts payable and accrued liabilities are stated at the estimated amounts required to settle the obligations. Actual amounts may change from these estimates. It is management's intention to pursue a financing agreement that will allow them to settle these liabilities.

2. NATURE OF OPERATIONS

The Company was incorporated on December 16, 1999 under the Business Corporations Act (Alberta) as 858393 Alberta Inc. On January 6, 2000, the Company changed its name to PsiNaptic Communications Inc. On May 1, 2001, the Company changed its name to PsiNaptic Inc. To date, the Company has not earned significant revenues and is considered to be in the development stage. The Company's focus has been research and development of deeply embedded wireless Java modules. These devices are intended for use in wireless distributed computing environments and are targeted for sale to original equipment manufacturers.

3. SIGNIFICANT ACCOUNTING POLICIES

Cash

Cash includes cash on hand, balances with banks.

Short-term investments

Short-term investments are short-term deposits with a maturity of less than 90 days from the date of purchase and are valued at the lower of cost and market value.

Capital assets

Capital assets are recorded at cost and are depreciated over their useful lives, from the month of acquisition, using the declining-balance method at the following annual rates:

Office furniture	20%
Tools and equipment	30%
Computer hardware	30%
Computer software	30% to 100%
Development tools	100%

Intellectual property

Intellectual property consists of patents and trademarks, which are recorded at cost and amortized on a straight-line basis over their useful lives, from the month of acquisition. The estimated useful life of the intellectual property is four years.

Research and development costs

Research costs are expensed as incurred. The costs of developing new products are capitalized as deferred development costs if they meet the Canadian Institute of Chartered Accountant's ("CICA") development capitalization criteria related to technical, financial and market feasibility. To date, all of the development costs have been expensed as all of the criteria for deferral has not yet been met.

Scientific research and experimental development investment tax credits (SRED)

Scientific research and experimental development investment tax credits are accounted for using the income approach and are recorded upon receipt of the credit. Credits are recorded as either a reduction of the cost of applicable assets or included in income depending on the nature of the expenditures that gave rise to the credits. With the completion of its initial public offering in 2004 the Company continues to qualify for SRED credits to apply against future taxes payable; however, the credits are no longer refundable.

Revenue recognition

The Company recognizes revenue when a licence agreement with the customer has been signed, the software product has been delivered, the amount of the fees to be paid by the customer is fixed and determinable, and collection of these fees is deemed probable. If collectability is not considered probable, revenue is recognized when the fee is collected.

The Company enters into software licence agreements that provide for future royalty/license payments to be made based on a per unit fee. These arrangements often specify a quarterly minimum payment. Revenue from the minimum payments is recognized on a straight-line basis. Revenue associated with unit fees in excess of any minimum payments is recognized when the amount becomes determinable, generally on a quarterly basis.

Future income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Stock based compensation

The Company has an incentive stock option plan as described in Note 6, which is administered by the Board of Directors and accounted for using the fair value based method, as defined by the CICA. The fair value method established the standards of recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services provided by employees and non-employees. Compensation expense is recognized on the fair value of the options as on the grant date and is amortized over the vesting life with an offsetting amount recorded in contributed surplus. Any consideration paid on exercise of stock options or purchase of stock is credited to share capital.

Financial instruments

On October 1, 2006, the Company was required to adopt new accounting standards issued by the Canadian Institute of Chartered Accountants, in Sections 1530 "Comprehensive Income", 3855 "Financial Instruments - Recognition and Measurement", and 3861 "Financial Instruments - Disclosure and Presentation".

Under the new standards, financial assets and financial liabilities are initially recognized at fair value on the balance sheet. Subsequent measurement of the financial instruments is based on their classification as either: loans and receivables, held-to-maturity financial assets, available-for-sale financial assets, held-for-trading financial assets and liabilities, and other financial liabilities. Held-for-trading and available-for-sale financial instruments are revalued each reporting period at fair value, with gains and losses recognized in net income and other comprehensive income, respectively. All other categories of financial instruments are recognized at amortized cost using the effective interest rate method.

The Company will be required to adopt Sections 3862 "Financial Instruments - Disclosures" and Section 3863 "Financial Instruments - Presentation" on October 1, 2007. It is expected the effect on the Company financial statements will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

As at October 1, 2007, the Company will also be required to adopt Section 1535 "Capital Disclosures" which requires entities to disclose their objectives, policies and processes for managing capital and whether the Company has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard and anticipates that the main impact will be additional financial statement note disclosure.

4. CAPITAL ASSETS

	Cost \$	Accumulated Depreciation \$	Impairment \$	Net Book Value \$
Office furniture	8,221	6,122	2,099	-
Tools and equipment	52,021	46,772	5,249	-
Computer hardware	40,533	32,844	7,689	-
Computer software	11,667	10,906	761	-
Development tools	101,411	101,411	-	-
	213,853	198,055	15,798	-

2006			
	Cost \$	Accumulated Depreciation \$	Net Book Value \$
Office furniture	17,953	12,451	5,502
Tools and equipment	52,021	44,523	7,498
Computer hardware	40,533	29,549	10,984
Computer software	11,667	10,580	1,087
Development tools	101,411	100,834	577
	223,585	197,937	25,648

During the year the Company assessed that the assets were impaired and recognized an impairment in the amount of \$15,798 (2006 - \$Nil) to record the impairment.

5. INTELLECTUAL PROPERTY

	Cost \$	Accumulated Amortization \$	Asset Impairment \$	Net Book Value \$
Patents and trademarks	57,759	56,693	1,066	-

2006			
	Cost \$	Accumulated Amortization \$	Net Book Value \$
Patents and trademarks	57,759	55,472	2,287

Amortization of \$1,221 (2006 - \$6,935) on the patents and trademarks is included in depreciation and amortization expense.

During the year the Company assessed that the assets were impaired and recognized an impairment in the amount of \$1,066 (2006 - \$Nil).

6. **SHARE CAPITAL**

	Number of Shares	Amount \$
Authorized		
Unlimited number of Class A common voting shares		
Unlimited number of Class B common non-voting shares		
Unlimited number of Special Warrants, issuable in series		
Issued		
<i>Common shares</i>		
Class A common shares		
Balance, September 30, 2005	23,786,812	4,578,414
Private placement at \$0.05 per share	8,000,000	400,000
Private placement at \$0.15 per unit	2,000,000	300,000
Less financing costs	-	(22,158)
Options exercised at \$0.10 per share	100,000	10,000
Balance, September 30, 2006	33,886,812	5,266,256
Shares issued in lieu at \$0.05 per share (Note 12)	4,000,000	200,000
Balance, September 30, 2007	37,886,812	5,466,256
<i>Contributed Surplus</i>		
Balance, September 30, 2006	-	101,312
Stock based compensation	-	17,138
Balance, September 30, 2007	-	118,450
Total, September 30, 2006	33,886,812	5,367,568
Total, September 30, 2007	37,886,812	5,584,706

Stock options

On September 22, 2003, the Company cancelled the existing stock option plan and adopted a new stock option plan for directors, officers, employees and consultants who help achieve the long-term objectives of the Company. The Board of Directors administers the plan. Under this plan, the directors can specify the exercise price and vesting terms on an individual basis. Options granted under this plan cannot expire more than five years after being granted.

The total number of options outstanding under this plan cannot exceed 10% of the issued and outstanding common shares. The Company has reserved 3,788,681 common shares and has granted options to purchase 2,152,500 common shares at an average price of \$0.18. In the event of resignation, retirement or termination, the optionee has 30 days to exercise the options.

Details of options outstanding under the plan are as follows:

Expiry	2007			
	Number of Options	Exercise Price	Weighted Average Contractual Life (Years)	Number Exercisable
September 15, 2008	1,054,500	\$0.25	.95	1,054,500
November 21, 2008	40,000	\$0.25	1.15	40,000
January 5, 2009	10,000	\$0.37	1.27	10,000
June 14, 2010	88,000	\$0.15	2.71	88,000
September 20, 2010	160,000	\$0.10	2.98	160,000
January 31, 2011	800,000	\$0.10	3.33	600,000
	2,152,500			1,952,500

	2007		2006	
	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
Outstanding, beginning of year	2,413,500	\$0.24	1,613,500	\$0.31
Granted	-	-	1,000,000	\$0.10
Exercised	-	-	(100,000)	\$0.10
Expired/forfeited	(261,000)	\$0.75	(100,000)	\$0.10
Outstanding, end of year	2,152,500	\$0.18	2,413,500	\$0.24

The Company has estimated the value of the options granted during past years using the Black-Scholes option pricing model. Based on the assumptions therein, the Company recorded \$17,138 (2006-\$10,679) on account of stock-based compensation expense for the year ended September 30, 2007.

For the options granted in 2006, the value was calculated based on an exercise price of \$0.10 per share, a risk-free interest rate of 4.04%, a vesting life of five years, and an expected volatility rate of 380%.

7. COMMITMENTS.

The Company has no leasing agreements or service arrangements.

8. INCOME TAXES

The Company has accumulated the following tax balances, the future benefit of which has not been reflected in these financial statements.

Non-capital losses of approximately \$4,250,000 available for carryforward expire as follows:

	\$
2008	865,000
2009	294,000
2010	795,000
2014	792,000
2015	844,000
2027	660,000

Investment tax credits of approximately \$53,000 are available for carryforward and expire between 2011 and 2014.

Unclaimed scientific research and experimental development expenditures of approximately \$672,000 carry forward indefinitely.

9. PER SHARE AMOUNTS

Loss per share has been calculated using the weighted average number of Class A common shares outstanding during the year of 35,903,250 (2006 - 30,075,031).

Diluted loss per share is not disclosed in these financial statements as the exercise of the stock options is anti-dilutive.

10. CONVERTIBLE NOTES

During the year, the Company issued convertible notes to certain directors of the Company, in the principal amount of \$14,000. The notes bear interest at the rate of 8% compounded monthly and can be converted to Class A common shares at the rate of the lesser of the lowest price at which the shares trade after the date of issue and \$0.05 per share. At September 30, 2007, the convertible notes include \$442 (2006 - \$Nil) in accrued interest.

11. CONTINGENCIES

On December 9, 2005, the Company commenced legal action arising from the breach of a licensing agreement for \$200,000 plus interest and court costs. The defendant has made a counterclaim for \$400,000 for misrepresentations and breach of the same contract. Management believes the counterclaim is without merit. No amount with respect to either of these claims has been accrued in these financial statements as the outcome is not determinable.

12. RELATED PARTIES

During the year 4,000,000 shares were issued to employees and directors of the Company in the amount of \$200,000. These were issued in lieu of salaries owed to the individuals and was recorded at the fair market value of the shares on the date of transaction.

Corporate Information

BOARD OF DIRECTORS

Aaron Dagan*
President & CEO
PsiNaptic Inc.

Stuart M. Olley*
Partner,
Stikeman Elliott LLP

Andrew L. Oppenheim
Partner,
Gowling Lafleur Henderson LLP

Stephen Eyre*
Alliance Manager
Microsoft Canada

MANAGEMENT TEAM

Aaron Dagan
President & CEO

Morris Bleviss
Chief Financial Officer

* member of Audit Committee

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BANKER

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REGISTRAR AND TRANSFER AGENT

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SHAREHOLDER INFORMATION

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STOCK EXCHANGE LISTING

TSX Venture Exchange

Trading Symbol: PST