

TRUE NORTH CORPORATION
Unaudited Interim Consolidated Financial Statements
September 30, 2007

Prepared by Management

TRUE NORTH CORPORATION

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September 30, 2007

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TRUE NORTH CORPORATION
Consolidated Balance Sheets
As at September 30, 2007 and December 31, 2006
(unaudited)

	Sept 30	Dec 31
	2007	2006
ASSETS		
CURRENT		
Cash	\$ 35,602	\$ 95,435
Short-term investments	150,025	352,383
Accounts receivable	1,438,417	2,564,089
Work in progress	322,366	227,796
Income taxes recoverable	20,620	20,620
Prepaid expenses	212,998	164,483
	<u>2,180,028</u>	<u>3,424,806</u>
Other		
Property and equipment (note 4)	598,216	824,925
Intangible assets (note 5)	1,923,872	3,225,256
	<u>2,522,088</u>	<u>4,050,181</u>
	<u>\$ 4,702,116</u>	<u>\$ 7,474,987</u>

TRUE NORTH CORPORATION
Consolidated Balance Sheets
As at September 30, 2007 and December 31, 2006
(unaudited)

	Sept 30 2007	Dec 31 2006
LIABILITIES		
CURRENT		
Bank indebtedness (note 6)	\$ -	\$ 1,092,847
Operating line of credit (note 7)	866,215	-
Accounts payable and accrued liabilities	2,859,476	3,596,070
Deferred revenue	754,656	861,163
Due to related parties (note 11)	42,039	61,310
Current portion, capital leases (note 8)	2,050	17,007
Debentures (note 10)	1,412,513	-
Promissory notes payable (note 9)	599,570	285,000
	6,536,519	5,913,397
LONG TERM		
Debentures (note 10)	3,881,271	3,773,296
Capital leases (note 8)	-	1,329
	3,881,271	3,774,625
	10,417,790	9,688,022
SHAREHOLDERS' DEFICIT		
SHARE CAPITAL (note 12)	4,871,387	4,850,387
EQUITY COMPONENT OF DEBENTURES (note 10)	772,272	290,120
CONTRIBUTED SURPLUS (note 12)	698,237	507,510
(DEFICIT)	(12,057,570)	(7,861,052)
	(5,715,674)	(2,213,035)
	\$ 4,702,116	\$ 7,474,987

Going Concern (note 1)
Commitments, Contingencies and Subsequent Events (notes 17, 21 and 24)
Approved on behalf of the Board:

TRUE NORTH CORPORATION
Consolidated Statements of Deficit
For the Nine Months Ended September 30, 2007 and 2006
(unaudited)

	Sept 30 2007 (3 months)	Sept 30 2006 (3 months)	Sept 30 2007 (9 months)	Sept 30 2006 (9 months)
DEFICIT , beginning of period	(\$11,067,240)	(\$3,872,252)	(\$7,861,052)	(\$1,938,667)
NET LOSS FOR THE PERIOD	(990,330)	(1,110,319)	(4,196,518)	(3,043,904)
DEFICIT , end of period	(\$12,057,570)	(\$4,982,571)	(\$12,057,750)	(\$4,982,571)

TRUE NORTH CORPORATION
Consolidated Statements of Operations
For the Nine Months Ended September 30, 2007 and 2006
(unaudited)

	Sept 30 2007 (3 months)	Sept 30 2006 (3 months)	Sept 30 2007 (9 months)	Sept 30 2006 (9 months)
REVENUE	\$ 2,395,393	\$ 1,797,292	\$ 7,618,434	\$ 8,046,530
DIRECT COSTS	498,052	738,190	2,285,676	4,252,680
GROSS PROFIT	1,897,341	1,059,102	5,332,758	3,793,850
Selling, administrative and general expenses	2,087,493	1,494,596	6,030,536	5,014,307
	(190,152)	(435,494)	(697,778)	(1,220,457)
Amortization of property and equipment	57,404	49,058	238,661	113,527
Amortization of intangible assets	429,101	13,062	1,301,385	39,186
Interest and transaction costs on long-term debt (note 13)	127,180	41,933	565,138	145,604
Interest on long-term debt	137,757	51,700	378,493	148,433
Other expenses (note 14)	-	495,868	882,086	895,868
Write down of intangible assets	-	-	-	457,625
Stock-based compensation (note 12(c))	48,736	23,204	132,977	23,204
	800,178	674,825	3,498,740	1,823,447
NET LOSS AND COMPREHENSIVE FOR THE PERIOD	(\$990,330)	(\$1,110,319)	(\$4,196,518)	(\$3,043,904)
BASIC AND DILUTED LOSS PER SHARE	(\$0.02)	(\$0.05)	(\$.08)	(\$0.14)
AVERAGE NUMBER OF SHARES OUTSTANDING	49,543,913	22,324,968	49,523,583	21,214,308

{See accompanying notes.}

TRUE NORTH CORPORATION
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 2007 and 2006
(unaudited)

	Sept 30 2007 (3 months)	Sept 30 2006 (3 months)	Sept 30 2007 (9 months)	Sept 30 2006 (9 months)
CASH PROVIDED BY (USED IN)				
OPERATING ACTIVITIES				
Net loss for the period	(\$990,330)	(\$1,110,319)	(4,196,518)	(\$3,043,904)
Items not involving cash:				
Amortization of capital assets	57,404	49,058	238,661	113,527
Amortization of intangible assets	429,101	13,062	1,301,385	39,186
Amortization of debt financing costs	-	8,672	-	39,631
Write-down of loan receivable		513,151		910,734
Write-down of intangible assets	-	-	-	457,625
Accretion expense on debentures	82,416	-	143,811	-
Stock-based compensation expense	48,736	23,204	132,977	23,204
Loss on extinguishment of debt	-	-	468,457	-
	(372,673)	(503,172)	(1,911,227)	(1,459,997)
Changes in non-cash working capital items (note 16)	(297,583)	448,349	139,485	1,189,209
Cash provided by (used in) operating activities	(670,256)	(54,823)	(1,771,742)	(270,788)
FINANCING ACTIVITIES				
Repayments under bank indebtedness – net	(1,000)	(315,000)	(1,092,847)	(379,203)
Proceeds from operating line of credit	87,793	-	866,215	-
Proceeds from debentures	207,693	-	1,907,693	250,000
Repayment of promissory notes payable	(60,000)	-	(145,000)	-
Repayments of amounts due to related parties – net	(5,807)	24,431	(19,273)	(475,892)
Repayment of obligation under capital leases	(5,872)	-	(16,285)	-
Financing costs	-	-	-	(45,935)
Proceeds from exercise of options	-	-	21,000	-
Proceeds from issue of common shares	-	378,000	-	878,000
Share issue costs	-	(30,700)	-	(81,962)
Cash provided by (used in) financing activities	222,807	56,731	1,521,503	145,008
INVESTING ACTIVITIES				
Acquisition of property and equipment	(63)	(1,908)	(11,952)	(18,593)
Redemption of short-term investments – net	469,975	-	202,358	-
Cash (used in) investing activities	469,912	(1,908)	190,406	(18,593)
INCREASE (DECREASE) IN CASH	(22,463)	-	(59,833)	(144,373)
CASH, BEGINNING OF PERIOD	13,139	-	95,435	144,373
CASH, END OF PERIOD	\$ 35,602	\$ -	\$ 35,602	\$ -

TRUE NORTH CORPORATION

Notes to Interim Consolidated Financial Statements (unaudited)

1. **BACKGROUND INFORMATION**

Nature of Operations

True North Corporation is a leading outsourced marketing services organization that provides sales, marketing and advertising agency services to numerous clients across a wide spectrum of industries including a fully integrated online marketing solution using its suite of promotions products.

Interim financial information

The financial information for the three-month and nine month periods ended September 30, 2007 and 2006 is unaudited. However, in the opinion of management, all adjustments necessary to present fairly the results of these periods have been included. The adjustments made were of a normal recurring nature. Interim results may not necessarily be indicative of results for the year.

These unaudited interim consolidated financial statements use the same accounting policies and methods used in the preparation of the Company's most recent annual consolidated financial statements, except as disclosed in note 2. All disclosures required for annual financial statements have not been included in these financial statements. These unaudited interim consolidated financial statements should therefore be read in conjunction with the Company's most recent audited annual consolidated financial statements.

Going Concern

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern which assumes that the Company will realize on its assets and satisfy its obligations as they become due in the normal course of operations. The Company recorded net losses of approximately \$5.9 million and \$4.2 million for the year ended December 31, 2006, and the nine months ended September 30, 2007, respectively, the Company has a cumulative deficit of approximately \$12.1 million and its current liabilities exceed its current assets at September 30, 2007 by approximately \$4.3 million. These circumstances lend doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, to the appropriateness of the use of accounting principles applicable to a going concern. The Company's ability to continue as a going concern is dependent on the successful execution of management's business plan, which includes the Company receiving the continued support of its lenders and other creditors, its ability to secure additional financing and its ability to generate future positive cash flow. While the Company was successful in issuing a \$1.7 million convertible debenture to Quorum Investment Pool Limited Partnership ("QIP") on May 22, 2007, maturing May 22, 2012 (See note 10 (d)) and \$0.2 million secured debenture to QIP on September 26, 2007 (See Note 10), and subsequent subscriptions of secured debentures of \$0.1M on October 12, 2007 and \$0.3M on October 30, 2007, maturing on January 15, 2008 (See notes 24(b) and 24 (d)), there is no assurance that management will be successful in raising additional capital or attaining positive cash flows from operations. If the going concern assumption was not appropriate for these financial statements, adjustments would be necessary in the carrying values of assets and liabilities, reported income and expenses and in the balance sheet classifications used. Such adjustments could be material.

Basis of Consolidation

These consolidated financial statements present the accounts of True North Corporation and its wholly-owned subsidiaries: Ross David Smith Enterprises Ltd.; TNAG True North Advertising Group Inc.; Empirical Corp (formerly Essentia Marketing Inc); Artshouse Communications Inc; AVP Event Marketing Inc.; C3 Online Marketing Inc; 1269483 Ontario Limited; and Empirical Research

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& Development Ltd. During the 2006 fiscal year, True North Corporation's wholly owned subsidiary, Local Knowledge Advertising & Promotions Inc., was dissolved. (The consolidated entities are hereafter referred to as "the Company.") All significant intercompany accounts and transactions have been eliminated.

2. **CHANGES IN ACCOUNTING POLICIES**

On January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855, "Financial Instruments - Recognition and Measurement." Section 1530 "Comprehensive Income" and Section 1506 "Accounting Changes". These standards have been adopted on a prospective basis.

The new recommendations covering financial instruments prescribe when such instruments and the amount are to be recognized on the balance sheet; sometimes using fair value and other times using cost-based measures. They also specify how financial instrument gains and losses are to be presented and define financial instruments to include accounts receivable and payable, loans, investments in debt and equity securities, and derivative contracts.

Upon the adoption of Section 3855, the Company classified cash and cash equivalents and short-term investments, bank indebtedness and operating line of credit as held for trading, and are measured at fair value. Accounts receivable are classified as loans and receivables and are measured at fair value. Accounts payable and accrued liabilities and due to related parties are classified as held for trading and are measured at fair value. Promissory notes payable and long-term debt including debentures, are classified as other financial liabilities and are measured at amortized cost. Transaction costs are recognized immediately in net income.

Prior to implementation of Section 3855 on January 1, 2007, transaction costs in respect of the issue of debt instruments were deferred and amortized to earnings over the term of the related debt financing. Since the implementation of Section 3855 on January 1, 2007, transaction costs are recognized in net income. Under the new standards, policies followed prior to the effective date generally are not changed and, therefore the comparative figures have not been restated. There were no unamortized transaction costs at December 31, 2006 and hence all transaction costs reported for the three and nine months ending September 30, 2007 as set out in Note 13 - Interest and Transaction costs represent transaction costs incurred in these respective periods. Transaction costs reported for the three and nine month periods ending September 30, 2006 as set out in Note 13 - Interest and Transaction costs represent amortization of transaction costs incurred in respect of previously issued debt instruments.

The new recommendations also require the Company to present among other things, certain unrealized gains and losses outside of net income or loss. Section 1530 defines comprehensive income as the change in equity (net assets) arising from transactions and other events and circumstances from non-owner sources. Since adoption of this standard, the Company has not been party to any such transactions.

3. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The most significant accounting policies are as follows:

(a) *Use of estimates*

The preparation of financial statements in conformity with Canadian generally accepted

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Notes to Interim Consolidated Financial Statements (unaudited)

accounting principles require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes.

Although these estimates are based on management's best knowledge of current events, actual results could differ from these estimates.

(b) ***Revenue recognition and work in progress***

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or on a monthly basis, as applicable, the sale price is fixed or determinable and collectibility is probable.

- (i) Traditional marketing service revenues from creative and design services, event and project management are recognized on a completed contract basis. Consulting services, are generally provided in conjunction with creative and design services and event and project management and do not have stand-alone value to a customer and are therefore recognized on a completed contract basis at the same time as the project to which they are tied. Call centre services and fulfillment and distribution services are recognized as services are rendered. Work in progress is recorded at the lower of cost and net realizable value. Cost is calculated as the sum of billable hours at standard cost rates plus material costs for projects in progress.
- (ii) Marketing service revenues earned from the Company's eMarketing suite of promotions products include hosting fees, implementation fees, subscription fees, software license fees and domain registration fees.
- (iii) Hosting fees are generated from hosting computer hardware and software operations of customers' applications. Hosting fees are billed in advance and revenue is recognized when the service has been provided, on a monthly basis.
- (iv) Implementation fees are generated from implementation services provided to customers in the set-up and management of purchased software. Assistance in running contests is also offered when requested. Implementation fees are recognized as the services are provided.
- (v) Subscription fees are generated from software licensing arrangements. The license arrangements do not provide for the right of return and are offered on a subscription basis. Subscription fees are billed annually and revenue is recognized monthly.
- (vi) Software license fees are generated from software licensing arrangements. The license arrangements do not provide for the right of return and are offered on a perpetual basis. Revenue from software license arrangement is recognized when the software products or services have been delivered to the customer. Delivery is considered to have occurred when electronic delivery of the software has occurred.
- (vii) Domain registration fees are generated from the sale of domain URLs and SSLs. Domain registration fees are billed and revenue is recognized upon purchase.

(d) ***Property and equipment***

Property and equipment are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful lives of the assets using the following annual rates and methods:

Computer software	1 to 2 years straight line
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Computer equipment	30% declining balance
Furniture and fixtures	20% declining balance
Leasehold improvements	straight line over life of lease
Machinery and equipment	20% declining balance
Office equipment	20% declining balance

(e) ***Leases***

Leases entered into by the Company as a lessee are classified as capital or operating leases. Leases that transfer substantially the entire risks and benefits incidental to ownership are classified as capital leases. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the asset's fair market value at the beginning of each lease. Rental payments under operating leases are expensed as incurred.

(f) ***Deferred revenue***

Funds received from customers in advance of delivery of services are recorded as deferred revenue until the corresponding project has been completed.

(g) ***Income taxes***

The company utilizes the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined on temporary differences, and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Company's provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

(h) ***Earnings per share***

Basic earnings per share are computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Fully diluted earnings per share are computed using the treasury stock method.

(i) ***Intangible assets***

Intangible assets consist of software acquired on the acquisition of C3 Online Marketing Inc. on November 10, 2006, and customer lists.

i) Software

Acquired software is amortized on a straight line basis over its estimated useful life to a maximum of two years from the date of acquisition.

ii) Customer Lists

Amortization is provided over a ten-year term on a straight line basis. In fiscal 2006, due to declining revenues, the Company wrote down customer lists to nominal value.

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(j) ***Stock-based compensation***

Stock-based payments to non-employees and direct awards of stock to employees and non-employees are accounted for using a fair-value method of accounting. This method requires the estimated fair value of the stock-based compensation to be recognized in earnings. Grants of stock options to employees are recognized in earnings as a compensation expense, based on the estimated fair value at the date of the grant, over the corresponding vesting period.

(k) ***Financial instruments***

The Company's financial instruments comprise cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness and operating line of credit, accounts payable and accrued liabilities, due to related parties, debentures and promissory notes payable. Cash and cash equivalents and short-term investments, bank indebtedness and operating line of credit are classified as held for trading and are measured at fair value. Accounts receivable are classified as loans and receivables and are measured at fair value. Accounts payable and accrued liabilities and due to related parties are classified as held for trading and are measured at fair value. Promissory notes payable and long-term debt including debentures, are classified as other financial liabilities and are measured at amortized cost. Transaction costs are recognized immediately in net income. The fair values of the Company's current financial instruments approximate their carrying values, unless otherwise noted, due to their short term to maturity.

(l) ***Foreign currency translation***

Monetary assets and liabilities of the Company arising in foreign currencies are translated at exchange rates prevailing at the balance sheet date. All other assets, liabilities, revenues and expenses arising in foreign currencies are translated at the exchange rates prevailing at the dates of transactions. The resulting gains or losses on foreign exchange are included in the results of operations for the year.

(m) ***Asset impairment***

Management reviews the carrying amount of property and equipment and intangible assets with finite lives when events or circumstances indicate that the carrying amount may not be recoverable. This evaluation is based on projections of future undiscounted cash flows. The total of these projected net cash flows is referred to as the "net recoverable amount." If the net recoverable amount is less than carrying value, the asset is written down to fair value.

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Notes to Interim Consolidated Financial Statements (unaudited)

4. **PROPERTY AND EQUIPMENT**

	Cost	Accumulated Amortization	Sept 30, 2007 Net Book Value	Dec 31, 2006 Net Book Value
Computer software	\$ 146,834	\$ 109,943	\$ 36,891	\$ 87,549
Computer equipment	525,436	231,529	293,907	373,135
Furniture and fixtures	326,091	190,566	135,525	159,487
Leasehold improvements	36,578	28,120	8,458	9,276
Machinery and equipment	429,311	350,194	79,117	142,721
Office equipment	<u>112,377</u>	<u>68,059</u>	<u>44,318</u>	<u>52,757</u>
	\$ <u>1,576,627</u>	\$ <u>978,411</u>	\$ <u>598,216</u>	\$ <u>824,925</u>

5. **INTANGIBLE ASSETS**

	Software	Sept 30, 2007	Dec 31, 2006
Net book value – beginning of period	\$ 3,229,951	\$3,229,951	
			\$1,364,260
Acquisition during the year			
- software	-	-	3,229,951
- other	-	-	240,409
	3,229,951	3,229,951	4,834,620
Asset impairment	-	-	(1,312,011)
Amortization	<u>(1,306,079)</u>	<u>(1,306,079)</u>	<u>(297,353)</u>
Net book value – end of period	\$ <u>1,923,872</u>	\$ <u>1,923,872</u>	\$ <u>3,225,256</u>

6. **BANK INDEBTEDNESS**

On April 10, 2007, the Company repaid its \$1,250,000 demand credit facility with the Royal Bank of Canada and discharged the Bank's security interests with the proceeds from a new revolving credit facility (See note 7).

7. **OPERATING LINE OF CREDIT**

On April 10, 2007, the Company entered into a renewable, one-year revolving operating line of credit arrangement with Greenfield Commercial Credit comprising a facility in the amount of \$1,450,000 and a further facility in the amount of \$300,000, which reduces by \$12,500 per month. At September 30, 2007, the total facility was \$1,675,000. Draws against the first facility may not exceed the lesser of \$1,450,000 and 85% of eligible receivables. Draws against the second facility may not exceed the lesser of the facility ceiling (\$225,000 at September 30, 2007) and 100% of eligible receivables. The interest rate on these instruments is prime plus 8% per annum, payable monthly. The facilities are secured by a General Security Agreement over the assets of the Company and a postponement of loans by related parties. Transaction fees of \$125,238 were paid to secure these facilities and have been expensed.

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Notes to Interim Consolidated Financial Statements (unaudited)

8. **CAPITAL LEASES**

	Sept 30, 2007	Dec 31, 2006
Capital lease obligations for computer equipment, bearing interest at an average rate of approximately 10% repayable in monthly payments of \$525 secured by the related equipment and maturing from Sept 2007 to February 2008	\$ 2,050	\$ 18,336
Less: Current portion	<u>2,050</u>	<u>17,007</u>
	<u>\$ -</u>	<u>\$ 1,329</u>

The future minimum lease payments for capital leases are as follows:

2007	\$ 1,575
2008	<u>1,050</u>
	2,625
Less: Amount representing interest	<u>575</u>
	<u>\$ 2,050</u>

9. **PROMISSORY NOTES**

	Sept 30, 2007	Dec 31, 2006
Unsecured promissory note due to an unrelated individual	\$ 140,000	\$ 285,000
Secured, non-interest bearing promissory note	<u>459,570</u>	<u>-</u>
	599,570	285,000
Less: Current portion	<u>599,570</u>	<u>285,000</u>
	<u>\$ -</u>	<u>\$ -</u>

Unsecured promissory note due to an unrelated individual

Under an Amended and Restated Loan Agreement signed on May 7, 2007, the terms of the promissory note include interest at 10% per annum (previously 8%), payable monthly; principal repayments of \$20,000 per month from May 15, 2007 to April 15, 2008, with an initial payment of \$45,000 upon signing; and, subordination and postponement of claim in favor of Quorum Investment Pool Limited Partnership ("QIP") under its convertible secured debenture arrangements with the Company (See note 10). The holder of promissory note is entitled to receive payment on account of its indebtedness until such time as a notice of default has been given to the holder by QIP.

Prior to the amendment and restatement of its loan agreement with the holder of the promissory note, the Company had been in default on the original promissory note for failure to repay the \$285,000 of principal on the original maturity date of March 15, 2007.

Secured, non-interest bearing promissory note (face value \$500,000)

On May 22, in conjunction with the amendment of its three existing convertible secured debentures agreements issued by the Company to Quorum Investment Pool Limited Partnership ("QIP"), Quorum Secured Equity Trust ("QSET") and Ontario SME Capital Corporation ("SME") and the issue of a new \$1,700,000 convertible secured debenture to QIP (See note 10(d)), the Company issued a secured, non-interest bearing promissory note with a face value of \$500,000 to SME payable on April 30, 2008 in either cash or common shares of the Company, at the option of the holder. The note is secured by subordinated fixed and floating mortgages and charges on the Company's assets, and has

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Notes to Interim Consolidated Financial Statements (unaudited)

been recorded at its fair value using the effective interest rate that discounts the estimated future cash payments through the expected life of the promissory note.

10. **DEBENTURES**

	<u>Sept 30, 2007</u>	<u>Dec 31, 2006</u>
Convertible secured debenture with a face value of \$1,435,185 bearing interest at a rate of 8% per annum calculated and payable quarterly in arrears, dated May 22, 2007, maturing December 15, 2009	\$ 1,435,185	\$1,435,185
Convertible secured debenture with a face value of \$1,225,926 bearing interest at a rate of 8% per annum calculated and payable quarterly in arrears, dated May 22, 2007, maturing January 4, 2008	1,204,820	1,174,324
Convertible secured debenture with a face value of \$1,388,889 bearing interest at a rate of 8% per annum calculated and payable quarterly in arrears, dated May 22, 2007, maturing March 17, 2011	1,203,837	1,163,787
Convertible secured debenture with a face value of \$1,700,000 bearing interest at a rate of 8% per annum calculated and payable quarterly in arrears, dated May 22, 2007, maturing May 22, 2011	1,242,249	-
Secured debenture with a face value of \$207,693 bearing interest at a rate of 8% per annum calculated monthly and payable quarterly in arrears, dated September 26, 2007, maturing January 15, 2008 (See note 24)	207,693	-
	5,293,784	3,773,296
Less: Current portion	<u>1,412,513</u>	<u>-</u>
	<u>\$ 3,881,271</u>	<u>\$ 3,773,296</u>

The liability components of the convertible secured debentures have been calculated using the present value of the cash flows at an interest rate applicable to non-convertible secured debt. The equity value of the convertible debt is comprised of the fair value of the conversion option. The liability portion of the convertible secured debenture is accreted over its term to the full face value by charges to interest expense.

All five debentures are secured by subordinated fixed and floating mortgages and charges on the Company's assets and rank *pari passu*.

On September 26, 2007, the Company issued a \$207,693 secured debenture to Quorum Investment Pool Limited Partnership the terms of which are described below. Transaction costs of \$12,693 were incurred and charged to income.

On May 22, 2007, the Company completed a convertible debenture financing (the "Financing") whereby the Company issued a \$1,700,000 convertible secured debenture (the "Debenture") to Quorum Investment Pool Limited Partnership ("QIP") the terms of which are described in (d) below. Transaction costs of \$163,319 were incurred and charged to income

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Prior to the Financing and at December 31, 2006, the Company was in default of its three then outstanding convertible secured debentures previously issued by the Company to QIP, QSET and SME due to a breach of financial covenants as well as a failure to make interest payments when due. QIP, QSET and SME waived these defaults and amended certain financial covenants of the previously issued and outstanding debentures described in (a), (b), and (c) below, upon completion of the Financing and the receipt of unpaid interest which was paid on closing of the Financing.

(a) 8% convertible secured debenture with a face value of \$1,435,185 issued to QSET

The principal amount of the debenture is convertible to common shares of the Company at the holder's option at (i) \$0.20 to May 21, 2009; (ii) \$0.22 from May 22, 2009 to December 15, 2009. The conversion price will automatically increase to \$0.25 per share upon the filing of audited annual financial statements, which disclose revenues of \$25,000,000 or "EBITDA," as defined in the amended debenture agreement, of at least \$4,000,000.

In connection with the Financing, the Company and QSET amended the terms of the convertible debenture to reduce the conversion price from \$0.35 per share to the amounts shown above.

(b) 8% convertible secured debenture with a face value of \$1,225,926 issued to Ontario SME

\$1,000,000 of the principal amount of the debenture is convertible at the holder's option at \$0.2319 to January 4, 2008. \$225,926 of the principal amount of the debenture is convertible to common shares of the Company at the holder's option at \$0.4630 to January 4, 2008.

In connection with the Financing, the Company and SME amended the terms of the convertible debenture to advance the maturity date of the debenture from February 28, 2008 to January 4, 2008 and the Company provided SME with a secured \$500,000 promissory note payable on April 30, 2008 in either cash or common shares of the Company, at the option of the holder. The amended and restated convertible secured debenture represents an extinguishment of the original financial liability. The accounting for the difference between the fair value of the new debt instrument and the carrying amount of the original debt instrument resulted in a loss on extinguishment of the original debt of \$468,457.

(c) 8% convertible secured debenture with a face value of \$1,388,889 issued to QIP

The principal amount of the debenture is convertible to common shares of the Company at the holder's option at (i) \$0.20 to May 21, 2009; (ii) \$0.22 from May 22, 2009 to May 21, 2010; (iii) \$0.242 from May 22, 2010 to May 21, 2011; (iv) \$0.2662 from May 22, 2011 to May 21, 2012. The conversion price will automatically increase to \$0.25 per share upon the filing of audited annual financial statements, which disclose revenues of \$25,000,000 or "EBITDA," as defined in the amended debenture agreement, of at least \$4,000,000.

In connection with the Financing, the Company and QSET amended the terms of the convertible debenture to reduce the conversion price from \$0.4630 per share to the amounts shown above.

(d) 8% convertible secured debenture with a face value of \$1,700,000 issued to QIP

The principal amount of the debenture is convertible to common shares of the Company at the holder's option at (i) \$0.10 to May 21, 2009; (ii) \$0.11 from May 22, 2009 to May 21, 2010; (iii) \$0.121 from May 22, 2010 to May 21, 2011; (iv) \$0.1331 from May 22, 2011 to May 21, 2012. The conversion price will automatically increase to \$0.15 per share upon the filing of audited annual financial statements, which disclose revenues of \$25,000,000 or "EBITDA," as defined in the Debenture Agreement, of at least \$4,000,000. One year of interest amounting to \$136,000 was

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prepaid on closing.

The Company is in default of its outstanding convertible secured debentures previously issued by the Company to QIP, QSET and SME due to breach of financial covenants. QIP, QSET and SME waived these defaults debentures described in (a), (b), (c) and (d) above.

11. DUE TO RELATED PARTIES

All transactions with related parties that occurred in the normal course of operations are measured at their fair value as determined by management, unless otherwise specified.

On March 31, 2006, the Company converted \$500,000 owed to officers into 3,125,000 common shares at \$0.16 per share. On November 10, 2006, the Company converted a debt of \$364,001 owing to Navigate Design Inc., a company controlled by officers of the Company into 2,600,000 common shares at \$0.14 per share. The Company also converted \$411,000 of debt assumed from C3 Online Marketing Inc., and owing to former officers of C3, into 2,935,721 common shares of the Company at \$0.14 per share.

At September 30, 2007, \$42,039 was outstanding and payable to officers of the Company (Dec 31, 2006 - \$61,310). These advances are unsecured and non-interest bearing.

12. SHARE CAPITAL

a) Authorized

Unlimited number of preference shares, without par value, issuable in one or more series. The directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.

Unlimited number of common shares.

b) Issued

	Common Shares	
	Number	Amount
Balance, January 1, 2006	19,079,969	\$ 745,833
Shares issued for cash	3,600,000	504,000
Conversion of debt	10,803,578	1,575,003
Business acquisition	15,910,366	2,068,348
Share issue costs	-	(42,797)
Balance, December 31, 2006	<u>49,393,913</u>	4,850,387
Stock options exercised	150,000	21,000
Balance, September 30, 2007	<u>49,543,913</u>	<u>\$4,871,387</u>

c) Stock options

The Company has a stock option plan (the "Plan") for certain directors, officers, employees and consultants to purchase a total of 2,975,248 common shares (See note 24 (c)). At the Annual Meeting of Shareholders on July 11, 2007, the Company's stock option plan was amended to increase the number of common shares issuable pursuant to the exercise of options granted under

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the Plan, from 3,775,990 to 9,900,000. The options are non-transferable and may be granted for a term not exceeding five years. The exercise price of the options is determined by the board of directors of the Company at the time of approving the grant of an option but, in any event, shall not be lower than the minimum exercise price allowed pursuant to the rules of the exchange on which the Company's shares are listed.

Option expense in the three-month period ending September 30, 2007 totaled \$48,736 (three months ended September 30, 2006- \$23,204) and \$132,978 for the nine-month period ending September 30, 2007 (nine months ended September 30, 2006- \$23,204) covering stock-based compensation to employees, officers and contractors. The weighted average grant date fair value of the options granted during 2007 is \$22,012 (12 months 2006- \$204,478).

Stock options are valued using the Black-Scholes option pricing model with the following assumptions:

- a) Risk-free interest rate 4.25%;
- b) Expected life of 5.0 years;
- c) Expected volatility of 170%; and
- d) Dividend rate of \$0.

The following table summarizes the options outstanding at September 30, 2007:

Weighted Average Exercise Price	Number of Options	Weighted Average Remaining Life
\$0.10	1,110,248	3.8 years
\$0.15	800,000	3.4 years
\$0.225	405,000	2.2 years
\$0.30	<u>660,000</u>	2.3 years
Options outstanding, September 30, 2007	<u>2,975,248</u>	
Options outstanding, December 31, 2006	<u>3,175,248</u>	

Stock option activity is summarized below:

	Number of Options	Weighted Average Exercise Price
Options outstanding, December 31, 2006	3,175,248	\$0.17
Granted in 2007	150,000	\$0.14
Cancelled in 2007	(200,000)	\$0.15
Exercised in 2007	<u>(150,000)</u>	\$0.14
Options outstanding, September 30, 2007	<u>2,975,248</u>	\$0.18
Options exercisable, September 30, 2007	<u>2,348,499</u>	\$0.19
Options exercisable, December 31, 2006	<u>1,733,972</u>	\$0.22

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d) Warrants

In connection with the Financing (See note 10), the Company issued QIP 6,022,804 common share purchase warrants (the Warrants”) exercisable to purchase a total of 6,022,804 common shares of the Company from treasury at \$0.12 per share up and until May 22, 2012. QIP has agreed to transfer the Warrants to officers of the Company that the Company and QIP consider to be essential to the revitalization of the Company. The Warrants vest and become exercisable by the holder as follows: 2,407,981 Warrants on January 1, 2008; 2,407,981 Warrants on April 1, 2009; and, 1,206,842 Warrants upon the achievement by the Company of repayment of all principal and interest repayment requirements represented by the amended and restated convertible secured debenture issued to SME as of November 10, 2006 (note 10 (b)) and the achievement of certain “EBITDA” targets in the Company’s 2007 fiscal year budget. The fair value of these warrants at the date of issuance was \$248,665, which was determined using the Black Scholes pricing model and the assumptions set out in Note 12 (c) above. The Company considers the arrangement to be a stock-based compensation arrangement.

At September 30, 2007, the Company had the following warrants outstanding:

<u>Number Outstanding</u>	<u>Strike Price</u>	<u>Expiration Period</u>
<u>6,022,804</u>	\$0.12	May 2012

Warrant activity is summarized below:

	Number Outstanding	Weighted Average Exercise Price
Balance, December 31, 2006	1,000,000	\$0.25
Granted in 2007	6,022,804	\$0.12
Expired in 2007	(1,000,000)	\$0.25
Exercised in 2007	-	
Balance, September 30, 2007	<u>6,022,804</u>	\$0.12
Warrants exercisable, Sept 30, 2007	-	
Warrants exercisable, December 31, 2006	<u>1,000,000</u>	\$0.25

e) Contributed Surplus

The following table summarizes information regarding contributed surplus:

	Sept 30, 2007	Dec 31, 2006
Opening Balance	\$ 507,510	\$ 429,251
Stock based compensation	132,977	78,259
Extinguishment of convertible debenture	<u>57,750</u>	-
Closing Balance	<u>\$ 698,237</u>	<u>\$ 507,510</u>

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13. **INTEREST & TRANSACTION COSTS ON LONG-TERM DEBT**

	Sept 30, 2007 (3 months)	Sept 30, 2006 (3 months)	Sept 30, 2007 (9 months)	Sept 30, 2006 (9 months)
Interest expense on short-term borrowings	\$32,071	\$ 33,261	\$120,076	\$105,974
Accretion interest	82,416	-	143,811	-
Transaction costs on long-term debt	<u>12,693</u>	<u>8,672</u>	<u>301,251</u>	<u>39,630</u>
	<u>\$127,180</u>	<u>\$ 41,933</u>	<u>\$565,138</u>	<u>\$ 145,604</u>

14. **OTHER EXPENSES**

	Sept 30, 2007 (3 months)	Sept 30, 2006 (3 months)	Sept 30, 2007 (9 months)	Sept 30, 2006 (9 months)
Severance costs on termination of executives	\$ -	\$ -	\$413,629	\$ -
Loss on extinguishment of debt (note 10(b))	-	-	468,457	-
Provision for loan receivable	<u>-</u>	<u>495,868</u>	<u>-</u>	<u>895,868</u>
	<u>\$ -</u>	<u>\$ 495,868</u>	<u>\$882,086</u>	<u>\$895,868</u>

15. **INVESTMENT TAX CREDITS AND INCOME TAX LOSS CARRY-FORWARDS**

As a result of scientific research and development expenditures incurred by C3 Online Marketing Inc. prior to its acquisition by the Company on November 10, 2006, it is estimated that there may be up to \$977,000 of refundable federal and provincial tax credits receivable following completion of an audit process by tax authorities. Due to uncertainties as to the amounts that will ultimately be approved and the timing of receipts, no amounts have been recorded in the accounts for these possible refunds. Once the amounts receivable can be reasonably estimated, these credits will be recorded as a reduction of the cost of software acquired as part of the acquisition. In addition, at December 31, 2006 the Company had non-capital losses of approximately \$5,026,000 available to reduce future income taxes. These non-capital losses expire between 2009 and 2016.

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16. **SUPPLEMENTARY CASH FLOW INFORMATION**

The changes in non-cash working capital items comprise the following:

	Sept 30, 2007 (3 months)	Sept 30, 2006 (3 months)	Sept 30, 2007 (9 months)	Sept 30, 2006 (9 months)
Change in accounts receivable	\$ 54,013	\$ 173,520	\$ 1,125,672	\$ 303,503
Change in income taxes receivable	-	-	-	30,555
Change in work in progress	156,865	44,487	(94,571)	721,103
Change in prepaid expenses and deposits	35,478	19,477	(48,515)	(65,920)
Change in accounts payables and accrued liabilities	(137,266)	80,345	(736,594)	720,921
Change in deferred revenue	(406,673)	<u>130,520</u>	<u>(106,507)</u>	<u>(520,953)</u>
	<u>\$ (297,583)</u>	<u>\$ 448,349</u>	<u>\$ 139,485</u>	<u>\$ 1,189,209</u>
Interest paid	\$ <u>182,521</u>	\$ <u>84,961</u>	\$ <u>799,820</u>	\$ <u>254,406</u>
Retirement of amounts due to related parties upon issuance of capital stock	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>500,000</u>

17. **COMMITMENTS**

The Company has non-cancellable operating lease commitments for its premises, vehicles and computer and office equipment. Future minimum annual lease payments are approximately as follows:

2007	\$ 122,200
2008	404,500
2009	368,800
2010	288,000
2011	259,200
Thereafter	<u>993,600</u>
	<u>\$ 2,436,300</u>

18. **SEGMENTED INFORMATION**

The Company provides its clients with a complete range of marketing solutions that include strategic consulting, branding, event management, direct marketing, interactive solutions, online and offline promotional solutions and fulfilment and distribution services through an integrated sales and marketing and delivery team. In the opinion of management, the Company carries on business in one operating segment.

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Revenue by geographic region:

	Sept 30, 2007 (3 months)	Sept 30, 2006 (3 months)	Sept 30, 2007 (9 months)	Sept 30, 2006 (9 months)
Canada	\$2,232,650	\$1,573,610	\$6,999,961	\$7,513,083
United States	<u>162,743</u>	<u>223,682</u>	<u>618,473</u>	<u>533,447</u>
	<u>\$2,395,393</u>	<u>\$1,797,292</u>	<u>\$7,618,434</u>	<u>\$8,046,530</u>

Revenues are attributed to countries based on location of customer. All of the Company's identifiable assets as at September 30, 2007 and December 31, 2006 are located in Canada.

19. **FINANCIAL INSTRUMENTS**

a) Credit risk

The Company in the normal course of business, reviews significant new customers' credit history before extending credit and performs periodic reviews of its existing credit performance.

b) Interest rate risk

The Company is exposed to interest rate risk on its operating line of credit based on the fluctuations in prime rates.

c) Fair value of financial instruments

The carry values of cash, short term investments, accounts receivable, bank indebtedness, operating line of credit, and due to related parties approximate their fair values because of the short term nature of these instruments. The carrying value of promissory notes payable and convertible debentures approximate their fair value because effective rates represent the rates that would be used to calculate fair value.

20. **ECONOMIC DEPENDENCE AND RISK CONCENTRATION**

For the nine months ended September 30, 2007 approximately 40.8% of the Company's revenue was derived from three customers. The Company does not believe that this exposes the Company to undue credit risk as each of these customers are major publicly traded international manufacturers of consumer goods. The Company believes that its maximum credit risk exposure on accounts receivable is limited to the amounts it has recorded as an allowance for doubtful accounts, which at September 30, 2007 amounted to \$101,465 (December 31, 2006- \$107,000)

21. **CONTINGENCIES**

- a) Four claims totaling \$750,000 have been brought against the Company and its subsidiaries alleging breaches of various contractual obligations. Included in this total, is a compensation claim in the amount of \$223,000, filed by former employee and officer of the Company, following the employee's resignation. No provisions have been made in the accounts as the Company considers these actions without merit and is defending these claims. (See note 24 (b))
- b) As a result of on-going operating losses and a working capital deficiency, the Company has in certain instances been unable to satisfy its suppliers payment terms. The Company's ability to

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continue as a going concern is dependent on the continued support of its suppliers as well as its ability to secure additional financing and generate future positive cash flows. Most suppliers continue to support the Company but there can be no assurance that certain suppliers will not seek legal remedies to collect amounts due beyond their credit terms.

22. **CHANGE OF NAME**

At the Annual Meeting of Shareholders on July 11, 2007, approval was obtained to change the name of the corporation to Empirical Inc. It is expected that Articles of Amendment pursuant to the Business Corporations Act (Alberta) to effect the name change will be filed shortly

23. **COMPARATIVE FIGURES**

The comparative financial statements have been reclassified, where necessary, to conform to the basis of presentation of the 2007 financial statements.

24. **SUBSEQUENT EVENTS**

- a) On September 26, 2007, The Company signed a letter of intent with Mediamix Marketing Group Inc. (“Mediamix”) to form an expanded marketing solutions platform through the business combination of each of the Company and Mediamix. The due diligence review is currently in progress. A definitive agreement has not been completed.
- b) On October 5, 2007, a former employee and an officer of the Company commenced legal action in the amount of \$1,500,000, claiming breach of contract. No provisions have been made in the accounts as the Company considers these actions without merit and is defending this claim.
- c) The Company issued a \$100,000 and a \$300,000 secured debenture on October 12, 2007 and October 30, 2007 respectively to Quorum Investment Pool Limited Partnership bearing interest at 8% per annum, calculated monthly and payable quarterly in arrears, due on October 30, 2007 and November 29, 2007. The debentures are secured by subordinated fixed and floating mortgages and charges on the Company’s assets and ranks *pari passu* with the Company’s outstanding debentures (See notes 10). The maturity dates on these debentures and the secured debenture with a face value of \$207,693 dated September 26, 2007 (See Note 10) have been changed to January 15, 2008.