Consolidated Financial Statements of

PHOTON CONTROL INC.

For the years ended December 31, 2011 and 2010

To the Shareholders of Photon Control Inc.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors and the Audit Committee are composed primarily of Directors who are neither management nor employees of the Company. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Board fulfills these responsibilities by reviewing the financial information prepared by management and discussing relevant matters with management and external auditors. The Audit Committee has the responsibility of meeting with management, and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Board is also responsible for recommending the appointment of Photon Control Inc.'s external auditors.

MNP LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, the Board of Directors, Audit Committee and management to discuss their audit findings.

March 29, 2012

"Christopher Weston"
CEO

"Vernon Smith"
CFO

INDEPENDENT AUDITORS' REPORT

To the Shareholders of **Photon Control Inc.:**

We have audited the accompanying consolidated financial statements of Photon Control Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010, and January 1, 2010, and the consolidated statements of comprehensive income, statements of changes in equity and statements of cash flows for the years ended December 31, 2011 and December 31, 2010, 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.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 auditors' 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 Photon Control Inc. and its subsidiaries as at December 31, 2011, December 31, 2010, and January 1, 2010, and their financial performance and their cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

MNP LLP

MNP LLP

27 March 2012
Vancouver, BC

Chartered Accountants

PHOTON CONTROL INC.

Consolidated Statements of Financial Position
(Expressed in Canadian dollars)
As at December 31, 2011, December 31, 2010 and January 1, 2010

		December 31, 2011		December 31, 2010 (Note 8)		January 1, 2010 (Note 8)
Assets						
Current assets:						
Cash and cash equivalents	$	975,108	$	933,503	$	12,955
Trade accounts receivable and other		1,541,843		2,376,202		1,445,416
Note receivable - related (note 9a)		29,248		29,600		24,668
Due from related party (note 9a)		965,190		810,519		626,419
Inventory (note 4)		2,047,213		1,138,856		1,103,914
Prepaid expenses and deposits		48,078		122,980		19,658
		5,606,680		5,411,660		3,233,030
Property and equipment (note 5)		291,642		402,963		551,649
Intangible assets (note 6)		255,792		276,443		189,766
Internally generated intangible assets (note 2(h))		150,616		152,724		189,938
Long term rental deposits		34,695		48,544		48,544
Note receivable -related (note 9a)		159,373		169,121		194,873
Restricted cash (notes 14, 10(b))		953,744		103,744		102,890
Deferred Taxes (notes 17)		3,926,888		-		-
	$	11,379,430	$	6,565,199	$	4,510,690
Liabilities and Shareholders' Equity						
Current liabilities:						
Deferred revenue (note 9)	$	178,257	$	376,811	$	263,935
Accounts payable and accrued liabilities (note 16)		814,717		1,078,752		1,626,085
Due to related party (note 9a)		340,365		221,346		30,971
Bank indebtedness (note 14)		-		-		
Provisions (note 10(b))		850,000		-		500,000
		2,183,339		1,676,909		2,420,991
Other liabilities (note 10(a))		-		310,499		310,499
Deferred rent and sublease deposits		-		76,124		131,365
Shareholders' equity (note 7):						
Share capital		28,246,173		28,246,173		28,148,968
Contributed surplus		1,997,903		1,951,100		1,910,415
Deficit		(21,047,985)		(25,695,606)		(28,411,548)
		9,196,091		4,501,667		1,647,835
Commitments and contingencies (notes 9 and 10)						
Subsequent events (note 18)						
	$	11,379,430	$	6,565,199	$	4,510,690

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

"Christopher Weston" Director "David C. Dueck" Director

PHOTON CONTROL INC.

Consolidated Statement of Comprehensive Income (Loss) and Deficit
(Expressed in Canadian dollars)
For the year ended December 31, 2011 and 2010

		Year Ended 2011		Year Ended 2010 (Note 8)
Revenue	$	11,485,883	$	13,273,263
Cost of sales		7,049,828		7,600,452
		4,436,055		5,672,811
Operating expenses (notes 9 and 11):				
General and administrative		2,704,468		1,745,071
Engineering		804,546		756,540
Business development		225,870		275,214
		3,734,884		2,776,825
		701,171		2,895,986
Other earnings (expenses):				
Interest and other earnings		27,448		7,712
Interest expense		(148)		(12,840)
Foreign exchange		(7,738)		(174,926)
		19,562		(180,054)
Net earnings (loss) and comprehensive income (loss) before taxes		720,733		2,715,932
Income Tax (expense) recovery		3,926,888		-
Net earnings and total comprehensive income		4,647,621		2,715,932
Basic and diluted earnings (loss) per share				
Weighted average common shares used in computing		102,909,518		102,190,915
Diluted average common shares used in computing		103,074,296		106,443,097
Basic earnings (loss) per share	$	0.05	$	0.03
Diluted earnings (loss) per share	$	0.05	$	0.03

See accompanying notes to consolidated financial statements.

PHOTON CONTROL INC

Consolidated Statements of Changes in Equity
(Expressed in Canadian dollars)
For the year ended December 31, 2011 and 2010

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
Balance at January 1, 2010	101,352,018	$ 28,148,968	$ 1,910,415	$(28,411,548)	$ 1,647,835
Stock-based compensation to employees			113,786		113,786
Total comprehensive income (loss) for the period				$ 2,542,990	$ 2,542,990
Shares issued for employee service	1,400,000	42,000	-	-	42,000
Shares issued on exercise of stock options	157,500	55,205	-	-	55,205
Stock-based compensation to employees	-	-	203	-	203
Fair value of options exercised	-	-	(39,454)	-	(39,454)
Incremental fair value related to option modification	-	-	8,150	-	8,150
Treasury shares issued to employees and R&D transferred employees	-	-	(42,000)	-	(42,000)
Total comprehensive income (loss) for the period	-	-	-	172,952	172,952
Balance at December 31, 2010	**$ 102,909,518**	**$ 28,246,173**	**$ 1,951,100**	**$(25,695,606)**	**$ 4,501,667**
Stock based compensation to employees	-	-	46,803	-	46,803
Total comprehensive income (loss) for the period	-	-	-	4,647,621	4,647,621
Balance at December 31, 2011	**$ 102,909,518**	**$ 28,246,173**	**$ 1,997,903**	**$(21,047,985)**	**$ 9,196,091**

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

PHOTON CONTROL INC.

Consolidated Statement of Cash Flows
(Expressed in Canadian dollars)
For the year ended December 30, 2011 and 2010

	2011	2010
Cash provided by (used in):		
Operations:		
Net earnings (loss)	$ 4,647,621	$ 2,715,933
Non-cash items:		
Amortization of property, equipment and intangibles	229,211	189,176
Stock-based compensation	46,803	122,140
Amortization of deferred development costs	2,108	37,214
Deferred rent and sublease deposits	(64,567)	(55,241)
Accretion Income	(18,401)	
Amortization on gain on sale to R&D	(29,900)	
Deferred Tax	(3,926,888)	-
Changes in non-cash operating working capital:		
Trade accounts receivable and other	834,359	(930,782)
Inventory	(908,357)	(34,942)
Prepaid expenses and deposits	74,902	(103,322)
Accounts payable and accrued liabilities	(228,408)	(547,332)
Net advance to related party	(71,115)	6,279
Contingent Liability	539,501	-
Deferred revenue	(168,654)	112,876
	958,215	1,511,999
Financing:		
Advances under credit facility	-	(500,000)
Repayment of sublease deposits	(11,557)	-
Receipt of long term deposits	13,849	
Shares issued for cash	-	15,750
Proceeds from note receivable	28,337	20,820
	30,629	(463,430)
Investments:		
Restricted cash	(850,000)	(854)
Purchase of equipment	(83,671)	(100,044)
Purchase of intangible assets	(13,568)	(27,123)
	(947,239)	(128,021)
Increase (decrease) in cash and cash equivalents	41,605	920,548
Cash and cash equivalents, beginning of year	933,503	12,955
Cash and cash equivalents, end of year	975,108	933,503
Supplementary information:		
Cash received for interest	6,582	7,628
Cash paid for interest	(148)	(12,840)

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

1. Nature of business and continuing operations:

Photon Control Inc. (the Company) is a publically traded company listed on the TSX Venture Exchange and is incorporated under the laws of British Columbia, Canada. The Company's head office is 200-8363 Lougheed Highway, Burnaby, British Columbia, Canada, V5A 1X3. The address of the registered office and records office is Koffman Kalef LLP, 19th Floor, 885 West Georgia Street, Vancouver, BC, Canada, V6C 3H4.

The consolidated financial statements of the Company for the year ended December 31, 2011 comprise the Company and its (inactive) subsidiaries. The financial statements were authorized for issue by the Board of directors on March 27, 2012.

The Company designs and manufactures a wide range of optical sensors and instruments to measure temperature, pressure, position, and flow. These products are used by original equipment manufacturers (OEM) as well as end-users in the Semiconductor, Oil and Gas, Power, Life Science, and Manufacturing industries. On August 17, 2000, the Company completed an initial public offering of its common shares, which are listed on the TSX Venture Exchange ("TSX-V") under the trading symbol PHO. In 2002, the Company changed its name from Coldswitch Technologies Inc. to Photon Control Inc.

2. Significant accounting policies:

(a) Basis of presentation and statement of compliance:

These consolidated financial statements represent the first annual financial statements of the Company and its subsidiaries prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). The Company adopted IFRS in accordance with IFRS 1, First time Adoption of International Financial Reporting Standards. The first date at which IFRS was applied was January 1, 2010. In accordance with IFRS, the Company has:

- provided comparative financial information;
- applied the same accounting policies throughout all periods presented;
- retrospectively applied all effective IFRS standards as of January 1, 2010, as required; and
- applied certain optional exemptions and certain mandatory exceptions as applicable for first time IFRS adopters.

The Company's consolidated financial statements were previously prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). Canadian GAAP differs in some areas from IFRS. In preparing these financial statements, management has amended certain accounting methods previously applied in the Canadian GAAP financial statements to comply with IFRS. Note 8 contains reconciliations and descriptions of the effect of the transition from Canadian GAAP to IFRS on changes in equity, loss and total comprehensive loss along with reconciliations of the statement of financial position as at December 31, 2010 and January 1, 2010, and the statement of loss and statement of total comprehensive loss for the year ended December 31, 2010.

These consolidated financial statements have been prepared on a going concern basis, under the historical cost convention, except for certain financial assets and financial liabilities which are measured at fair market value.

(b) Basis of consolidation

The Company consolidates subsidiaries controlled by the Company. 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 subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Inter-company balances and transactions, including any income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

These consolidated financial statements include the accounts of the Company's wholly owned subsidiaries Lai Lightwave Aerospace Inc. and The Lightswitch Company Inc., both of which are inactive.

(c) Cash and cash equivalents:

Cash and cash equivalents consist of highly liquid investments that are readily convertible to known amounts of cash. Short-term investments have maturity dates of three months or less from the date of purchase, or they are redeemable prior to maturity.

(c) Use of estimates:

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported revenue and expenses during the years. Significant items subject to such estimates and assumptions include the recoverable amount of equipment, deferred development costs and intangible assets, and valuation allowances for deferred income tax, receivables and inventory and assumptions used in determining the fair value of options and warrants.

These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(d) Inventory:

Inventory consists of optical, mechanical and electronic components and finished goods and is valued at the lower of cost or net realizable value. Cost is determined on a first in first out basis, and 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.

2. Significant accounting policies (continued):

(e) Property and equipment:

Property and equipment are stated at cost. Amortization is provided on the declining balance basis at the following annual rates:

Asset	Rate
Lab equipment	20%
Computers, office furniture and equipment	20%
Computer software	100%
Production equipment	30%
Leasehold improvements	Over the lesser of the initial term of the lease and the useful life of assets

(f) Intangible assets:

The costs of acquiring intangible assets, consisting of licenses, patents and trademarks are capitalized. Costs are amortized over the lesser of the estimated useful life of the intangible asset or the license term.

(g) Revenue recognition:

Revenue from sales of products is recognized when goods are shipped and title passes, there is persuasive evidence of an arrangement, collection is probable and fees are fixed and determinable. Cash collected prior to revenue recognition criteria being met is recorded as deferred revenue on the consolidated balance sheet.

(h) Research and development costs:

Research costs are expensed as incurred. Development costs are expensed as incurred unless all of the following can be demonstrated:

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. The amount amortized in fiscal year 2011 was nil (2010 - $37,214). The

2. Significant accounting policies (continued):

Company has a balance of internally generated intangible assets as at December 31, 2011 of $150,616 (December 31, 2010 - $152,724).

(i) Government assistance:

The Company makes periodic applications for financial assistance under available government incentive programs. Government assistance relating to capital expenditures is reflected as a reduction of the cost of such assets, while government assistance relating to current expenses is recorded as a reduction of such expenses. The benefits of government assistance are recognized when there is reasonable assurance that they will be realized. Reasonable assurance is considered to have occurred when the relevant authorities have indicated that the Company's research and development activities qualify for government assistance. The Company did not receive any government assistance during the years ended December 31, 2011 nor December 31, 2010.

(j) Earnings (loss) per share:

Basic earnings (loss) per share amounts are calculated by dividing net earnings (loss) by the weighted average number of common shares outstanding during the year. Diluted earnings per share amounts are computed similarly to basic earnings 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.

(k) Income taxes:

Tax expense comprises current and deferred tax. Tax is recognized in the consolidated statements of comprehensive income except to the extent it relates to items recognized in other comprehensive income or directly in equity.

Current income tax

Current tax expense is based on the results for the period as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax

Deferred taxes are the taxes expected to be payable or recoverable on differences between the carrying amounts of assets in the Consolidated Statements of Financial Position and their corresponding tax bases used in the computation of taxable profit, and are accounted for

2. Significant accounting policies (continued):

using the balance sheet asset and liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences between the carrying amounts of assets and their corresponding tax bases. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets in a transaction that affects neither the taxable profit nor the accounting profit.

(l) Share issue costs:

The costs of issuing common shares are applied to reduce the stated value of such shares

(m) Translation of foreign currencies:

Monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet dates and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in earnings.

2. Significant accounting policies (continued):

(n) Stock-based compensation plans:

The Company has a stock-based compensation plan, which is described in Note 7(c). The fair value of the services rendered is determined indirectly by reference to the fair value of the equity instruments granted. Compensation cost attributable to options granted to employees and directors is measured at the fair value at the grant date using the Black-Scholes option pricing model. Compensation expense is recognized over the vesting period of the underlying option. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to share capital. No compensation cost is recognized for options that employees forfeit if they fail to satisfy the service requirement for vesting. Compensation expense is recognized for stock-based payments to non-employees using the fair value of the goods or services received, unless the fair value of the equity instruments granted is more reliably determinable.

(o) Warranty provision estimate:

The Company accrues for the estimated obligation under warranty provisions at the time sales are recognized and any changes in estimates are recognized prospectively. 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.

(p) Financial instruments:

The Company has classified its financial instruments as follows:

- Cash and cash equivalents and bank indebtedness, if any, as “held-for-trading”.
- Trade accounts receivable, the note receivable and amounts due from related parties are classified as”loans and receivables”.
- Accounts payable and accrued liabilities, amounts due to related parties and advances under credit facility are classified as “other financial liabilities”.

All financial instruments are initially recognized at fair value and are subsequently accounted for based on their classification. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, financial assets and liabilities classified as held-for-trading are measured at fair value with changes in fair value recorded in the Consolidated Statements of Operations. Financial assets classified as ”loans and receivables” and “other financial liabilities” are carried at amortized cost using the effective interest rate method. The fair values are based on quoted market bid process if available, otherwise fair value is obtained using discounted cash flow analysis. Transaction costs that are directly attributable to the issuance of financial assets or liabilities are accounted for as part of the carrying value at inception, and are recognized over the term of the assets or liabilities using the effective interest method.

---

2. Significant accounting policies (continued):

(q) Impairment of property, equipment, intangibles and internally generated intangible assets:

At each date of the balance sheet, the Company's carrying amounts of its assets are reviewed to determine whether there are any indications of impairment. If such indication exists, the recoverable amount of the assets is estimated using the higher of (a) fair value less costs to sell, and (b) value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount is less than its carrying amount, the carrying amount is reduced to its recoverable amount and the impairment loss is recognized in profit or loss for the period. When there are indicators that the conditions giving rise to the impairment previously recognized have reversed, then the reversal of the impairment loss is reversed in that period.

(r) Comparative figures:

Certain comparative figures have been reclassified to conform to IFRS financial statement presentation adopted in 2011.

3. Accounting standards issued but not yet effective:

Certain pronouncements were issued by the IASB or the International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods after December 31, 2011. Pronouncements that are not applicable or do not have a significant impact to the Company have been excluded from the table below.
The following five new Standards were issued by the IASB in May 2011, and are effective for annual periods beginning on or after January 1, 2013. Early application is permitted if all five Standards are adopted at the same time.

Consolidated Financial Statements - IFRS 10 Consolidated Financial Statements ("IFRS 10") will replace existing guidance on consolidation in IAS 27 Consolidated and Separate Financial Statements, and SIC 12 Consolidation – Special Purpose Entities. The portion of IAS 27 that deals
with separate financial statements will remain. IFRS 10 changes the definition of control, such that the same consolidation criteria will apply to all entities. The revised definition focuses on the need to have both "power" and "variable returns" for control to be present. Power is the current ability to direct the activities that significantly influence returns. Variable returns can be positive, negative or both. IFRS 10 requires continuous assessment of control of an investee in line with any changes in facts and circumstances.

Joint Arrangements - IFRS 11 Joint Arrangements ("IFRS 11") will replace IAS 31 Interests in Joint Ventures, and SIC 13 Jointly Controlled Entities – Non-monetary Contributions by Venturers. IFRS 11 defines a joint arrangement as an arrangement where two or more parties contractually agree to share control. Joint control exists only when the decisions about activities that significantly affect the returns of an arrangement require the unanimous consent of the

parties sharing control. The focus is not solely on the legal structure of joint arrangements, but rather on how the rights and obligations are shared by the parties to the joint arrangement. IFRS 11 eliminates the existing policy choice of proportionate consolidation for jointly controlled entities. In addition, the Standard categorizes joint arrangements as either joint operations or joint ventures.

Disclosure of Interests in Other Entities - IFRS 12 Disclosure of Interests in Other Entities ("IFRS 12") is the new Standard for disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. Matters covered include information about the significant judgments and assumptions that any entity has made in determining whether it has control, joint control or significant influence over another entity.

Separate Financial Statements - IAS 27 Separate Financial Statements ("IAS 27") has been updated to require an entity presenting separate financial statements to account for those investments at cost or in accordance with IFRS 9 Financial Instruments. The amended IAS 27 excludes the guidance on the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent currently within the scope of the current IAS 27 Consolidated and Separate Financial Statements that is replaced by IFRS 10.

Investments in Associates and Joint Ventures - IAS 28 Investments in Associates and Joint ventures ("IAS 28") has been revised and it is to be applied by all entities that are investors with joint control of, or significant influence over, an investee. The scope of IAS 28 Investments in Associates does not include joint ventures.

IFRS 13 Fair Value Measurement ("IFRS 13") was issued by the IASB in May 2011, and is effective for annual periods beginning on or after January 1, 2013. Early application is permitted. IFRS 13 was issued to remedy the inconsistencies in the requirements for measuring fair value and for disclosing information about fair value measurement in various current IFRSs. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price.

The IASB has issued an amendment to IFRS 7, Financial Instruments: Disclosures ("IFRS 7"), requiring incremental disclosures regarding transfers of financial assets. This amendment is effective for annual periods beginning on or after July 1, 2011. The Company will apply the amendment at the beginning of its 2012 financial year. The Company does not expect the implementation to have a significant impact on the Company's disclosures.

The IASB has issued a new standard, IFRS 9, Financial Instruments ("IFRS 9"), which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase of this project. IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial assets, 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. IFRS 9 requires a single impairment method to be used, replacing multiple impairment methods in IA 39. For financial liabilities measured at fair value, fair value changes due to changes in an entity's credit risk are presented in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Company does not expect the implementation to have a significant impact on the Company's results of operations, financial position and disclosures.

3. Accounting standards issued but not yet effective (continued):

The IASB has issued an amendment to IAS 1, Presentation of Financial Statements ("IAS 1"), which requires entities to group items presented in other comprehensive income (OCI) on the basis of whether they might at some point be reclassified from OCI to profit or loss at a later date when specified conditions are met. By requiring items of OCI to be grouped on this basis, their potential effect on profit or loss in future periods will be clearer. This amendment is effective for annual periods beginning on or after July 1, 2012 and requires full retrospective application. The Company does not expect IAS 1 to have a material impact on the financial statements.

4. Inventory:

As at December 31	2011	2010
Raw materials	$ 1,345,355	$ 721,496
Work in process	254,062	273,778
Finished goods	447,796	143,582
	$ 2,047,213	$ 1,138,856

For the year ended December 31, 2011, inventory recognized as an expense in cost of sales amounted to $4,326,807 (2010 - $4,889,421) Included in the above amounts were inventory write downs of $ 109,905 (2010 - $50,000). There were no reversals of previously recorded inventory write downs for 2011 (2010 - $25,830). As of December 31, 2011, the company anticipates the net inventory will be realized within one year.

5. Property and equipment:

	Laboratory equipment	Computers, office furniture and equipment	Production equipment	Leasehold improvements	Total
Asset Cost					
Balance Jan 1, 2010	317,153	307,403	333,057	369,030	**1,326,643**
Additions				1,154	**1,154**
Disposals					-
Balance December 31, 2010	**317,153**	**307,403**	**333,057**	**370,184**	**1,327,797**
Additions	29,293	3,695	3,193	1,226	**37,407**
Disposals			-		-
Balance December 31, 2011	**346,446**	**311,098**	**336,250**	**371,410**	**1,365,204**
Accumulated amortization					
Balance Jan 1, 2010	176,210	146,228	210,921	241,635	**774,994**
Amortization for period	25,393	32,230	36,634	55,583	**149,840**
Disposals					-
Balance December 31, 2010	**201,603**	**178,458**	**247,555**	**297,218**	**924,834**
Amortization for period	22,495	25,900	26,141	74,192	**148,728**
Disposals					-
Balance December 31, 2011	**224,098**	**204,358**	**273,696**	**371,410**	**1,073,562**
Carrying Amounts					
At January 1, 2010	140,943	161,175	122,136	127,395	**551,649**
At December 31, 2010	115,550	128,945	85,502	72,966	**402,963**
At December 31, 2011	122,348	106,740	62,554	-	**291,642**

6. Intangible assets:

	Patents	Trademarks	Computer software	Computer system (SW)	Total
Asset Cost					
Balance Jan 1, 2010	336,327	28,602	90,573	-	**455,502**
Additions	27,123	-		98,888	**126,011**
Disposals					-
Balance December 31, 2010	**363,450**	**28,602**	**90,573**	**98,888**	**581,513**
Additions	13,568	-		46,264	**59,832**
Disposals	-				-
Balance December 31, 2011	**377,018**	**28,602**	**90,573**	**145,152**	**641,345**
Accumulated amortization					
Balance Jan 1, 2010	154,268	20,895	90,573	-	**265,736**
Amortization for period	37,792	1,541	-		**39,333**
Disposals					-
Balance December 31, 2010	**192,060**	**22,436**	**90,573**	**-**	**305,069**
Amortization for period	44,077	1,541		34,866	**80,484**
Disposals					-
Balance December 31, 2011	**236,137**	**23,977**	**90,573**	**34,866**	**385,553**
Carrying Amounts					
At January 1, 2010	182,059	7,707	-	-	**189,766**
At December 31, 2010	171,390	6,166	-	98,888	**276,444**
At December 31, 2011	140,881	4,625	-	110,286	**255,792**

7. Share capital:

(a) Authorized:

Unlimited number of common shares without par value

(b) Issued and outstanding:

Common shares:

		Number of shares	Stated values
Issued and outstanding as at December 31, 2010	$	102,909,518	$ 28,246,173
Shares issued in 2011		-	-
Issued and outstanding as at December 31, 2011	$	102,909,518	$ 28,246,173

Contributed surplus	Amount
Balance, December 31, 2009	$ 1,910,415
Stock-based compensation to employees	113,989
Fair value of options exercised	(39,454)
Incremental fair value related to option modification	8,150
Treasury shares issued to employees and R&D transferred employees	(42,000)
Balance, December 31, 2010	$ 1,951,100
Stock-based compensation to employees	46,803
Balance, December 31, 2011	$ 1,997,903

7. Share capital (continued):

(c) Stock options:

The number of options reserved for issuance under the Company's stock option plan is equal to 10% of the issued and outstanding shares in the Company. Accordingly, as at December 31, 2011, the Company's board of directors had reserved 10,290,952 options for issuance under the Company's stock option plan. As of December 31, 2011, there was no change in either the number of shares or the reserved 10,290,095 options. The stock option plan provides that options may be granted with an exercise price of no less than the market price of the Company's stock on the grant date less applicable discounts permitted by the TSX-V. The stock option plan also provides that the term of the options shall not exceed five years.

Stock option transactions are summarized as follows:

	Number of shares	Weighted average exercise price
Outstanding, December 31, 2009	4,330,000	$ 0.19
Granted	2,830,000	0.10
Cancelled	(846,250)	0.19
Expired	(1,563,750)	0.18
Exercised	(157,500)	0.10
Outstanding, December 31, 2010	4,592,500	$ 0.10
Granted	20,000	0.12
Granted	10,000	0.11
Granted	20,000	0.10
Cancelled	(575,000)	0.10
Expired	(535,000)	0.10
Exercised		0.00
Outstanding, December 31, 2011	3,532,500	$ 0.10

50,000 stock options were granted during the year ended December 31, 2011 (December 31, 2010 – 2,830,000).

7. Share capital (continued):

(c) Stock options (continued):

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

	Options outstanding			Options exercisable	
Exercise price	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$0.10	3,482,500	2.05	$ 0.100	2,125,625	$ 0.100
$0.105	10,000	3.75	$ 0.105	2,500	$ 0.105
$0.11	20,000	4.10	$ 0.110	2,500	$ 0.110
$0.115	10,000	3.95	$ 0.115	2,500	$ 0.115
$0.135	10,000	4.39	$ 0.135	-	$ 0.135
	3,532,500	2.08	$ 0.100	2,133,125	$ 0.100

The options outstanding at December 31, 2011 expire between March 12, 2012 and September 21, 2016.

The fair value of options granted was estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2011	2010
Expected option lives	5 years	5 years
Risk-free interest rate	1.44% to 2.59%	2.33%
Dividend yield	0%	0%
Volatility	150% to 369.89%	219%

During the year ended December 31, 2011, the Company recorded $46,803 (2010 - $122,139) of compensation expense representing the fair value of the options and shares vesting during the year with a corresponding increase to contributed surplus.

---

7. Share capital (continued):

(d) Net earnings (loss) per share:

The weighted average number of shares outstanding as at December 31, 2011 of 102,909,518 (December 31, 2010 - 102,190,915) was used in the calculation of basic earnings per share and 103,074,296 (December 31, 2010 - 106,443,097) was used in the calculation of diluted earnings per share.

8. Adoption of IFRS:

The Company's financial statements for the year ending December 31, 2011 are the first annual financial statements to comply with IFRS and were prepared as described in Note 1, including the application of IFRS 1.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the "Transition Date").

IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

8. (a) Explanation of Transition to IFRS:

Initial elections upon adoption

Set forth below are the IFRS 1 applicable exemptions and exceptions applied in the conversion from Canadian GAAP to IFRS.

IFRS Optional Exemptions Applied

i. Property Plant, and Equipment – IAS 16 provides the option for an entity to use the cost model for the valuation of property, plant, and equipment, or the revaluation model. The revaluation model requires the restatement of property, plant and equipment to fair market values on an annual basis. Given the existence of equipment only, the Company has elected to use the cost model for valuation.

ii. Business Combinations - IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3 Business Combinations retrospectively to business combinations that occurred before the date of transition to IFRS. The Company has taken advantage of this election and has applied IFRS 3 to business combinations that occurred on or after January 1, 2010.

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

IFRS Mandatory Exemptions Applied

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

All other mandatory exceptions in IFRS 1 were not applicable because there were no significant differences in management's application of Canadian GAAP in those areas.

Presentation Reclassifications

Statement of Operations:

1. RECLASSIFICATION OF AMORTIZATION AND DEPRECIATION

Under Canadian GAAP, the Company separately presented amortization expense under operating expenditures. IFRS requires the Company to either present expenditures based on their nature or function and does not allow the two to be mixed. As a result, amortization has been allocated to the underlying functions of the Company.

2. RECLASSIFICATION OF WARRANTY EXPENSE

Under IFRS the Company has present revenue net estimates for warranty claims. Under Canadian GAAP estimates for warranty claims were presented in cost of sales.

Balance Sheet:

At January 1, 2010, as a part of the Company's annual impairment assessment of tangible assets it became apparent that the assets classified as software were in fact intangible in nature. As a result, these assets have been reclassified as intangible assets. A total of $0.07 million, $0.10 million and $0.15 million were reclassified between tangible and intangible assets, respectively for the periods as at December 31, 2011, December 31, 2010 and January 1, 2010.

PHOTON CONTROL INC.

GAAP to IFRS Reconciliation of Previous Year's Statement of Operations for the year ended December 31, 2010

	Canadian GAAP Unaudited	Effect of transition to IFRS		IFRS
Revenue	$ 13,414,270	(141,007)	Note 8 (1)	$13,273,263
Cost of sales	7,679,431	(141,007)	Note 8 (1)	7,600,452
		62,028	Note 8 (2)	
Gross margin	5,734,839			5,672,811
Operating expenses:				
General and administrative	1,657,257	87,814	Note 8 (1)	1,745,071
Engineering services	717,386	39,154	Note 8 (1)	756,540
Business development	275,034	180	Note 8 (1)	275,214
Amortization	189,176	(189,176)	Note 8 (1)	-
Operating expenses	2,838,853			2,776,825
Other earnings (expenses):				
Interest and other earnings	7,712			7,712
Interest expense	(12,840)			(12,840)
Foreign exchange	(174,916)			(174,916)
	(180,044)			(180,044)
Net earnings	2,715,922			2,715,922
Deficit, beginning of year	(28,411,548)			(28,411,548)
Deficit, end of year	$ (25,695,606)			$ (25,695,606)
Basic and diluted earnings per share	$ 0.03			$ 0.03
Weighted average common shares used in computing:				
Basic earnings per share	102,190,915			102,190,915

PHOTON CONTROL INC.

Reconciliation of Balance Sheet from Canadian GAAP to IFRS as at January 1, 2010

	Canadian GAAP	Effect of transitions to IFRS *Adjustments*	Effect of transition to IFRS *Reclassifications*	IFRS
Assets				
Current assets:				
Cash and cash equivalents	$ 12,955	$ -	$ -	$ 12,955
Trade accounts receivable and other	1,445,416	-	-	1,445,416
Note receivable	24,668	-	-	24,668
Due from related party	626,419	-	-	626,419
Inventory	1,103,904	-	-	1,103,904
Prepaid expenses and deposits	19,658	-	-	19,658
	3,233,030	-	-	3,233,030
Property and equipment	551,649	-	-	551,649
Intangible assets	189,766	-	-	189,766
Deferred development costs	189,938	-	-	189,938
Long term rental deposits	48,544	-	-	48,544
Note receivable	194,873	-	-	194,873
Restricted cash	102,890	-	-	102,890
	$ 4,510,690	$ -	$ -	$ 4,510,690
Liabilities and Shareholders' Equity				
Current liabilities:				
Deferred revenue	$ 263,935	$ -	$ -	$ 263,935
Accounts payable and accrued liabilities	1,626,085	-	-	1,626,085
Due to related party	30,971	-	-	30,971
Bank indebtedness	500,000	-	-	500,000
	2,420,991	-	-	2,420,991
Other liabilities	310,499	-	-	310,499
Deferred rent and sublease deposits	131,365	-	-	131,365
Shareholders' equity:				
Share capital	28,148,968	-	-	28,148,968
Contributed surplus	1,910,415	-	-	1,910,415
Deficit	(28,411,548)	-	-	(28,411,548)
	1,647,835	-	-	1,647,835
	$ 4,510,690	$ -	$ -	$ 4,510,690

Note: No adjustments were required to convert Canadian GAAP to IFRS.

PHOTON CONTROL INC.

Reconciliation of Balance Sheet from Canadian GAAP to IFRS as at December 31, 2010

	Canadian GAAP	Effect of transitions to IFRS *Adjustments*	Effect of transition to IFRS *Reclassifications*	IFRS
Assets				
Current assets:				
Cash and cash equivalents	$ 933,503	$ -	$ -	$ 933,503
Trade accounts receivable and other	2,376,202	-	-	2,376,202
Note receivable	29,600	-	-	29,600
Due from related party	810,519	-	-	810,519
Inventory	1,138,856	-	-	1,138,856
Prepaid expenses and deposits	112,980	-	-	112,980
	5,411,660	-	-	5,411,660
Property and equipment	501,851	-	(98,888)	402,963
Intangible assets	177,555	-	98,888	276,443
Deferred development costs	152,724	-	-	152,724
Long term rental deposits	48,544	-	-	48,544
Note receivable	169,121	-	-	169,121
Restricted cash	103,744	-	-	102,744
	$ 6,565,199	$ -	$ -	$ 6,565,199
Liabilities and Shareholders' Equity				
Current liabilities:				
Deferred revenue	$ 376,811	$ -	-	$ 376,811
Accounts payable and accrued liabilities	1,078,752	-	-	1,078,752
Due to related party	221,346	-	-	221,346
Bank indebtedness	-			-
	1,676,909	-	-	1,676,909
Other liabilities:	310,499	-	-	310,499
Deferred rent and sublease deposits	76,124	-	-	76,124
Shareholders' equity:				
Share capital	28,246,173	-	-	28,246,173
Contributed surplus	1,951,100	-	-	1,951,100
Deficit	(25,695,606)	-	-	(25,695,606)
	4,501,666	-	-	4,501,666
	$ 6,565,199	$ -	$ -	$ 6,565,199

Note: No adjustments were required to convert Canadian GAAP to IFRS.

9. Related party balances and transactions:

(a) Related company balances and transactions

All transactions with related parties have been translated in the normal course of operations and have been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Related party transactions include transactions with Photon Control R&D Ltd. Photon Control R&D Ltd. commenced providing engineering consulting and research and development services to the Company on October 1, 2008 and, as a result, the Company has reduced its internal research and development operations. The Company subleases space to Photon Control R&D Ltd. at the same facility. The Company charges Photon Control R&D Ltd. premises and related expenses to recover the Company's costs. Amounts outstanding with Photon Control R&D Ltd. are non-interest bearing, unsecured and due on demand. This account is active and payments are received on a monthly basis, and the balance is paid out at least twice during the year.

As at December 31	2011	2010
Balance Sheet		
Accounts receivable	$ 965,190	$ 810,641
Note receivable	188,786	198,721
Accounts payable and accrued liabilities	340,365	272,552
Statement of Operations		
Recovery of premises and related expenses	$ 234,064	$ 159,088
Payroll Reimbursement	1,096,254	719,117
Engineering, research and development services expenses	394,847	681,955
Royalties	354,382	188,703
Revenue from sales of products and services	206,907	119,038
Management services (finance, payroll, IT, software)	209,695	269,969

9. Related party balances and transactions (continued):

The Company indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Company to the extent permitted by law. The Company has acquired and maintains liability insurance for directors and officers of the Company.

During 2009, the Company finalized and amended the terms of its agreement to transfer its R&D workforce to Photon Control R&D Ltd. Under the finalized terms, Photon Control R&D Ltd. issued a $315,000 promissory note to the Company as consideration for the transfer. The promissory note bears a coupon rate of 3% per annum, is repayable in equal monthly instalments of $3,089 beginning April 1, 2010 and matures March 1, 2020. For accounting purposes, the transaction was recognized at the exchange amount and the promissory note was discounted at an estimated market rate of 10% resulting in a carrying value of the note receivable at issuance of $217,487 and a deferred gain as at December 31, 2010. The deferred gain of $24,668 was recognized in income as principal payments on the note receivable, collected by the Company. The promissory note receivable is being accreted up to its face value of $315,000 by the effective interest method and as at December 31, 2011, $18,401 (2010 - $4,148) in accretion was recognized in interest income.

As at December 31	2011	2010
Promissory note receivable – face value	$315,000	$ 315,000
Less: discount	(97,513)	(97,513)
	217,487	217,487
Accretion	16,025	4,184
Principal repayment	(44,727)	(22,950)
Carrying amount	188,785	198,721
Current portion	(29,412)	(29,600)
Long-term portion	$159,373	$ 169,121

(b) Compensation of key management personnel

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 Technology Officer (CTO)

9. Related party balances and transactions (continued):

Total compensation expense for key management personal and the composition thereof, is as follows:

As at December 31	2011	2010
Short term benefits	$444,092	$ 400,236
Post-employment benefits	-	-
Termination benefits	223,077	-
Share-based compensation	-	-
Carrying amount	667,169	400,236

10. Commitments and contingencies:

(a) Leases:

The Company has entered into premises leases requiring the following minimum lease payments and related costs as follows:

2012	$ 629,916
2013	674,787
2014	720,513
2015	766,188
2016	811,989
	$ 3,603,393

For the year ended December 31, 2011, lease payments and related costs recognized as an expense amounted to $529,488 (2010 - $595,382) Note: a lease on an addition location expired January 2011 and was not renewed.

---

10. Commitments and contingencies (continued):

(b) Litigation:

In October 2001, a former member of management and President of the Company (the “Claimant”) initiated an arbitration proceeding asserting that certain amounts were owing to him by the Company. The Company had commenced an action against the Claimant for a declaration that it had properly rescinded a loan agreement between the Company and the Claimant dated March 5, 2001 (the "Loan Agreement") and that the debt owed to the Claimant (the "Claimant Debt"), being $340,887 as at the date of the Loan Agreement, was repayable in shares of the Company at a rate of one share per dollar of debt.

In addition, the Claimant has filed a claim against the Company seeking unspecified damages for wrongful dismissal. The Company considered the allegations in the lawsuit to be without merit and subsequently proceeded to defend the action.

The Company’s application to dismiss the claim was denied in September 2009. The trial commenced on May 9, 2011 but did not complete on May 20, 2011 as scheduled. The trial resumed on June 13 and was completed on June 17, 2011.

As announced in the News Release dated August 2, 2011, the Supreme Court of British Columbia has released a decision that the Company did not have the right to rescind the Loan Agreement and that this debt is repayable in accordance with the Loan Agreement. The amount of the Claimant Debt payable is $374,562 including interest as at September 30, 2010 plus interest thereafter.

The Court also ruled that the Claimant was dismissed without cause in 2001 and awarded 18 months notice at $130,000 per year in salary plus the value of the benefits payable to him.

As announced in the News Release dated September 12, 2011, Photon Control has filed a Notice of Appeal from the decision of the Supreme Court of British Columbia, and the appeal is from the Court's decision on both, rescission of the loan agreement and the dismissal of the Claimant from the Company. Subsequently, the Company's appeal of both the Loan Agreement decision and the wrongful dismissal decision was heard by the British Columbia Court of Appeal on March 15 and 16, 2012. At the end of the hearing, judgment was reserved, without any indication as to how long the Court of Appeal's judgment may be reserved. A charge for the Claimant Debt in the amount of $310,499 was previously taken by the Company as a long term liability and was reported on the Company’s previous financial statements. Subsequently, the Company recorded an additional $539,501 in Q4 2011 to reflect the decision of the Court and the current estimate of this claim. Both of these amounts, totalling $850,000, were classified in Q4 2011 as a provision per IAS 37 and dependent upon the results of the appeal in the current fiscal year 2012.

Appropriate adjustments to the charge will be made in the Company's 2012 financial statements to reflect the decision of the Court.

As announced in the News Release dated September 22, 2010 and the Company's Management's Discussion and Analysis, Photon Control has filed two lawsuits in the United States, the first in the United States District Court, Northern District of California at San Francisco against Azbil North America, Inc. ("Azbil") (formerly Yamatake Sensing Control, Ltd.), a California company with offices in Santa Clara, California, and the second in the Superior Court of the State of California, County of Santa Clara, against Yamatake Corp. ("Yamatake"), a Japanese company with offices in Tokyo, Japan, which is the parent company of Azbil. The disputes related to Photon Control's proprietary and trade secret fiber optic temperature sensor technology.

As announced in the News Release dated May 24, 2011, Photon Control resolved its disputes with Azbil and Yamatake and both litigations have been dismissed without prejudice. The parties have agreed to continue their working relationship and have entered into a new agreement with the expectation that all parties involved will benefit from continued cooperation in the development and supply of fiber optic temperature sensors to their customers throughout the world. Photon Control will continue to provide products and technical support and assistance in the area of optical temperature sensors to both Azbil and its customers. Moreover, the parties have agreed to work together to develop and protect their intellectual property in the area of optical temperature sensors.

11. Supplementary information:

As at December 31	2011	2010
General and administrative:		
Salaries and fees	$ 585,867	$ 558,126
Office premises expenses	218,183	367,998
Legal, filing fees and auditing	760,017	400,141
Legal judgements (Contingent)	539,501	-
Audit	107,399	60,500
Insurance	163,987	133,764
Stock option compensation expense	18,918	107,249
Depreciation and amortization	134,959	68,383
Other expenses	175,637	48,910
	$ 2,704,468	$ 1,745,071
Engineering expenses:		
Salaries and fees	$ 341,698	215,822
Materials	-	18,566
Certification and testing	1,230	4,158
Travel and entertainment	12,103	-
Consulting fees	393,622	471,776
Depreciation and amortization	43,560	39,154
Other expenses	12,333	7,064
	$ 804,546	$ 756,540
Business development and marketing:		
Salaries and consulting fees	$ 100,032	$ 143,276
Travel expenses	8,569	819
Trade shows	77,567	14,253
Promotion	35,143	90,164
Depreciation and amortization	2,057	135
Other expenses	2,503	26,567
	$ 225,870	$ 275,214

12. Financial instruments:

Fair Value of Financial Assets and Liabilities:

The Company has no financial instruments recorded fair value as at December 31, 2011, nor as at December 31, 2010.

The note receivable from related party is measured at amortized cost. Its market value was determined at inception based upon discounting contractual cash flows at estimated market discount rates considering the credit risk of the counterparty. The estimated market value as at December 31, 2011 is estimated to approximate its carrying value.

The fair value of the Company's cash and cash equivalents, trade accounts receivable and other amounts due under credit facility, amounts due to and from related parties, accounts payable and accrued liabilities approximate their respective carrying amounts due to their short maturities or are discounted at market interest rates.

Risk Management:

(a) Credit and interest rate risk:

The Company is exposed to credit risk associated with its trade accounts receivable and related party receivables. Credit risk is minimized substantially by ensuring the credit worthiness of the entities with which it carries on business. In November 2009, the Company entered into an agreement with Export Development Canada to insure its non-Canadian accounts receivable up to a maximum of USD $1,500,000. As at December 31, 2011 the maximum credit risk, which is the total of its uninsured trade receivables (primarily Canadian based customers and intercompany), was $1,039,651 or 41% (2010 - $ 687,235 or 29%) of the total outstanding accounts receivable balances.

The following table provides information regarding the aging of trade receivables as at December 31, 2011:

Current	31-60 days	61-90 days	91 days +
39%	30%	8%	23%

The following table provides information regarding the aging of trade receivables as at December 31, 2010:

Current	31-60 days	61-90 days	91 days +
39%	35%	12%	14%

The Company holds its cash and cash equivalents at a major Canadian banking institution. As at December 31, 2011, the Company was not exposed to significant credit or interest rate risk.

Allowance for Doubtful Accounts

At each period end, the Company reviews the collectability of outstanding receivables. The specific accounts are only written off once all the collection avenues have been explored or when legal bankruptcy has occurred. The following is a reconciliation of the allowance account.

Reconciliation of the allowance for doubtful accounts	December 31, 2011	December 31, 2010
Balance, beginning of the year	$ 108,130	$ 108,130
Write-offs of specific accounts	-	-
Change in provisions	35,005	-
Balance, end of year	$ 143,135	$ 108,130

The following table identifies the percentage of trade accounts receivable from individual customers comprising 10% or more of the Company's trade receivables:

	2011	2010
Customer A	41%	26%
Customer B	16%	15%
Customer C	12%	15%
Customer D	11%	11%

(b) Market, interest and foreign exchange risk:

Market risk is the risk that changes in market prices such as foreign exchange rates and interest rates will affect the Company's net earnings or the values of financial instruments. The Company is exposed to interest rate risk with regard to the cash, cash equivalents and amounts due under credit facility and its related party note receivable. The majority of the Company's sales revenues and trade receivables are denominated in United States dollars. As such, the Company may be subject to material, realized and unrealized exchange gains or losses resulting from above average changes in exchange rates between the Canadian and the United States dollar. As at December 31, 2011, the Company did not utilize any forward exchange contracts to mitigate any of the risks as mentioned above. The following table lists the United States dollar balances of monetary items denominated in United States dollars as at December 31:

Amounts denominated in U.S. dollars as at December 31	2011	2010
Cash	$ 423,669	$ 398,761
Trade accounts receivable	1,402,714	2,016,880
Trade accounts payable	3,202	95,935

12. Financial instruments (continued):

The estimated impact on net earnings at December 31, 2011 with a +/- 10% change in foreign exchange rates is $182,958 (December 31, 2010 - $125,642).

The above sensitivity demonstrates the effect of a change in foreign exchange rates in isolation. In reality, there may be other contributing factors that will materially alter the estimated outcome. Furthermore, the financial position of the Company may vary at the time that a change in foreign currency exchange rates occurs, again, causing the impact on the Company's results to differ materially from the estimated outcome shown above.

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The ability to do this relies on the Company being able to successfully rely on external financing as well as the timely collection of its outstanding trade accounts receivable. As at December 31, 2011, the Company's accounts trade payable and accrued liabilities were $850,344 (2010 - $1,078,752) which fall due for payment within twelve months of the balance sheet date. As at December 31, 2011, the Company had an unutilized credit facility of $500,000 (unutilized as at December 31, 2010). As at December 31, 2011, the Company recorded contingent liability of $850,000 (2010 - $310,499) which may become due in 2012.

Significant cash commitments in years subsequent to 2011 are as follows:

	1 year	2 years	3 years	4 years	5 years	Total
Accounts trade payable and accrued liabilities	$ 814,717	$ -	$ -	$ -	$ -	$ 814,717
Due to related party	304,365	-	-	-	-	304,365
Lease obligation	629,616	674,787	720,513	766,188	811,989	3,603,093
Credit facility	-	-	-	-	-	

13. Capital disclosure:

The Company's objectives when managing capital are:

- To maintain its ability to continue as a going concern.
- To provide adequate working capital.
- To maintain cash on hand in highly liquid and highly rated financial instruments.
- Meet the debt covenants imposed by the Company's banking institution.

The Company includes the following items in the management of capital: cash, cash equivalents, credit facility and shareholders' equity comprised of issued capital, contributed surplus and deficit. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions. The Company may adjust its capital structure in the future, by issuing

shares and adjusting debt utilization. As at December 31, 2011, the Company's capital is as follows:

As at December 31	2011	2010
Credit facility	$ -	$ -
Cash	975,108	933,503
Net debt	975,108	933,503
Shareholders' equity	5,269,203	4,501,666
	$ 4,294,095	$ 3,568,163

13. Capital disclosure (continued):

The Company is subject to the following capital requirements relating to the covenants and conditions of its bank line of credit:

- The working capital ratio shall not be less than 1.1:1.
- The debt to tangible net worth ratio shall not at any time exceed 2.75:1.
- There will be no dividends, reduction in loans from shareholders, subsidiaries or related parties, or other withdrawals of similar nature without the prior consent of the bank.
- The bank reserves the right to require foreign receivables to be insured by the EDC with direction by the Company to pay all insurance proceeds to the bank.

The Company was in compliance with the above noted covenants as at December 31, 2010, and at December 31, 2011.

14. Bank credit facility and restricted cash:

In November 2007, the Company secured a bank operating line credit facility of up to $500,000 under the Export Development Canada's Master Accounts Receivable Guarantee (MARG) program. This credit facility is secured by a cash deposit of $50,000 plus interest earned thereon, a general security agreement, a general assignment of book debts and a $450,000 MARG program with Export Development Canada and assignment of all risk insurance coverage. This facility bears interest at the bank's prime plus 1.25% per annum.

The Company also obtained a corporate credit card in June 2007. The credit card is secured by a $51,750 cash deposit. The deposit earns interest at prime minus 2.35%. The facility is subject to periodic review by the bank not less frequently than annually. All amounts outstanding under the credit facility are due on demand.

In addition, restricted cash also includes $850,000 as a guarantee against a lawsuit for which judgement in 2011 was rendered in favour of the Plaintiff. (See Note 10 (b) Litigation.)

15. Segmented information:

Photon Control Inc. designs and manufactures a wide range of optical sensors and instruments to measure temperature, pressure, position, and flow. These products are used by original equipment manufacturers (OEM) as well as end-users in the Semiconductor, Oil and Gas, Power, Life Science, and Manufacturing industries. Photon Control's products have competitive advantages in both performance and cost. Photon Control's approach to creating shareholder value has been to pursue Original Equipment Manufacturer (OEM) sales whether directly or through a distributor and to investigate the market potential of products by working directly with customers in select industries to foresee their sectors' requirements. These collaborations often include commitments to conduct trials of the new products on industrial sites.

(a) Geographic information:

Information regarding revenue earned from major customers by geographic segments, based on the location of the customer, is as follows:

	For the year ended	
	Dec 31, 2011	**Dec 31, 2010**
Revenue:		
Canada	$ 476,580	$ 708,908
United States	8,552,547	9,469,353
Europe	30,460	208,837
Taiwan	14,043	11,628
China	1,972,537	2,579,301
Russia	114,808	153,822
Other	324,908	282,421
Total	$11,485,883	$ 13,414,270

All of the Company's equipment and intangible assets are located in Canada.

(b) Major customers:

The following table identifies the percentage of revenue generated from individual customers comprising 10% or more of the Company's revenue:

	2011	2010
Entity A	39%	28%
Entity B	17%	19%
Entity C	13%	10%
Entity D	9%	12%
	78%	69%

16. Trade payables and accrued liabilities

As at December 31	2011	2010
Trade payables	$ 183,273	$ 461,422
Accrued liabilities	493,652	423,479
Warranty provision	137,792	193,851
	$ 814,717	$ 1,078,752

The following is a reconciliation of the warranty provision during the year.

Reconciliation of warranty provision	December 31, 2011	December 31, 2010
Provision as at December 31, 2010, beginning of the year	$ 193,851	$ 110,663
Warranty Costs incurred	(172,113)	(48,785)
Warranty provision - additions or changes	116,054	131,973
Balance, end of year	$ 137,792	$ 193,851

Due to the uncertainty surrounding the timing of warranty returns, the entire provision has been classified as current.

17. Income Taxes

The components of the Company's net income tax expense which has been recorded in the consolidated financial statements are as follows:

	2011	2010
Income (loss) before income taxes	$ 702,333	$ 2,715,937
Canadian statutory income tax rate	26.5%	28.5%
Computed "expected" income tax expense	186,118	774,042
Differences resulting from:		
Permanent differences	12,279	72,409
Effect of change in tax rates	(11,380)	-
Deferred tax assets not previously recognized	(4,116,556)	(768,540)
Other	2,651	(77,911)
Provision for (recovery of) income taxes	$ (3,926,888)	$ -

17. Income taxes (continued):

The tax effects of deductible and taxable temporary differences that give rise to the Company's deferred tax assets and liabilities are as follows:

		2011		2010
Property and equipment	$	485,196	$	439,297
Intangible assets		39,257		30,183
Non-capital loss carry-forwards		1,429,181		1,810,484
Reserves		251,082		110,136
Scientific research and development expenses		1,722,126		1,722,126
Share issuance costs		46		4,330
Total gross deferred tax assets		3,926,888		4,116,556
Deferred tax assets not recognized		-		(4,116,556)
Net deferred tax assets	$	3,926,888	$	-

As at December 31, 2011, the Company has non-capital loss carry forwards for income tax purposes of approximately $5,716,722 (2010 - $7,241,935) available to reduce taxable income of future years. These losses expire as follows:

2015 – 2025	$	1,299,519
2026		947,016
2027		2,434,172
2028		1,036,015
TOTAL	$	5,716,722

The Company has research and development expenditures of $6,888,504 which are available to reduce taxable income of future years. These amounts can be carried forward indefinitely.

The Company has unamortized share issue costs for tax purposes of $183 which are available to reduce taxable income of future years.

The Company has federal and provincial Scientific Research and Experimental Development (SR&ED) investment tax credits in the amount of $1,647,400 as a result of incurring research and development costs in prior years. The Company can utilize these investment tax credits to offset future corporate income taxes. They expire over twenty years from the year in which the investment tax credits are earned. The benefit of these investment tax credits have not been recognized in net future income tax assets.

18. Subsequent Events:

See Note 10 (b) for subsequent events with respect to litigation issues