

**Akers Biosciences, Inc. and
Subsidiaries**
(A Development Stage Company)

Financial Report
December 31, 2002

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

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McGladrey & Pullen

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and
Stockholders of Akers Biosciences, Inc.
(A Development Stage Company)
Thorofare, New Jersey

We have audited the accompanying consolidated balance sheets of Akers Biosciences, Inc. (formerly Akers Laboratories, Inc.) and Subsidiaries (a development stage company) as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in stockholders' deficiency and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements of Akers Laboratories, Inc. (a development stage company) as of December 31, 1999, 1998 and 1997 and the related consolidated statements of operations, changes in stockholders' deficiency and cash flows for the years ended December 31, 1999, 1998, 1997 and 1996 were audited by Rudolph, Palitz LLC, independent accountants, whose members merged with McGladrey & Pullen LLP on August 1, 2000. Rudolph, Palitz LLC's report dated June 21, 2000 expressed an unqualified opinion on those statements. The consolidated financial statements of Akers Laboratories, Inc. as of December 31, 1995 and the related consolidated statements of operations, changes in stockholders' deficiency and cash flows for the period from March 8, 1989 (Inception) through December 31, 1995, were audited by other auditors whose report dated July 26, 1996, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Akers Biosciences, Inc. and Subsidiaries (a development stage company) as of December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 12 to the financial statements, the Company is a development stage company with no significant operating results to date, has suffered recurring losses and is experiencing difficulty in generating sufficient cash to meet its obligations and sustain its operations, all of which raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 12. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Blue Bell, Pennsylvania
May 8, 2003

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

	<u>2002</u>	<u>2001</u>
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 1,205,639	\$ 1,609,336
Accrued interest payable	80,986	960,904
Other current liabilities	-	48,382
Senior notes payable (Note 4)	-	1,750,000
Note payable, bank (Note 5)	-	250,000
Convertible notes payable (Note 6)	-	1,350,000
Current portion of long-term debt (Note 7)	978,646	466,894
Current portion of obligations under capital leases (Note 8)	9,941	9,941
	<u>2,275,212</u>	<u>6,445,457</u>
LONG-TERM DEBT		
Long-term debt, net of current portion (Note 7)	538,126	672,001
Obligations under capital leases, net of current portion (Note 8)	903	9,979
	<u>539,029</u>	<u>681,980</u>
COMMITMENTS (Notes 8 and 14)		
STOCKHOLDERS' DEFICIENCY (Notes 10 and 11)		
Preferred stock, no par value		
Authorized 15,000,000 shares, no shares issued and outstanding at December 31, 2002 and 2001	-	-
Common stock, no par value		
Authorized 60,000,000 shares issued and outstanding 39,618,395 and 32,219,627 shares at December 31, 2002 and 2001	42,178,577	30,807,934
Deficit accumulated during development stage	(43,848,892)	(36,833,131)
Total stockholders' deficiency	<u>(1,670,315)</u>	<u>(6,025,197)</u>
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY	<u>\$ 1,143,926</u>	<u>\$ 1,102,240</u>

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>	Cumulative Amounts from Inception (March 8, 1989 to <u>December 31, 2002</u>)
Revenues	\$ 811,628	\$ 621,388	\$ 2,697,904
Cost of production	1,125,462	1,139,087	5,415,826
Gross loss	<u>(313,834)</u>	<u>(517,699)</u>	<u>(2,717,922)</u>
Sales and general and administrative expenses	4,906,734	3,972,040	23,984,250
Research and development expenses	<u>849,778</u>	<u>759,858</u>	<u>7,781,449</u>
Total expenses	<u>5,756,512</u>	<u>4,731,898</u>	<u>31,765,699</u>
Loss from operations	<u>(6,070,346)</u>	<u>(5,249,597)</u>	<u>(34,483,621)</u>
Discontinued operations			
Loss from operations	-	-	(4,594,164)
Loss on disposal of Franklin Development	-	-	<u>(870,276)</u>
Total discontinued operations	<u>-</u>	<u>-</u>	<u>(5,464,440)</u>
Other income (expense)			
Miscellaneous	-	-	75,302
Interest income	10,975	6,429	233,530
Forgiveness of trade payables	327,469	2,712	1,044,772
Sale of New Jersey NOL's (Note 9)	242,396	371,254	946,759
Loss on disposal of property and equipment	-	-	(836,904)
Foreign currency transactions gains	74,335	-	74,335
Interest expense	(268,031)	(268,013)	(4,106,066)
Debt conversion expense (Notes 6 and 7)	<u>(1,332,559)</u>	-	<u>(1,332,559)</u>
Total other income (expense)	<u>(945,415)</u>	<u>112,382</u>	<u>(3,900,831)</u>
Net loss	<u>\$ (7,015,761)</u>	<u>\$ (5,137,215)</u>	<u>\$ (43,848,892)</u>

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

FROM MARCH 8, 1989 (INCEPTION) TO DECEMBER 31, 2002

	Preferred Stock		Common Stock		Deficit Accumulated During the Development Stage (March 1, 1989 to December 31, 2002)	Total
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>		
Balance, December 31, 1989	-	\$ -	100	\$ 100	\$ (69,252)	\$ (69,152)
650 for 1 stock split effective September 26, 1990	-	-	65,000	-	-	-
Retirement of original shares	-	-	(100)	-	-	-
Issuance of stock for cash	-	-	5,000	250,000	-	250,000
Expenses associated with the sale of stock	-	-	-	(20,000)	-	(20,000)
Issuance of stock in connection with raising capital	-	-	6,000	70,850	-	70,850
Net loss for the year ended December 31, 1990	-	-	-	-	(405,508)	(405,508)
Balance, December 31, 1990	-	-	76,000	300,950	(474,760)	(173,810)
Issuance of stock for cash	-	-	1,500	75,000	-	75,000
Issuance of stock in exchange for \$7,500 in cash and \$17,500 in satisfaction of trade payable balance during 1991	-	-	500	25,000	-	25,000
Net loss for the year ended December 31, 1991	-	-	-	-	(652,357)	(652,357)
Balance, December 31, 1991	-	-	78,000	400,950	(1,127,117)	(726,167)
96 for 1 stock split effective September 10, 1992	-	-	7,410,000	-	-	-
Expiration of repurchase rights	-	-	-	77,500	-	77,500
Issuance of stock for net assets of Shantou Assoc.	-	-	388,889	106,136	-	106,136
Issuance of stock for cash	-	-	2,643,629	1,572,895	-	1,572,895
Expenses associated with the sale of stock	-	-	-	(30,000)	-	(30,000)
Issuance of stock in connection with raising capital	-	-	736,272	-	-	-
Net loss for the year ended December 31, 1992	-	\$ -	-	\$ -	\$ (1,228,624)	\$ (1,228,624)

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

FROM MARCH 8, 1989 (INCEPTION) TO DECEMBER 31, 2002

	Preferred Stock		Common Stock		Deficit Accumulated During the Development Stage (March 1, 1989 to December 31, 2002)	Total
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>		
Balance, December 31, 1992	-	\$ -	11,256,790	\$ 2,127,481	\$ (2,355,741)	\$ (228,260)
Issuance of preferred stock for stock of Franklin, Inc.	350,000	1,091,636	-	-	-	1,091,636
Issuance of stock for cash	-	-	2,772,405	2,972,288	-	2,972,288
Cost of stock issued subject to repurchase	-	-	-	(665,502)	-	(665,502)
Expenses associated with the sale of stock	-	-	-	(205,000)	-	(205,000)
Issuance of stock and warrants in connection with debt	-	-	250,000	280,000	-	280,000
Expiration of repurchase rights	-	-	-	234,667	-	234,667
Issuance of stock in connection with raising capital	-	-	45,000	-	-	-
Stock option plan and warrant transactions	-	-	-	219,892	-	219,892
Net loss for the year ended December 31, 1993	-	-	-	-	(3,107,631)	(3,107,631)
Balance, December 31, 1993	<u>350,000</u>	<u>1,091,636</u>	<u>14,324,195</u>	<u>4,963,826</u>	<u>(5,463,372)</u>	<u>592,090</u>
Issuance of stock for cash	-	-	4,315,463	6,167,920	-	6,167,920
Cost of stock issued subject to repurchase	-	-	-	(861,357)	-	(861,357)
Expenses associated with the sale of stock	-	-	-	(446,337)	-	(446,337)
Issuance of stock for products and services	-	-	39,089	58,634	-	58,634
Issuance of stock in connection with raising capital	-	-	24,000	-	-	-
Stock option plan and warrant transactions	-	-	-	27,750	-	27,750
Warrants issued in connection with debt	-	-	-	300,000	-	300,000
Net loss for the year ended December 31, 1994	-	\$ -	-	\$ -	\$ (4,730,005)	\$ (4,730,005)

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

FROM MARCH 8, 1989 (INCEPTION) TO DECEMBER 31, 2002

	Preferred Stock		Common Stock		Deficit Accumulated	Total
	Shares	Amount	Shares	Amount	During the Development Stage (March 1, 1989 to December 31, 2002)	
Balance, December 31, 1994	350,000	\$ 1,091,636	18,702,747	\$ 10,210,436	\$ (10,193,377)	\$ 1,108,695
Issuance of stock for cash	-	-	914,500	1,264,250	-	1,264,250
Expiration of repurchase offer	-	-	-	153,510	-	153,510
Expenses associated with the sale of stock	-	-	-	(75,775)	-	(75,775)
Issuance of stock for products and services	-	-	27,787	37,980	-	37,980
Increase in basis of assets acquired from Shantou	-	-	-	243,710	-	243,710
Issuance of stock in connection with raising capital	-	-	66,891	-	-	-
Stock option plan and warrant transactions	-	-	-	60,625	-	60,625
Stock issued in connection with debt	-	-	553,518	553,518	-	553,518
Net loss for the year ended December 31, 1995	-	-	-	-	(5,643,213)	(5,643,213)
Balance, December 31, 1995	350,000	1,091,636	20,265,443	12,448,254	(15,836,590)	(2,296,700)
Issuance of stock for cash	-	-	59,793	103,301	-	103,301
Expiration of repurchase offer	-	-	-	262,200	-	262,200
Stock option plan and warrant transactions	-	-	-	720,000	-	720,000
Net loss for the year ended December 31, 1996	-	-	-	-	(5,355,148)	(5,355,148)
Balance, December 31, 1996	350,000	1,091,636	20,325,236	13,533,755	(21,191,738)	(6,566,347)
Issuance of stock for cash	-	-	695,704	555,872	-	555,872
Expiration of repurchase offer	-	-	-	353,899	-	353,899
Issuance of stock and warrants in connection with debt	-	-	187,500	392,292	-	392,292
Issuance of stock in conversion of debt	-	-	200,000	150,000	-	150,000
Expenses associated with the sale of stock	-	-	-	(7,500)	-	(7,500)
Net loss for the year ended December 31, 1997	-	\$ -	-	\$ -	\$ (2,055,544)	\$ (2,055,544)

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

FROM MARCH 8, 1989 (INCEPTION) TO DECEMBER 31, 2002

	Preferred Stock		Common Stock		Deficit Accumulated During the Development Stage (March 1, 1989 to December 31, 2002)	Total
	Shares	Amount	Shares	Amount		
Balance, December 31, 1997	350,000	\$ 1,091,636	21,408,440	\$ 14,978,318	\$ (23,247,282)	\$ (7,177,328)
Issuance of stock for cash	-	-	2,929,004	1,526,250	-	1,526,250
Expiration of repurchase offer	-	-	-	757,250	-	757,250
Issuance of stock for products and services	-	-	126,565	94,840	-	94,840
Issuance of stock in conversion of debt	-	-	263,014	197,258	-	197,258
Expenses associated with the sale of stock	-	-	-	(117,075)	-	(117,075)
Conversion of previously issued stock for debt	-	-	(250,000)	(250,000)	-	(250,000)
Repurchase of previously issued preferred stock in exchange for cash and debt	(175,000)	(545,818)	-	404,640	-	(141,178)
Net loss for the year ended December 31, 1998	-	-	-	-	(1,743,232)	(1,743,232)
Balance, December 31, 1998	175,000	545,818	24,477,023	17,591,481	(24,990,514)	(6,853,215)
Issuance of stock for cash	-	-	2,166,421	3,405,255	-	3,405,255
Repurchase of previously issued stock for cash	-	-	(106,440)	(129,917)	-	(129,917)
Repurchase of previously issued preferred stock in exchange for cash and debt	(175,000)	(545,818)	-	348,572	-	(197,246)
Expenses associated with the sale of stock	-	-	-	(143,906)	-	(143,906)
Issuance of stock in conversion of debt	-	-	2,771,503	2,078,628	-	2,078,628
Net loss for the year ended December 31, 1999	-	-	-	-	(2,717,253)	(2,717,253)
Balance, December 31, 1999	-	-	29,308,507	23,150,113	(27,707,767)	(4,557,654)
Issuance of stock for cash	-	-	2,054,244	3,765,427	-	3,765,427
Stock option plan and warrant transactions	-	-	-	305,508	-	305,508
Issuance of common stock for trade payables	-	-	-	184,993	-	184,993
Exercise of options and warrants	-	-	127,500	79,800	-	79,800
Interest expense on warrants issued	-	-	-	267,826	-	267,826
Issuance of stock in conversion of debt	-	-	366,114	732,227	-	732,227
Net loss for the year ended December 31, 2000	-	\$ -	-	\$ -	\$ (3,988,149)	\$ (3,988,149)

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY

FROM MARCH 8, 1989 (INCEPTION) TO DECEMBER 31, 2002

	Preferred Stock		Common Stock		Deficit Accumulated During the Development Stage (March 1, 1989 to December 31, 2002)	Total
	Shares	Amount	Shares	Amount		
Balance, December 31, 2000	-	\$ -	31,856,365	\$ 28,485,894	\$ (31,695,916)	\$ (3,210,022)
Issuance of stock for cash	-	-	272,262	414,875	-	414,875
Stock option plan and warrant transactions (Note 11)	-	-	-	1,712,065	-	1,712,065
Issuance of stock for products and services (Note 11)	-	-	26,000	52,000	-	52,000
Exercise of options and warrants (Note 11)	-	-	20,000	2,000	-	2,000
Issuance of common stock in exchange of trade payables	-	-	45,000	141,100	-	141,100
Net loss for the year ended December 31, 2001	-	-	-	-	(5,137,215)	(5,137,215)
Balance, December 31, 2001	-	-	32,219,627	30,807,934	(36,833,131)	(6,025,197)
Issuance of stock for cash	-	-	124,167	215,000	-	215,000
Net proceeds from IPO (Note 10)	-	-	2,525,000	3,818,068	-	3,818,068
Issuance of warrants for products and services (Note 11)	-	-	-	425,000	-	425,000
Exercise of options and warrants (Note 11)	-	-	132,500	165,000	-	165,000
Issuance of common stock in exchange of debt (Notes 4, 6 and 7)	-	-	2,994,202	5,111,996	-	5,111,996
Issuance of common stock in exchange of trade payables	-	-	209,326	325,579	-	325,579
Issuance of common stock in exchange for termination of warrants (Note 11)	-	-	1,413,573	1,310,000	-	1,310,000
Net loss for the year ended December 31, 2002	-	-	-	-	(7,015,761)	(7,015,761)
Balance, December 31, 2002	-	\$ -	39,618,395	\$ 42,178,577	\$ (43,848,892)	\$ (1,670,315)

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>	<u>Cumulative Amounts from Inception (March 8, 1989 to December 31, 2002)</u>
OPERATING ACTIVITIES			
Net loss	\$ (7,015,761)	\$ (5,137,215)	\$ (43,848,892)
Adjustments to reconcile net loss to cash used in operating activities			
Depreciation and amortization	146,851	146,935	2,140,948
Forgiveness of trade payables	(327,469)	(2,712)	(1,044,772)
Amortization of discount on long-term debt	-	3,105	585,862
Debt conversion costs	1,332,559	-	1,600,385
Amortization of deferred finance costs	4,443	8,191	20,824
Stock, stock options and warrants issued to employees and non-employees	1,735,000	1,764,065	4,824,733
Loss on conversion of debt to common stock	-	-	194,040
Loss from disposition of property and equipment	-	-	756,730
Loss on disposal of division	-	-	870,276
Deferred compensation	-	-	115,000
Changes in operating assets and liabilities:			
(Increase) decrease in:			
Trade receivables	(209,318)	39,712	(270,190)
Inventories	(15,831)	(81,931)	(200,762)
Prepays and other current assets	(118,884)	44,406	(138,977)
Deposits and other assets	(4,360)	4,000	(1,548)
Increase (decrease) in:			
Accounts payable and accrued expenses	249,321	822,818	3,677,964
Other current liabilities	(48,382)	48,382	-
Net cash used in operating activities	<u>(4,271,831)</u>	<u>(2,340,244)</u>	<u>(30,718,379)</u>
INVESTING ACTIVITIES			
Purchase of property, equipment and subsidiaries	(49,258)	(87,619)	(3,362,414)
Purchase of intangible assets	-	(50,147)	(549,295)
Net proceeds from sale of property and equipment	-	-	1,817,904
Net cash used in investing activities	<u>(49,258)</u>	<u>(137,766)</u>	<u>(2,093,805)</u>
FINANCING ACTIVITIES			
Net proceeds (payment) from release of funds held in escrow/restricted funds	-	-	296,002
Proceeds from issuance of stock, net	4,033,068	416,875	25,346,814
Proceeds from warrants exercised	165,000	-	165,000
Proceeds from issuance of convertible debt	-	1,350,000	1,350,000
Proceeds from borrowings	967,247	275,000	13,692,423
Repayments on officers' and stockholders' borrowings	-	-	(263,725)
Repayments of convertible debt	(400,000)	-	(400,000)
Repayments of capital lease obligations	(9,076)	(9,760)	(27,296)
Repayments on borrowings	(639,821)	(363,882)	(7,345,076)
Net cash provided by financing activities	<u>4,116,418</u>	<u>1,668,233</u>	<u>32,814,142</u>
INCREASE (DECREASE) IN CASH	(204,671)	(809,777)	1,958
CASH, BEGINNING OF YEAR	206,629	1,016,406	-
CASH, END OF YEAR	<u>\$ 1,958</u>	<u>\$ 206,629</u>	<u>\$ 1,958</u>

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Continued)

YEARS ENDED DECEMBER 31, 2002 AND 2001

	<u>2002</u>	<u>2001</u>	<u>Cumulative Amounts from Inception (March 8, 1989 to December 31, 2002)</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Non-cash investing and financing activities are as follows:			
Issuance of preferred stock and notes payable in connection with the acquisition of a subsidiary	\$ -	\$ -	\$ 1,321,636
Capital lease obligation incurred related to acquisition of equipment	\$ -	\$ -	\$ 38,140
Conversion of debt and accrued interest payable to common stock (Notes 4, 6 and 7)	\$ 5,111,996	\$ -	\$ 5,650,183
Common stock and warrants issued in connection with debt	\$ -	\$ -	\$ 1,143,518
Conversion of trade payable to debt	\$ 143,000	\$ -	\$ 398,088
Conversion of trade payable to common stock	\$ 325,579	\$ 141,100	\$ 669,172
Acquisition of its preferred stock for debt	\$ -	\$ -	\$ 341,820
Conversion of accrued interest payable to debt	\$ -	\$ -	\$ 327,353
Conversion of the Company's common stock for debt	\$ -	\$ -	\$ 250,000
Conversion of Directors' loan to common stock	\$ -	\$ -	\$ 2,050,000
CASH PAID DURING THE PERIOD FOR INTEREST	\$ 108,245	\$ 148,247	\$ 3,225,351

See Notes to Consolidated Financial Statements.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Summary of Significant Accounting Policies below and the other notes to the Consolidated Financial Statements on the following pages are integral parts of the accompanying Consolidated Financial Statements.

Description of Business

Akers Biosciences, Inc. and its subsidiaries (the "Company" or "Akers") is a New Jersey Corporation, which was incorporated on March 8, 1989. The Company commenced research and development operations in September 1989, and is devoting substantially all its efforts to establish the new business through the date of these financial statements. Akers has generated only minimal sales of its primary products and is considered to be in the development stage. Accordingly, the accompanying financial statements represent those of a development stage enterprise.

During the year ended December 31, 2002, the Company changed its name to Akers Biosciences, Inc. and increased the authorized preferred shares and common shares to 15,000,000 and 60,000,000, respectively.

Patents and Trade Secrets

The Company has developed several diagnostic tests that can detect the presence of various substances in a person's blood, urine and saliva. Proprietary protection for the Company's products, technology and process is important to its competitive position. To date, the Company has received three patents from the United States Patent Office (5,565,366, 5,231,035, and 5,827,749). Other patents have been granted through the world Patent Cooperation Treaty ("PCT") (WO 92/05440), European Patent Convention (EP 0 556 202 B1), and in Japan (516757/91). Patents are in the national phase of prosecution in many PCT-participating countries. Additional proprietary technology consists of eleven different inventions. The Company intends to file additional patent applications, where appropriate, relating to new products, technologies and their use in the US, European and Asian markets. Management intends to protect all other intellectual property (e.g., copyrights, trademarks and trade secrets) using all legal remedies available to the Company.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
(A Development Stage Company)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*Continued*)

Principles of Consolidation

The consolidated financial statements include the accounts of the Company. All significant intercompany balances and transactions are eliminated. The subsidiaries have been inactive since December 31, 1996 and have no assets or liabilities.

Revenue Recognition

The Company recognizes sales at the time goods are shipped.

Trade Receivables

Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectable. Recoveries of trade receivables previously written off are recorded when received.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market, and primarily consist of raw materials used for research and development and manufacturing.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed over the estimated useful lives of the respective assets using straight-line and accelerated methods. Upon sale or retirement of assets, the related costs and accumulated depreciation are eliminated from the accounts and the resulting gain or loss is included in operations. Expenditures for repairs and maintenance that do not increase the useful lives of the assets are charged to operations as incurred.

Patent Costs

Costs associated with applying for patents are capitalized as patent costs. Once the patents are approved, the respective costs are amortized over a period of twelve to seventeen years on a straight-line basis. Patent pending costs for patents that are not approved are charged to operations the year the patent is rejected. Accumulated amortization was \$84,931 and \$81,448 as of December 31, 2002 and 2001, respectively. Amortization expense amounted to \$3,483 and \$6,746 for the years ended December 31, 2002 and 2001, respectively.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*Continued*)

Deferred Financing Costs

Costs incurred in connection with long-term financing have been capitalized and are being amortized on the straight-line basis over the term of the related debt. As of December 31, 2002 and 2001, accumulated amortization was \$18,333 and \$50,747, respectively. Amortization expense for the years ended December 31, 2002 and 2001 was \$4,443 and \$8,191, respectively.

Research and Development Costs

Research and development costs are charged to operations when incurred.

Advertising and Promotion

Advertising and promotion costs are charged to current operations when incurred. Advertising and promotion costs for the years ended December 31, 2002 and 2001 were \$17,759 and \$34,247, respectively.

Stock-Based Compensation

The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 "*Accounting for Stock-Based Compensation*," but elected to continue to utilize the "*intrinsic value*" method of accounting for recording stock-based compensation expense for employees, as provided for in Accounting Principles Board No. 25 "*Accounting for Stock Issued to Employees*" ("APB No. 25").

Income Taxes

Deferred income taxes are provided on a liability method. Whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*Continued*)

Stock Options and Warrants

The Company's intention is to issue stock options and warrants at no less than fair market value on the date of grant. On infrequent occasions, stock options and warrants have been issued at less than fair market value for services and in connection with financings, and the effect of these issuances has been recorded as an expense in the period of issuance of the option or warrant. Generally, the fair market value of common stock has been determined based on the price that the Company has received for the issuance of stock to investors during a comparable time period.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Impairment of Long-Lived Assets

In accordance with SFAS No. 121, "*Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*", the Company assesses the recoverability of fixed assets and intangibles based on undiscounted estimated future operating cash flows. If the Company determines that the carrying values have been impaired, the measurement and recognition of the impairment will also be based on estimated future operating cash flows. As of December 31, 2002 and 2001, the carrying value of these assets has been determined not to be impaired.

Recently Issued Accounting Standards

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "*Accounting for Impairment or Disposal of Long-Lived Assets*", which requires that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and broadens the presentation of discontinued operations to include more disposal transactions. The Statement has become effective in the fiscal year ending December 31, 2002. Management does not believe the adoption of Statement 144 will have a significant impact on its financial position or results of operations.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to credit risk consist of cash and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution and place investments with financial institutions evaluated as being creditworthy, which are exposed to minimal interest rate and credit risk. From time to time the Company had bank deposits that exceeded federally insured limits. Concentration of credit risk, with respect to accounts receivable, is limited due to the Company's credit evaluation process. The Company does not require collateral from its customers. Historically, the Company has not incurred any significant credit related losses.

The Company derived over 90% of its sales from four customers and three customers during the years ended December 31, 2002 and 2001, respectively. For the year ended December 31, 2002, 97% of the net outstanding accounts receivables represented balances due from these four customers. For the years ended December 31, 2002 and 2001, \$0 and \$161,800 represented sales to a company in which its Chairman was also a Director of the company.

NOTE 3. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	Estimated Useful Lives in Years	<u>2002</u>	<u>2001</u>
Machinery and equipment	5-15	\$1,025,109	\$ 982,863
Office furniture and equipment	5-7	66,702	59,690
Leasehold improvements	6	89,900	89,900
Transportation equipment	3-5	3,850	3,850
Assets held under capital lease	5	<u>40,300</u>	<u>40,300</u>
		1,225,861	1,176,603
Less: accumulated depreciation and amortization		<u>858,944</u>	<u>715,577</u>
		<u>\$ 366,917</u>	<u>\$ 461,026</u>

Depreciation and amortization expense for the years ended December 31, 2002 and 2001 amounted to \$143,367 and \$140,189, respectively.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. SENIOR NOTES PAYABLE

On February 25, 1994, the Company entered into a note agreement with Milan Holding Company, Inc. ("Milan") whereby Milan provided \$1,000,000 in exchange for a Senior Secured Note ("Senior Note"). The Senior Note bears annual interest at 4% and is past due as of December 31, 2001.

Subsequent to August 30, 1995, Milan made additional advances to the Company totaling \$750,000, of which \$400,000 bore interest at 10% and \$350,000 bore interest at prime plus 1%. Senior notes payable noted totaling \$1,750,000 were past due as of December 31, 2001. The notes were collateralized by a security interest in Patent No. 5,231,035, issued July 27, 1993, entitled: Latex Agglutination Assay.

During the year ended December 31, 2002, Milan converted its outstanding debt along with accrued interest to common stock. The debt was converted to common stock at a stock conversion price consistent with the stock's fair value.

NOTE 5. NOTE PAYABLE, BANK

On November 16, 2001, the Company borrowed \$250,000 from Commerce Bank, N.A. The loan was evidenced by a promissory note, and secured by corporate assets as well as the personal guarantee of the Company's Chief Executive Officer. Additional collateral in the form of personal real estate was also pledged. The loan bore interest at prime rate plus 1.0%, and was due and repaid in February 2002.

NOTE 6. CONVERTIBLE NOTES PAYABLE

During 2001, the Company entered into transactions evidenced by subordinated convertible notes with various individuals and/or entities, for which the Company received \$1,350,000. The notes were for a one-year period expiring through November 2002, and bore interest at 9%. They were also convertible into shares of the Company's common stock at a conversion price of either \$2.00 or \$2.50. In addition, the notes had detachable warrants which are convertible into 135,000 shares of the Company's common stock at an exercise price of either \$2.00 or \$2.50. These warrants have an expiration term of one to two years, through November 2003. These warrants are considered detachable warrants and the associated expense determined using the Black-Scholes pricing model was \$0 and \$3,250 for 2002 and 2001, respectively.

During the year ended December 31, 2002, \$950,000 of the aforementioned notes were converted into common stock at \$1.50 and \$1.75 per share, and the remaining balance of \$400,000 was repaid. Since the conversion of \$950,000 of debt to common stock was at a lower conversion price per share than original conversion rates, this transaction was deemed an induced debt conversion and a debt conversion expense of \$262,730 was recorded during 2002.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEBT OBLIGATIONS

	<u>2002</u>	<u>2001</u>
<p>Note payable, Small Business Administration, due in monthly installments of \$5,094 including fixed interest of 7.77%. The loan is collateralized by a second lien on the Company's equipment, and is guaranteed by the Company's CEO. The loan is due September 2016.</p>	\$ 513,792	\$ 534,136
<p>Note payable, individual, unsecured, due in monthly installments of \$3,000 including interest, imputed at 6%. The note, with the face amount of \$176,000, was issued in connection with the Company's repurchase of certain preferred stock. The loan was due and repaid in July 2002.</p>	-	23,476
<p>Note payable, individual, unsecured, in connection with the Company's repurchase of preferred stock. This portion of the obligation is being amortized to the future payment of \$60,000, imputed at 6% and is due February 2009. The note is convertible into 75,000 shares of the Company's common stock at the option of the Payee.</p>	46,314	43,209
<p>Note payable, bank, due in 84 monthly principal installments of \$5,362 plus interest at prime plus 1.5% through May 2002. The note was collateralized by a first lien on all equipment owned by the Company and was guaranteed by officers of the Company and the Small Business Administration. The note was repaid in June 2002.</p>	-	39,627
<p>Note payable, stockholder, unsecured, payable with interest at 18%. Unpaid principal and interest was due and repaid in March 31, 2002.</p>	-	128,446
<p>Note payable, corporation, unsecured, payable in quarterly installments of \$28,125 including interest at 10%, through December 31, 2000. The note was due March 30, 2001 and was repaid in full in April 2002.</p>	-	11,562

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEBT OBLIGATIONS (*Continued*)

	<u>2002</u>	<u>2001</u>
Note payable, stockholder, unsecured, payable upon demand with interest at 4%.	\$ 100,000	\$ 100,000
Note payable, stockholder, unsecured. Interest is payable at 15% with principal due June 30, 1999. The loan along with accrued interest totaling \$64,640 plus 375,000 outstanding warrants were converted to common stock in March 2002. Since the Company converted the debt and accrued interest at conversion prices lower than the original stated price, as an inducement to the holder to convert, a debt conversion expense totaling \$356,610 was recorded during 2002.	-	36,250
Note payable, stockholder, unsecured. Interest is payable at 15% with principal due June 30, 1999. The loan, along with accrued interest totaling \$129,281 plus 750,000 outstanding warrants, was converted to common stock in March 2002. Since the Company converted the debt and accrued interest at conversion prices lower than the original stated price, as an inducement to the holder to convert, a debt conversion expense totaling \$713,219 was recorded during 2002.	-	72,500
Note payable, stockholder, unsecured including interest at prime plus 1.0% (5.25% at December 31, 2002), due on demand.	34,689	34,689
Note payable, vendor, as payment for trade debt, payable in monthly installments of \$6,000 including interest at 7%, commencing March 1, 2003 through April 1, 2005	143,000	-
Notes payable, insurance premiums financed	68,975	-
Notes payable, stockholders, interest at 18% annually, payable monthly. The principal amounts of the notes are due June 30, 2003. The notes are secured by real estate pledged by an officer of the Company.	370,000	-
Note payable, individual, unsecured,	125,000	-

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEBT OBLIGATIONS (*Continued*)

Deferred compensation, employee, non-interest bearing, due 2003	<u>\$ 115,000</u>	<u>\$ 115,000</u>
	1,516,770	1,138,895
Less: current maturities	<u>978,646</u>	<u>466,894</u>
Long-term debt	<u>\$ 538,126</u>	<u>\$ 672,001</u>

Annual maturities on long-term debt are as follows:

<u>YEARS ENDING DECEMBER 31,</u>	<u>AMOUNT</u>
2003	\$ 978,646
2004	23,752
2005	25,665
2006	27,731
2007	76,278
Thereafter	<u>384,698</u>
	<u>\$1,516,770</u>

NOTE 8. COMMITMENTS

Capital Leases

The Company leases certain computer equipment with a cost of \$40,300 under a capital lease expiring in January 2004. The assets under capital leases are recorded at lower of the present value of the future minimum lease payments or the fair value of the assets.

Total minimum future obligations under capital leases is \$12,359 through 2004.

Amortization of \$7,737 and \$12,896 related to the assets under capital leases is included in depreciation and amortization expense in the accompanying financial statements for the years ended December 31, 2002 and 2001, respectively.

Interest expense related to capital lease obligations was \$1,381 and \$2,599 for the years ended December 31, 2002 and 2001, respectively.

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. COMMITMENTS (*Continued*)

Operating Leases

The Company leases office space in Thorofare, New Jersey under a noncancellable-operating lease with annual rentals of \$141,000 plus common area maintenance (CAM) charges. The Company's lease term expires May 31, 2004.

In addition, the Company leases certain equipment under noncancellable operating leases, which expire at various dates through May 21, 2006. Minimum future rental payments under all noncancellable-operating equipment leases are as follows:

<u>YEARS ENDING DECEMBER 31,</u>	<u>AMOUNT</u>
2003	\$12,059
2004	11,592
2005	7,397
2006	<u>190</u>
Total	<u>\$31,238</u>

Rent expense for the years ended December 31, 2002 and 2001 was \$224,436 and \$211,325, respectively.

Employment Contracts

Certain officers of the Company have employment contracts in the normal course of business ranging from one to five years. Certain of these officers were also given options as part of their agreement. During 2002 and 2001, respectively, 160,000 and 314,000 options were granted at prices per share ranging from \$1.00 to \$2.00. The Company records compensation expense relating to options provided to employees in accordance with APB No. 25 (Note 1) in which the intrinsic value (fair market value less exercise price) is recorded to compensation expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. INCOME TAXES

The Company has deferred tax assets of approximately \$14,800,000 and \$13,600,000 as of December 31, 2002 and 2001, respectively, primarily related to net operating loss carryforwards, which have yet to be utilized. At December 31, 2002 and 2001, the Company established a 100% valuation allowance against the deferred tax assets as the likelihood of recognizing this benefit is not certain. The utilization of these losses to reduce future income taxes will depend upon the generation of sufficient taxable income prior to the expiration of the net operating loss carryforwards. In addition, based on ownership changes resulting from the private placements of stock, as well as historical issuances of common stock, the annual utilization of the otherwise available net operating loss carryforward may be limited by the provisions of Section 382 of the Internal Revenue Code, as amended.

The Company has Federal and state loss carryforwards available totaling \$37,000,000 and \$25,000,000, respectively. The loss carryforwards are available to offset future taxable income liabilities at December 31, 2002, that expire at various dates through the year 2020.

In each of the years ended December 31, 2002 and 2001, the Company sold New Jersey State operating loss carryforwards, which resulted in proceeds of \$242,396 and \$371,254, respectively.

NOTE 10. CAPITAL

During May 2002, the Company went public on the London Stock Exchange ("Alternative Investment Market"). The offering placed 2,525,000 shares at a price of \$2 (U.S. dollars) per share. Net proceeds, representing gross proceeds less stock offering costs, totaled \$3,818,068.

As noted in the statement of stockholders' deficiency, the Company issued certain warrants and shares of stock in lieu of cash payment for certain products and services received. These transactions were accounted in accordance with SFAS No. 123 "*Accounting for Stock-Based Compensation*". The basis of assigning value of the stock issued was the fair market value of the related products or services received.

Net loss per common share, calculated on the basic method (net loss divided by the weighted number of outstanding common shares), was \$0.19 and \$0.16 for the years ended December 31, 2002 and 2001, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. STOCK WARRANTS AND OPTIONS AND RELATED PARTY TRANSACTIONS

Stock Warrants

The Company has issued warrants to various employees and consultants of the Company for their services either in connection with the Company's ongoing efforts to raise capital or the development of the Company's products. Each warrant granted may be exchanged for a prescribed number of shares of common stock. The warrants expire at various dates through December 2009.

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance, December 31, 2000	6,742,155	\$1.11
Options Granted	169,500	2.19
Options Exercised	(20,000)	.10
Options Expired/Terminated	<u>(712,501)</u>	<u>1.50</u>
Balance, December 31, 2001	6,179,154	1.27
Options Granted	1,133,750	1.85
Options Exercised	(32,500)	2.00
Options Expired/Terminated	<u>(3,721,073)</u>	<u>1.19</u>
Balance, December 31, 2002	<u>3,559,331</u>	<u>\$1.55</u>

During March 2002, the Company induced certain warrant holders to convert their warrants to common stock, at a ratio less than 1 for 1. The Company waived the payment of the warrant exercise price ("cashless" transaction). A total of 2,572,415 warrants related to non-employees were converted into 758,573 shares of common stock. No compensation or inducement expense is required to be recorded related to non-employees.

During March 2002, the Company also converted 1,000,000 warrants held by two officers into 655,000 shares of common stock in a cashless exchange. Compensation expense, totaling \$1,310,000, was recorded representing 655,000 shares converted at a fair market value of \$2 per share for the year ended December 31, 2002.

During 2001, the Company recorded additional compensation expense attributable to warrants issued in conjunction with services performed in the amount of \$42,615.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. STOCK WARRANTS AND OPTIONS AND RELATED PARTY TRANSACTIONS (*Continued*)

Stock Options

The Company has adopted two option plans that permit the granting of options to purchase shares of common stock. The plans provide for the granting of both incentive stock options ("Incentive Stock Plan"), as defined in Section 422 of the Internal Revenue Code (the "Code"), and options defined by Section 422 of the Code ("Non-qualified options").

The plans are administered by a Compensation Committee, which is appointed by the Board of Directors who grants all options and determines their terms. Options are non-transferable and are only granted to employees, officers and directors, and advisors or consultants who agree to be employed or to provide services to the Company for a period of at least one year after the grant date. The maximum term of any option under the plans is ten years.

During 2001, the Company modified certain employee stock options by reducing the exercise price or extending the exercisable term. Modifications to employee stock options require a new measurement of compensation cost at the modification date. Compensation relating to these modifications totaled \$0 and \$1,666,000 for 2002 and 2001, respectively.

Qualified option holders may exercise their options at their discretion through various dates ending November 2008. Each option granted may be exchanged for a prescribed number of shares of common stock.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. STOCK WARRANTS AND OPTIONS AND RELATED PARTY TRANSACTIONS *(Continued)*

Stock Options (Continued)

<u>Employee Plan – Qualified Options</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance, December 31, 2000	1,543,750	\$1.14
Options Granted	517,665	1.34
Options Exercised	-	-
Options Expired/Terminated	<u>-</u>	<u>-</u>
Balance, December 31, 2001	2,061,415	1.19
Options Granted	250,000	1.90
Options Exercised	(22,500)	1.79
Options Expired/Terminated	<u>(159,000)</u>	<u>1.76</u>
Balance, December 31, 2002	<u>2,129,915</u>	<u>\$1.06</u>
<u>Directors' Plan</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance, December 31, 2000	170,500	\$1.00
Options Granted	129,500	1.58
Options Exercised	-	-
Options Expired/Terminated	<u>(500)</u>	<u>1.00</u>
Balance, December 31, 2001	299,500	1.47
Options Granted	275,000	2.00
Options Exercised	(28,000)	1.00
Options Expired/Terminated	<u>-</u>	<u>-</u>
Balance, December 31, 2002	<u>546,500</u>	<u>\$1.75</u>

AKERS BIOSCIENCES, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. STOCK WARRANTS AND OPTIONS AND RELATED PARTY TRANSACTIONS *(Continued)*

Stock Options (Continued)

Non-qualified option holders may exercise their options at their discretion through various dates ending December 2006. The Company has granted non-qualified options as follows:

<u>Non-Qualified Options</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance, December 31, 2000	347,000	\$1.00
Options Granted	175,000	1.00
Options Exercised	-	-
Options Expired/Terminated	<u>(300,000)</u>	<u>1.00</u>
Balance, December 31, 2001	222,000	1.00
Options Granted	-	-
Options Exercised	(72,000)	1.00
Options Expired/Terminated	<u>-</u>	<u>-</u>
Balance, December 31, 2002	<u>150,000</u>	<u>\$1.00</u>

The following table summarizes information concerning outstanding exercisable warrants and options at December 31, 2002:

<u>Range of Exercise Prices</u>	<u>Options and Warrants Outstanding</u>			<u>Options and Warrants Exercisable</u>	
	<u>Number Outstanding</u>	<u>Weighted-Average Remaining Contractual Life</u>	<u>Weighted-Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted-Average Exercise Price</u>
\$.10 – .99	865,000	5.33	\$.70	865,000	\$.70
1.00 – 1.49	2,894,825	5.44	1.00	2,894,825	1.00
1.50 – 1.99	705,000	2.56	1.50	705,000	1.50
2.00 – 2.49	1,838,421	6.10	2.00	1,460,439	2.00
2.50	82,500	.77	2.50	82,500	2.50

Options and warrants exercisable at December 31, 2002 and 2001 were 6,007,764 and 8,462,069, respectively.

The weighted-average per share fair value of warrants and options on grant date was approximately \$1.90 and \$2.20 for 2002 and 2001, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. STOCK WARRANTS AND OPTIONS AND RELATED PARTY TRANSACTIONS (*Continued*)

With respect to stock options granted to employees, the Company has adopted the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," but applies APB Opinion No. 25 "Accounting for Stock Issued to Employees" in accounting for its stock compensation plan. Accordingly, no compensation costs have been recognized with respect to stock options granted to employees, officers and directors in 2002 and 2001, except as relating to modifications made on certain options as noted above and new options granted to employees, officers and directors during each year. Additional compensation cost that would have been recognized in accordance with the basis of fair value pursuant to SFAS No. 123 would have increased the Company's net loss for 2002 and 2001 by approximately \$-0- and \$340,000, respectively. The method of determining proforma compensation costs for 2002 and 2001 was based on certain assumptions, including expected volatility of 5%, a risk free interest rate between 5%-6%, expected life of options of 5 years and no expected payment of dividends.

With respect to stock options granted to non-employees, the Company records the appropriate expense as required by SFAS No. 123. During 2002 and 2001, the Company incurred approximately \$-0- and \$-0-, respectively of expense as a result of issuing common stock to service providers some of which were issued below the Company's fair market value.

Stock Issued for Services

The Company values stock issued for services at its fair market value at the date of issuance.

NOTE 12. BUSINESS OPERATIONS

The Company has incurred, during its developmental stage, substantial losses since its inception. While the Company has received several FDA approvals, the Company has not yet begun mass distribution of these products. Sales since inception have primarily been to several international customers. Accordingly, the Company has a limited operating history upon which an evaluation of its future performance and prospects can be made. The Company's plan of operation and prospects must be considered in light of the risks, expenses, difficulties and problems frequently encountered in the establishment of a new business. Additionally, the Company intends to market its products through corporate partnerships and a network of carefully selected international distributors. No assurance can be given that the Company will be able to develop a distribution network or successfully manage such distributors or that existing or future distributors will be able to sell the Company's products in a satisfactory manner or in sufficient quantities, or that its sales and marketing efforts will be successful.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12. BUSINESS OPERATIONS (*Continued*)

The Company believes that it has available sources of financing to fully develop its technologies into commercially viable products and services. However, to the extent that funds generated from operations and existing capital resources are insufficient, the Company will have to raise additional funds. While there can be no assurance that future equity fundings or other sources of financing will be successful, the Company believes that the proceeds from future offerings will be sufficient to fund its operations and anticipated growth for at least the next 12 months following the report date. If adequate funds are not available, the Company may be required to curtail its operations.

NOTE 13. DISCONTINUED OPERATIONS

During 1996, the Company adopted a formal plan to sell the Franklin division. On October 15, 1996, the Company completed the sale of the Franklin division. The assets consisted primarily of inventories and equipment. The selling price was \$1,096,000 in cash. The income statements related to periods prior to 1997 have been restated, and operating results of the Franklin division are shown separately as discontinued operations.

Net sales of the Franklin division for the period October 29, 1993 (the purchase date of the Franklin division) through December 31, 1993 was \$97,000 and for the years ended December 31, 1994, 1995 and 1996 was \$1,110,000, \$1,828,000 and \$1,718,000, respectively. These amounts are not included in net sales in the accompanying income statements.

NOTE 14. SUBSEQUENT EVENTS

On April 18, 2003, the Company executed an asset based line of credit agreement with its bank. The facility is for \$1,000,000, matures on April 1, 2004 and provides advances to the company from time to time based on an amount not greater than 80% of eligible accounts receivable plus 50% of inventory, exclusive of work in progress.