ATI AIRTEST TECHNOLOGIES INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

(Expressed in Canadian dollars)

DALE MATHESON CARR-HILTON LABONTE LLP
CHARTERED ACCOUNTANTS & BUSINESS ADVISORS

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INDEPENDENT AUDITOR'S REPORT

To the shareholders of ATI Airtest Technologies Inc.,

We have audited the accompanying consolidated financial statements of ATI Airtest Technologies Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of comprehensive loss, changes in shareholders' deficiency and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of ATI Airtest Technologies Inc. as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis* of *matter

We draw attention to Note 1 in the consolidated financial statements which advises that ATI Airtest Technologies Inc. has had recurring operating losses and additional material uncertainties that may cast significant doubt about its ability to continue as a going concern. Our opinion is not qualified in respect of this matter.

DMCL

May 1, 2013
Vancouver, Canada

DALE MATHESON CARR-HILTON LABONTE LLP
CHARTERED ACCOUNTANTS

ATI AIRTEST TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian dollars)

	Note	December 31, 2012	December 31, 2011
ASSETS			
Current			
Cash		$ 1,769	$ 34,550
Trade receivables	4	505,593	452,389
Inventory	5	271,378	241,692
Prepaid expenses		9,708	65,126
		788,448	793,757
Non-current			
Equipment	6	10,532	13,470
		$ 798,980	$ 807,227
LIABILITIES			
Current			
Trade payables and accrued liabilities	8	$ 1,699,635	$ 1,655,019
Customer deposits		12,960	12,960
Loans	9	1,418,876	1,091,235
Convertible debt notes	9	74,014	74,014
Share subscriptions received		-	416,000
Due to related parties	11	312,273	229,104
		3,517,758	3,478,332
SHAREHOLDERS' DEFICIENCY			
Share capital	10	9,315,281	8,879,407
Subscriptions receivable	10	(157,000)	(157,000)
Reserve		1,358,239	1,303,271
Deficit		(13,235,298)	(12,696,783)
		(2,718,778)	(2,671,105)
		$ 798,980	$ 807,227

Nature of operations (Note 1)

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

APPROVED ON BEHALF OF THE BOARD

/s/ "George Graham"

/s/ "Darrel Taylor"

ATI AIRTEST TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

YEARS ENDED DECEMBER 31, 2012 AND 2011
(Expressed in Canadian dollars)

	Note	2012	2011
PRODUCT SALES		$ 2,797,931	$3,000,364
COST OF GOODS SOLD		1,699,273	1,853,613
GROSS PROFIT		1,098,658	1,146,751
EXPENSES			
General and administrative	12	688,812	841,584
Business development and marketing	12	516,799	521,557
Factoring fees and finance charges	9	384,562	387,988
Research and development		47,000	409,547
		(1,637,173)	(2,160,676)
OTHER ITEM			
Write-off of intangible asset	7	-	(60,000)
NET AND COMPREHENSIVE LOSS		(538,515)	(1,073,925)
Loss per shares – basic and diluted		$ (0.02)	$ (0.06)
Weighted average number of common shares outstanding – basic and diluted		23,132,856	19,458,935

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

ATI AIRTEST TECHNOLOGIES INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHARHOLDERS' DEFICIENCY

YEARS ENDED DECEMBER 31, 2012 AND 2011
(Expressed in Canadian dollars)

		Share capital					
	Note	Number of shares	Amount $	Subscriptions receivable $	Stock-based reserve $	Deficit $	Total shareholders' deficiency $
Balance, December 31, 2010		18,152,176	8,266,195	(22,000)	1,301,703	(11,622,858)	(2,076,960)
Shares issued for cash:							
-Private placement units at $0.30 per unit	10	2,230,000	669,000	(135,000)	-	-	534,000
Finders units issued	10	50,000	15,000	-	-	-	15,000
Share issuance costs	10	-	(70,788)	-	1,568	-	(69,220)
Comprehensive loss for the year		-	-	-	-	(1,073,925)	(1,073,925)
Balance, December 31, 2011		20,432,176	8,879,407	(157,000)	1,303,271	(12,696,783)	(2,671,105)
Shares issued for cash:							
-Private placement units at $0.13 per unit	10	3,352,885	435,874	-	-	-	435,874
Stock options granted	10	-	-	-	32,775	-	32,775
Stock options repriced	10	-	-	-	22,193	-	22,193
Comprehensive loss for the year		-	-	-	-	(538,515)	(538,515)
Balance, December 31, 2012		23,785,061	9,315,281	(157,000)	1,358,239	(13,235,298)	(2,718,778)

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

ATI AIRTEST TECHNOLOGIES INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011
(Expressed in Canadian dollars)

	2012	2011
CASH PROVIDED BY (USED IN):		
Operating Activities:		
Net loss	$ (538,515)	$ (1,073,925)
Items not involving cash:		
Amortization	2,938	3,895
Stock based compensation	54,968	-
Write-off of intangible assets	-	60,000
Changes in non-cash working capital items:		
Trade receivables	(53,204)	(100,742)
Inventory	(29,686)	165,313
Interest payable	106,692	163,713
Prepaid expenses	55,418	(54,500)
Trade payables and accrued liabilities	58,614	275,925
Net cash used in operating activities	(342,775)	(560,321)
Financing Activities:		
Proceeds from share issuance	435,878	479,782
Share subscriptions received	(416,000)	416,000
Loan (repayments) proceeds	206,949	(412,460)
Advances from related parties	83,167	59,233
Net cash from financing activities	309,994	542,555
Decrease in cash	(32,781)	(17,766)
Cash, beginning of year	34,550	52,316
Cash, end of year	$ 1,769	$ 34,550

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

1. Nature of operations

ATI Airtest Technologies Inc. (the "Company") was incorporated in British Columbia on March 13, 1996. The primary business activity is the manufacture and sale of air testing equipment and related services in Canada and the United States. The Company's shares are traded on the TSX Venture Exchange ("TSX-V").

The Company's head office is located at Unit 9-1520 Cliveden Ave, Delta, British Columbia V3M 6J8.

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. They do not include adjustments, if any, that may be required for the realization of assets or the settlement of liabilities should the Company be unable to continue as a going concern. The Company has experienced significant operating losses since its inception and has a working capital deficiency at December 31, 2012 of $2,729,310 and has accumulated a deficit of $13,325,298 to date. The Company has financed its operations through equity, factoring loans, third party loans, related party advances and deposits. Future operations are dependent upon the Company's ability to obtain additional financing, continued support of existing creditors and lenders, continued financial support from related parties, and ultimately attaining profitable operations. The realization and settlement of amounts reported for assets is dependent upon market acceptance of the Company's products and services and generation of future profitable operations.

Management believes that the Company can meet financial requirements through equity financing, sales growth, support of related parties, and bridge financing for at least the ensuing 12 month period. There is no certainty that the Company will be able to acquire sufficient financing or increase sales to levels necessary to achieve profitability. If the Company is unable to achieve profitable operations and is unable to settle payment of liabilities with creditors and related parties, the going concern assumption may not be sustainable. These uncertainties may cast significant doubt about the Company's ability to continue as a going concern. It is reasonable to assume that if the going concern assumption cannot be sustained that material adjustments to the carrying value of assets and liabilities may be required.

2. Basis of presentation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS represents standards and interpretations approved by the International Accounting Standards Board, and are comprised of IFRS's, International Accounting Standards, and interpretations issued by the International Financial Reporting Interpretations Committee.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of May 1, 2013, the date the Board of Directors approved these financial statements.

The consolidated financial statements of the Company have been prepared on a historical cost basis, except for financial instruments classified as fair value through profit and loss, which are stated at their value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

3. Significant accounting policies

Basis of consolidation

The Company consolidates all entities under its control. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases. Any changes in the effective ownership interest, where control continues, are recorded as acquisition or disposals through equity. The Company has 3 inactive wholly owned subsidiaries:

These consolidated financial statements include the accounts of the Company and each of its wholly owned inactive subsidiaries: Airwave Environmental Technologies Inc. (Canada), Airtest Technologies Corp. (US), and Clairtec Inc. (US).Inter-company transactions and balances have been eliminated upon consolidation.

Inventory

Inventories include raw materials, work in process and finished goods, all of which are stated at the lower of weighted average cost and net realizable value. Cost includes the cost of direct material, direct labour and other overhead costs. Labour costs are allocated to items based on actual labour rates. Fixed and variable overhead are allocated to production activities in converting materials to finished goods.

Equipment

Equipment is stated at historical cost less accumulated depreciation and accumulated impairment losses. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive loss during the financial period in which they are incurred.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the statement of comprehensive loss.

Amortization is calculated on a declining-balance method to write off the cost of the assets to their residual values over their estimated useful lives. The amortization rates applicable to each category of equipment are as follows:

Asset	Basis	Rate
Computer hardware	declining-balance	30%
Office furniture and fixtures	declining-balance	20%
Assembly equipment	declining-balance	20%
Testing equipment	declining-balance	30%

3. Significant accounting policies (continued)

Revenue recognition

Product sales revenue is recognized when evidence of a contractual arrangement exists, prices are fixed, and the risks of ownership or title pass to the customer. This is normally when products are shipped from the warehouse, provided collection is reasonably assured.

Service revenue is recognized when the service has been completed to the customer's specification and collection is reasonably assured.

Warranty provision

The Company accrues for estimated warranty obligations under a warranty provision at the time sales are recognized and any changes in estimates are recognized prospectively through the provision. The Company provides its customers with a limited right of return for defective products. All warranty returns must be authorized by the Company prior to acceptance. Warranty provisions are estimated based on the Company's experience and to date have been insignificant.

Research and development

Research and development costs are expensed as incurred unless development costs meet the criteria for capitalization: a) The technical feasibility of completing the intangible asset so that it will be available for use or sale b) The intention to complete the intangible asset and use or sell it c) The ability to use or sell the intangible asset; d) How the intangible asset will generate probable future economic benefits; e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and f) The ability to measure reliably the expenditure attributable to the intangible asset during its development.

The Company amortizes costs, commencing with commercial production, over the expected future benefit period based upon quantities delivered compared to expected levels contracted to be delivered.

Impairment of assets

The carrying amount of the Company's long term assets are reviewed at each reporting date to determine whether there is any indication of impairment. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. An impairment loss is recognized whenever the carrying amount of an asset, or the asset's cash generating unit, exceeds its recoverable amount. Impairment losses are recognized in the statement of comprehensive income (loss).

The recoverable amount of an asset is measured at the greater of its fair value less cost to sell and its value in use. In assessing value in use, the estimated attributable future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is only reversed if there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount, however, a reversal cannot exceed the carrying amount that would have been determined had no impairment loss been recognized in previous years.

3. Significant accounting policies (continued)

Impairment of assets (continued)

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment.

Share-based payments

The Company operates a stock option plan. Share-based payments to employees are measured at the fair value of the instruments issued and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of goods or services received or the fair value of the equity instruments issued, if it is determined the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. The corresponding amount is recorded to the option reserve. The fair value of options is determined using the Black–Scholes Option Pricing Model. The number of shares and options expected to vest is reviewed and adjusted at the end of each reporting period such that the amount recognized for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

Loss per share

Basic loss per share amounts are calculated by dividing net loss by the weighted average number of common shares outstanding during the year.

Diluted loss per share amounts are computed similarly to basic loss per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of additional options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the year.

Significant accounting judgments, estimates and assumptions

The preparation of the Company's consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent assets and liabilities and reported amounts of revenues and expenses at the date of the financial statements and during the reporting period. Estimates and assumptions are made and continuously evaluated based upon management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Areas requiring a significant degree of management estimation relate to the determination of the useful lives of property, plant and equipment, the recoverability of the carrying value of assets, recoverability of receivables, realizable value of inventory, fair value measurements for financial instruments, stock-based compensation and other equity-based payments, warranty accruals, cost allocations, and the measurement of deferred tax assets and liabilities. Management attempts to use all current and relevant information available in making estimates, however actual results may differ substantially from those estimates.

3. Significant accounting policies (continued)

Significant accounting judgments, estimates and assumptions: (continued)

Areas requiring a significant degree of management judgment include reviewing for indicators of impairment of intangible assets, determining functional currency, determining cost centers and cash generating units for impairment, selection of fair value models, and the potential exposure related to tax filing positions or non-compliance.

Income taxes:

Current income tax assets and liabilities for the period and as at the year end are measured at the amount expected to be recovered from or paid to taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date, in the countries where the Company operates and generates taxable activities.

Current income tax relating to items recognized directly in other comprehensive income or equity is recognized in other comprehensive income or equity and not in profit or loss. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income tax is provided using the asset and liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and recognized only to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets and deferred income tax liabilities are offset only if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Functional currency and foreign currency translation

These consolidated financial statements are presented in Canadian dollars which is the parent Company's and each of the subsidiaries functional currency.

3. Significant accounting policies (continued)

Functional currency and foreign currency translation (continued)

Transactions and balances:

Where the functional currency of the entity is the same as the parent company, foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transaction. Foreign currency monetary items are translated at the period-end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were initially determined.

Exchange differences arising on the translation of monetary items or on settlement of monetary items are recognized in profit or loss in the statement of comprehensive income in the period in which they arise, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognized in other comprehensive income in the statement of comprehensive income to the extent that gains and losses arising on those non-monetary items are also recognized in other comprehensive income. Where the non-monetary gain or loss is recognized in profit or loss, the exchange component is also recognized in profit or loss.

Financial Instruments:

The Company classifies its financial instruments in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale and financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. Management determines the classification of financial instruments at initial recognition.

Financial assets are classified at fair value through profit or loss when they are either held for trading for the purpose of short-term profit taking, derivatives not held for hedging purposes, or when they are designated as such to avoid an accounting mismatch or to enable performance evaluation where a group of financial assets is managed by key management personnel on a fair value basis in accordance with a documented risk management or investment strategy. Such assets are subsequently measured at fair value with changes in carrying value being included in profit or loss.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are subsequently measured at amortized cost. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period.

Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and it is the Company's intention to hold these investments to maturity. They are subsequently measured at amortized cost. Held-to-maturity investments are included in non-current assets, except for those which are expected to mature within 12 months after the end of the reporting period.

3. Significant accounting policies (continued)

Financial Instruments: (continued)

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not suitable to be classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity investments and are subsequently measured at fair value in current assets. Unrealized gains and losses are recognized in other comprehensive income, except for impairment losses and foreign exchange gains and losses.

Financial liabilities (excluding financial guarantees that are derivatives) are subsequently measured at amortized cost.

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. At each reporting date, the Company assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a significant and prolonged decline in the value of the instrument is considered to determine whether impairment has arisen.

Recent accounting pronouncements, not yet adopted:

New standard IFRS 9 “Financial Instruments”

This new standard is a partial replacement of IAS 39 “Financial Instruments: Recognition and Measurement”. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets.

The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015.

New standard IFRS 10 “Consolidated Financial Statements”

This new standard will replace IAS 27 “Consolidated and Separate Financial Statements”, and Standing Interpretations Committee abstract (“SIC”) 12 “Consolidation – Special Purpose Entities”. Concurrent with IFRS 10, the IASB issued IFRS 11 “Joint Ventures”; IFRS 12 “Disclosures of Involvement with Other Entities”; IAS 27 “Separate Financial Statements”, which has been amended for the issuance of IFRS 10 but retains the current guidance for separate financial statements; and IAS 28 “Investments in Associates and Joint Ventures”, which has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11.

IFRS 10 uses control as the single basis for consolidation, irrespective of the nature of the investee, eliminating the risks and rewards approach included in SIC-12, and requires continuous assessment of control over an investee. The above consolidation standards are effective for annual periods beginning on or after January 1, 2013.

3. Significant accounting policies (continued)

Recent accounting pronouncements, not yet adopted: (continued)

New standard IFRS 11 “Joint Arrangements”

This new standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes lAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities-Non-monetary Contributions by Venturers.

New standard IFRS 12 “Disclosure of Interests in Other Entities”

This new standard establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

New standard IFRS 13 “Fair value measurement”

This new standard replaces the fair value measurement guidance currently included in various other IFRS standards with a single definition of fair value and extensive application guidance. IFRS 13 provides guidance on how to measure fair value and does not introduce new requirements for when fair value is required or permitted. It also establishes disclosure requirements to provide users of the financial statements with more information about fair value measurements. IFRS 13 is effect for annual periods beginning on or after January 1, 2013.

Amendments to IAS 32 “Financial Instruments: Presentation”

These amendments address inconsistencies when applying the offsetting requirements, and is effective for annual periods beginning on or after January 1, 2014.

Financial statement presentation

In June 2011, the IASB and the Financial Accounting Standards Board (“FASB”) issued amendments to standards to align the presentation requirements for other comprehensive income (“OCI”). The IASB issued amendments to IAS 1 “Presentation of Financial Statements” to require companies preparing financial statements under IFRS to group items within OCI that may be reclassified to the profit or loss. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The amendments are effective for fiscal years beginning on or after July 1, 2012.

The Company has not early adopted these revised standards and is currently assessing the impact that these standards will have on its consolidated financial statements.

Other accounting standards or amendments to existing accounting standards that have been issued but have future effective dates are either not applicable or are not expected to have a significant impact on the Company’s financial statements.

(Expressed in Canadian dollars)

4. Trade receivables

	December 31, 2012	December 31, 2011
Trade receivables	$ 33,124	$ 28,701
Trade receivables factored (Note 9(a))	477,825	429,089
Allowance for doubtful amounts	(5,356)	(5,401)
	$ 505,593	$ 452,389

5. Inventory

	December 31, 2012	December 31, 2011
Finished goods	$ 135,634	$ 110,036
Work in progress	3,135	10,991
Raw materials and component parts	132,609	120,665
	$ 271,378	$ 241,692

For the year ended December 31, 2012, inventory recognized as an expense in cost of sales amounted to $1,502,305 (2011 - $1,645,766) with write downs of $nil (2011 - $10,292). There were no reversals of previously recorded inventory write downs for 2012 and 2011.

6. Equipment

	Office furniture & fixtures	Computer hardware	Testing equipment	Assembly equipment	Total
Cost					
At December 31, 2010	$ 39,765	$ 73,255	$ 17,967	$ 5,793	$ 136,780
At December 31, 2011	39,765	73,255	17,967	5,793	136,780
At December 31, 2012	39,765	73,255	17,967	5,793	136,780
Amortization					
At December 31, 2010	29,383	68,107	16,585	5,341	119,416
Charge for the period	2,036	1,354	414	90	3,894
At December 31, 2011	31,419	69,461	16,999	5,431	123,310
Charge for the period	1,628	946	291	73	2,938
At December 31, 2012	33,047	70,407	17,290	5,504	126,248
Net book value					
At December 31, 2011	$ 8,346	$ 3,794	$ 968	$ 362	$ 13,470
At December 31, 2012	$ 6,718	$ 2,848	$ 677	$ 289	$ 10,532

(Expressed in Canadian dollars)

7. Intangible Assets

During the year ended December 31, 2011, the Company discontinued its funding under a new product development project. As a result, the Company relinquished many, if not all, of its rights under the agreement. As part of the review for indicators of impairment, the Company's determined that its rights have been impaired and has written-off the carrying value of the intangible asset to the statement of comprehensive loss.

8. Trade payables and accrued liabilities

	December 31, 2012	December 31, 2011
Trade payables	$ 1,323,294	$ 1,363,433
Due to government agencies	92,013	10,549
Payroll accrual and vacation payable	48,522	7,418
Accrued obligations	235,806	273,619
	$ 1,699,635	$ 1,655,019

9. Loans, advances and convertible debt

Loans and advances

	December 31, 2012	December 31, 2011
i) Factoring loan, secured against receivables with full recourse for uncollectable accounts	$ 486,914	$ 457,507
ii) Loans and advances, unsecured, due on demand:		
non-interest bearing	25,000	25,000
interest at 10% per annum	18,828	29,828
interest at 18% per annum	681,467	578,900
interest at 20% per annum	206,667	-
	$ 1,418,876	$ 1,091,235

i) Factoring loan facility:

During July 2004, the Company entered into a lending arrangement whereby the Company may borrow up to 80% of its trade receivables that are less than 90 days overdue. In addition, the Company may request loans or advances against purchase orders received from customers. The specified trade receivables are pledged as security for the arrangement, with full recourse against the Company.

9. Loans, advances and convertible debt (continued)

The loans bear interest at 1.5% per month for the first 60 days outstanding, 3.5% per month for the period outstanding greater than 61 days and up to 90 days, and 5% per month for the period outstanding greater then 90 days. There is a 3% processing charge for all trade receivables factored and advances received.

The amount due to the lender at December 31, 2012 includes current purchase orders for orders in progress.

The Company does not record a sale of the trade receivable or offset factored trade receivables to the related liability as the Company retains all the risks and rewards of ownership.

ii) All loans due on demand are effectively in default. The Company is working with the parties to settle loans through new funding, debt settlements and other arrangements. To date, none of the counterparties have taken legal action to recover the funds, however demands for payment have been made.

Until the Company arranges new equity funding or can settle the obligations, the loans and advances will continue in default and accrue interest, where applicable. Uncertainty remains over timing and amount of ultimate settlement.

Convertible debt notes:
The Company issued convertible debt instruments in 2004 and 2005. The remaining debt instruments are unsecured and originally bore interest at 1.5% per month. Each of the instruments matured and are now repayable on demand. At December 31, 2012, the outstanding balance of the demand notes was $74,014 (December 31, 2011 – $74,014). No interest has been accrued on these notes due to uncertainty over timing and amount of ultimate settlement.

10. Share capital

Authorized:
Unlimited common shares without par value

Private placements:

On March 13, 2012, the Company entered into a private placement of 3,352,885 share units at $0.13 per unit for total gross proceeds of $435,875. Each unit consists of one common share and one share purchase warrant. Each warrant entitles the holder to acquire three quarters of an additional common share of the Company at a price of $0.20 per share for a period of 60 months from March 13, 2012.

The fair value of the warrant included in the unit was estimated to be $0.02 using the Black-Scholes Option Pricing Model with volatility of 115%, dividend yield of 0%, expected life of 5 years and a risk free rate of 1.10%. The entire value of the share unit has been included in share capital.

On July 12, 2011, the Company entered into a private placement of 1,196,667 share units at $0.30 per unit for total gross proceeds of $359,000. Each unit consists of one common share and one share purchase warrant. Each warrant entitles the holder to acquire one additional common share of the Company at a price of $0.60 per share for a period of 24 months from July 12, 2011.

(Expressed in Canadian dollars)

10. Share capital (continued)

The fair value of the warrant included in the unit was estimated to be $0.02 using the Black-Scholes Option Pricing Model with volatility of 133%, dividend yield of 0%, expected life of 2 years and a risk free rate of 1.22%. The entire value of the share unit has been included in share capital. In connection with the financing, the Company paid cash finders fees of $46,220 and issued 50,000 finders' units, with a market value of $15,000, and issued 119,667 Agents' warrants with an estimated fair value of $1,568, determined using the Black-Scholes Option Pricing Model and assumptions noted above.

On April 28, 2011, the Company completed a private placement of 1,033,333 share units at $0.30 per unit and netted cash proceeds of $167,000. As a result of certain subscription agreements not being honored, the Company's management has retained control of share certificates representing 450,000 share units which were held at year end to be returned to treasury. Each unit consists of one common share and one share purchase warrant. Each warrant entitles the holder to acquire one additional common share of the Company at a price of $0.60 per share for a period of 24 months from April 28, 2011. At the date of this report, management is still seeking recovery of the amount due for the subscribed amounts. The 450,000 shares and the related subscription price of $135,000 has been recorded as a separate component and reduction of shareholders equity.

The fair value of the warrant included in the unit was estimated to be $0.06 using the Black-Scholes Option Pricing Model with volatility of 119%, dividend yield of 0%, expected life of 2 years and a risk free rate of 1.18%. The entire value of the share unit has been included in share capital. In connection with the financing, the Company paid cash finders' fees of $8,000.

(d) Stock options:

The Company's Board of Directors may, from time to time, grant stock options, subject to regulatory terms and approval, to employees, officers, directors and consultants. The exercise price of each option can be set at no less than the closing market price of the common shares on the TSX-V on the date of grant. Options terminate 30 days following the termination of employment. Vesting and the option terms are set at the discretion of the Board of Directors at the time the options are granted.

The following summarizes the movement in the Company's stock options for the year:

	December 31, 2012		December 31, 2011	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	1,566,667	$ 0.60	1,566,667	$ 0.60
Granted	1,000,000	0.10	-	-
Expired	(183,333)	0.60	-	-
Outstanding, end of year	2,383,334	$ 0.10	1,566,667	$ 0.60

As at December 31, 2012, stock options have a weighted average exercise life of 3 years.

(Expressed in Canadian dollars)

10. Share capital (continued)

During the year ended December 31, 2012, 1,000,000 stock options were granted to employees and directors. The fair value of the options was estimated to be $32,775 using the Black-Scholes Option Pricing Model with volatility of 184%, dividend yield of 0%, expected life of 5 years at a risk free rate of 1.37%.

During the year ended December 31, 2012, the Company repriced and extended the terms of 1,216,617 stock options. The incremental fair value of the modification was estimated at $22,193 using the Black-Scholes Option Pricing Model with a volatility of 184%, dividend yield of 0%, expected life of 5 years and a risk free rate of 1.37%.

(e) Warrants

	December 31, 2012		December 31, 2011	
	Warrants	Weighted average exercise price	Warrants	Weighted average exercise price
Outstanding, beginning of year	3,333,000	$ 0.60	933,333	$ 0.60
Issued	2,514,664	0.20	2,399,667	0.60
Expired	(933,333)	0.60	-	-
Outstanding, end of year	4,914,331	$ 0.16	3,333,000	$ 0.60

As at December 31, 2012, the warrants have a weighted average exercise life of 1.1 years.

11. Related party transactions

During the year ended December 31, 2012, the Company paid or accrued professional and management fees to directors of $26,000 (2011 - $26,000).

At December 31, 2012, $312,273 (December 31, 2011 - $229,104) is payable to directors for accrued services and advances.

Amounts due to related parties are non-interest bearing, unsecured, and without specified terms of repayment.

Key management personnel compensation

The Company's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company and consist of the Company's Board of Directors and the Company's Executive Leadership Team. The Executive Leadership Team consists of the CEO and President, and Chief Financial Officer (CFO).

	Year ended	
	December 31, 2012	December 31, 2011
Salaries	$ 280,000	$ 280,000
Stock-based compensation	54,968	-
Total	$ 334,968	$ 280,000

(Expressed in Canadian dollars)

12. Supplementary information

Presentation of the Company's operating expenses by nature versus function for the years ended December 31, 2012 and 2011 is as follows:

	2012	2011
OPERATING EXPENSES		
General and administrative:		
Amortization	$ 2,938	$ 3,893
Automotive	19,136	18,843
Bad debts	-	20
Bank charges and interest	44,126	51,871
Consulting fees	-	60,806
Foreign exchange (gain) loss	(9,300)	25,925
Freight	46,740	44,195
Office and general	45,840	38,855
Professional and management fees (Note 11)	83,195	149,310
Regulatory fees	24,315	31,612
Rent and property tax	55,350	55,504
Salaries, benefits and stock-based compensation	376,472	360,750
Total general and administrative	$ 688,812	$ 841,584
Business development and marketing:		
Advertising	$ 13,520	$ 4,048
Auto	14,085	14,127
Business promotion	12,301	15,447
Meals and entertainment	3,795	6,889
Office and general	9,263	9,399
Salaries and benefits	438,250	438,245
Trade shows	11,573	9,540
Travel	14,012	23,862
Total business development and marketing	$ 516,799	$ 521,557

13. Financial Instruments

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, interest rate, liquidity and funding risk.

Currency risk

The Company is potentially exposed to foreign currency risk as a portion of its assets and liabilities are held in foreign currencies. At December 31, 2012, the Company's significant foreign denominated liabilities consist of US$679,223 and Euro €30,222 (December 31, 2011- US$800,847 and Euro €113,734). Based on the year end exposures should the Canadian dollar to US dollar exchange rate appreciate or depreciate by 10%, the anticipated impact on operations would be a gain or loss of $67,922, respectively. Should the Canadian dollar to Euro exchange rate appreciate or depreciate by 10%, the anticipated impact on operations would be a gain or loss of $3,022. The Company does not use hedges or derivative instruments to reduce its exposure to currency risk.

(Expressed in Canadian dollars)

13. Financial Instruments (continued)

Liquidity and funding risk

The Company's approach to managing liquidity risk is to attempt to manage cash flows so that the Company will have sufficient available resources to meet operating liabilities as they are due. Due to Company's financial position and current economic conditions in capital and selling markets, the Company has a high risk associated with liquidity. The Company does not hold complex financial instruments or significant long-term assets. The Company uses a factoring agent to provide immediate liquidity from its trade receivables and certain purchase orders. This is a high cost of capital that will only be relieved by equity infusion. At December 31, 2012, all of the Company's' non-derivative liabilities are due on demand.

Funding risk is the risk that the Company may not be able to raise equity or alternative financing in a timely manner and on terms acceptable to management. There are no assurances that such financing will be available when, and if, the Company requires additional equity financing. Under economic conditions for the Company funding risk is considered high.

Credit risk

The Company is exposed to moderate credit risk due to concentration of the majority of its trade receivables with a small number of customers. As at December 31, 2012, there are two customers that represent approximately 18% ($502,814) and 14% ($393,871) of year-to-date revenue. Four customers represent approximately 66% (December 31, 2011 – 66%) of trade receivables. Management performs a periodic assessment of the credit worthiness of customers to reduce exposure to credit risk. The Company regularly factors trade receivables and pledges qualifying receivables to the lender (Note 9 (i)). Aged receivables pose a greater amount of credit risk. The aging of the Company's receivables is as follows:

	Current	30-60 days	60-90 days	90-120 days	120+ days
Trade receivables	38%	44%	15%	0%	4%

Fair value

The fair value of the Company's financial assets and liabilities approximates the carrying amount.

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 – Inputs that are not based on observable market data.

13. Financial Instruments (continued)

The Company has classified its financial instruments as follows :

Accounts	Classification	Fair Value Input
Cash	Fair value through profit and loss	Level 1
Trade receivables	Loans and receivables	Level 3
Trade payables, customer deposits, loans, amounts payable to related parties and convertible debt	Other financial liabilities	Level 3

14. Capital Management:

The Company's principal sources of capital are cash from operations and from the issuance of debt and equity securities. The Company manages its cash, trade receivables and loans in conjunction with budgeted or expected capital needs. The Company's objective when managing capital is to maintain sufficient liquidity to continue to meet ongoing expenditure and operational needs.

The Company manages the capital structure and makes adjustments to capital management strategies based on economic conditions and as risk characteristics of its capital change. To maintain or adjust the capital structure, the Company may consider the issuance of shares, factoring additional receivables, debt issues or other management policies. Management plans additional funding in 2013 to assist with current working capital needs. The funding may be debt or equity or a combination of both.

The Company is not subject to externally imposed capital requirements other than under factoring arrangements as described in note 9.

(Expressed in Canadian dollars)

15. Income Taxes

Income tax recovery attributable to net loss before income tax recovery differs from the amounts computed by applying the combined Canadian federal and provincial income tax rate of 25.0% (2011 – 26.5%) to income before income taxes as follows:

		2012		2011
Net loss for the year	$	(538,515)	$	(1,073,925)
Statutory tax rate		25.0%		26.5%
Expected income tax recovery at substantively enacted rates	$	(134,629)	$	(284,590)
Tax effect on:				
Permanent differences and other		13,742		(20,766)
Impact of tax rate changes		(94,033)		18,428
Change in valuation allowance		214,920		286,928
Income tax recovery	$	-	$	-

The Company has the following deductible temporary differences for which no deferred tax asset has been recognized:

		December 31, 2012		December 31, 2011
Non-capital loss carry-forwards and other discretionary deductions	$	1,736,000	$	1,521,000
Equipment		44,000		44,000
	$	1,780,000	$	1,565,000

The tax pools relating to these deductible temporary differences expire as follows:

	Canadian non-capital losses
2014	$ 695,000
2015	596,000
2026	778,000
2027	318,000
2028	736,000
2029	488,000
2030	1,127,000
2031	962,000
2032	500,000
	$ 6,200,000