Consolidated Financial Statements of

PHOTON CONTROL INC.

For the years ended December 31, 2012 and 2011

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 21, 2013

"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, 2012 and 2011, and the consolidated statements of comprehensive loss, statements of changes in equity and statements of 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.

Auditors' 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 audits 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 December 31, 2012 and 2011, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

MNP LLP

MNP LLP

21 March 2013
Vancouver, BC

Chartered Accountants

ACCOUNTING › CONSULTING › TAX
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PHOTON CONTROL INC.

Consolidated Statements of Financial Position

(Expressed in Canadian dollars)

As at December 31, 2012 and December 31, 2011

		December 31, 2012		December 31, 2011
Assets				
Current assets:				
Cash and cash equivalents	$	3,607,507	$	975,108
Trade accounts receivable and other		1,288,206		1,541,843
Note receivable - related (note 9(a))		24,711		29,248
Due from related party (note 9(a))		833,522		965,190
Inventory (note 4)		1,442,599		2,047,213
Prepaid expenses and deposits		61,840		48,078
		7,258,385		5,606,680
Property and equipment (note 5)		245,684		291,642
Intangible assets (note 6)		187,328		255,792
Internally generated intangible assets (note 2(h))		148,825		150,616
Long term rental deposits		34,695		34,695
Note receivable - related (note 9(a))		142,953		159,373
Restricted cash (notes 14, 10(b))		903,744		953,744
Deferred taxes (Note 17)		5,303,841		3,926,888
Total Assets	$	14,225,455	$	11,379,430
Liabilities and Shareholders' Equity				
Current liabilities:				
Deferred revenue	$	152,430	$	178,257
Accounts payable and accrued liabilities (note 16)		718,872		814,717
Due to related party (note 9(a))		169,400		340,365
Provisions (note 10(b))		850,000		850,000
		1,890,702		2,183,339
Shareholders' equity (note 7):				
Share capital		28,246,173		28,246,173
Contributed surplus		2,099,797		1,997,903
Deficit		(18,011,217)		(21,047,985)
		12,334,753		9,196,091
Commitments and contingencies (note 10)				
Bank indebtedness (note 14)				
Subsequent events (note 18)				
Total liabilities and Shareholders' Equity	$	14,225,455	$	11,379,430

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
(Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

	Year Ended Dec. 31, 2012	Year Ended Dec. 31, 2011
Revenue	$ 10,368,279	$ 11,485,883
Cost of sales	6,469,177	7,049,828
	3,899,102	4,436,055
Operating expenses (notes 9 and 11):		
General and administrative	1,548,109	2,704,468
Engineering	353,913	804,546
Business development	281,660	225,870
	2,183,682	3,734,884
Net earnings before other earnings and tax	1,715,420	701,171
Other earnings (expenses):		
Interest and other earnings	25,050	27,448
Interest expense	(1,947)	(148)
Foreign exchange	(78,708)	(7,738)
	(55,605)	19,562
Net earnings from operating activities	1,659,815	720,733
Income tax (expense) recovery	1,376,953	3,926,888
Net earnings and total comprehensive income	3,036,768	4,647,621
Basic and diluted earnings (loss) per share		
Weighted average common shares used in computing	102,909,518	102,909,518
Diluted average common shares used in computing	107,052,455	103,074,296
Basic earnings per share	$ 0.03	$ 0.05
Diluted earnings per share	$ 0.03	$ 0.05

See accompanying notes to consolidated financial statements.

PHOTON CONTROL INC

Consolidated Statements of Changes in Equity
(Expressed in Canadian dollars)
As at December 31, 2012 and 2011

	Share Capital		Contributed Surplus and Deficit		
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
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	-	-	-	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**
Stock based compensation to employees	-	-	101,894	-	101,894
Total comprehensive income	-	-	-	3,036,768	3,036,768
Balance at December 31, 2012	**102,909,518**	**$ 28,246,173**	**$ 2,099,797**	**$ (18,011,217)**	**$ 12,334,753**

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 years ended December 31, 2012 and 2011

As at December 31	2012	2011
Cash provided by (used in):		
Operations:		
Net earnings	$ 3,036,768	$ 4,647,621
Non-cash items:		
Amortization of property, equipment and intangibles	134,928	229,211
Stock-based compensation	101,894	46,803
Amortization of deferred development costs	1,791	2,108
Deferred rent and sublease deposits	-	(64,567)
Accretion income	(8,164)	(18,401)
Amorization on gain on sale to R&D	(27,182)	(29,900)
Deferred tax	(1,376,953)	(3,926,888)
Changes in non-cash operating working capital:		
Trade accounts receivable and other	253,637	834,359
Inventory	604,614	(908,357)
Prepaid expenses and deposits	(13,762)	74,902
Accounts payable and accrued liabilities	(95,845)	(228,408)
Due to/from related party	(39,297)	(71,115)
Received from related party	-	-
Contingent liabilities	-	539,501
Deferred revenue	1,355	(168,654)
	2,573,784	958,215
Financing:		
Advances under credit facility	-	-
Repayment of sublease deposits	-	(11,557)
Repayment of inter-company debt	-	-
Receipt of long term deposits	-	13,849
Shares issued for cash	-	-
Proceeds from note receivable	29,121	28,337
	29,121	30,629
Investments:		
Restricted cash	50,000	(850,000)
Purchase of equipment	(19,471)	(83,671)
Purchase of intangible assets	(1,035)	(13,568)
Deferred development costs		-
	29,494	(947,239)
Increase (decrease) in cash and cash equivalents	2,632,399	41,605
Cash and cash equivalents, beginning of year	975,108	933,503
Cash and cash equivalents, end of year	3,607,507	975,108
Supplementary information:		
Cash received for interest	16,025	6,582
Cash paid for interest	(1,947)	(148)

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 publicly-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 19th Floor, 885 West Georgia Street, Vancouver, British Columbia, Canada, V6C 3H4.

The consolidated financial statements of the Company for the year ended December 31, 2012 comprise the Company and its (inactive) subsidiaries. The financial statements were authorized for issue by the Board of Directors on March 21, 2013.

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 of the Company and its subsidiaries were prepared in compliance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). The first date at which IFRS was applied was January 1, 2011. In accordance with IFRS, the Company has:

- provided comparative financial information; and
- applied the same accounting policies throughout all periods presented.

These consolidated financial statements have been prepared on the historical cost basis except for certain financial assets and financial liabilities which are measured at fair market value. The consolidated financial statements are presented in Canadian (CAD) dollars which is the Company's functional currency.

(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.

2. Significant accounting policies (continued):

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 Industries Ltd., CST Coldswitch Holdings Inc., The Lightswitch Company Inc., and Photon Control (Alberta) Inc., all 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 six months or less from the date of purchase, or they are redeemable prior to maturity.

(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.

(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 statement of financial position.

2. Significant accounting policies (continued):

(h) Research and development costs:

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

ii) The technical feasibility of completing the intangible asset so that it will be available for use or sale;

iii) The intention to complete the intangible asset and use or sell it;

iv) The ability to use or sell the intangible asset;

v) How the intangible asset will generate probable future economic benefits;

vi) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

vii) 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 Company has a balance of internally generated intangible assets as at December 31, 2012 of $148,825 (December 31, 2011 - $150,616). Amount amortized or discounted for the year ending December 31, 2012 was $1,791 (2011 - $2,108)

Asset Cost		
Balance January 1, 2011	$	219,071
Additions		-
Balance December 31, 2011		219,071
Additions		-
Balance December 31, 2012	$	219,071
Accumulated Amortization		
Balance January 1, 2011	$	66,347
Amortization for the year		2,108
Balance December 31, 2011		68,455
Amortization for the year		1,792
Balance December 31, 2012	$	70,247
Carrying Amounts		
As at January 1, 2011	$	152,724
As at December 31, 2011	$	150,616
As at December 31, 2012	$	148,824

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2. Significant accounting policies (continued):

(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 year ended December 31, 2011 nor for the year ending December 31, 2012.

(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 are 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 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

2. Significant accounting policies (continued):

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 Statement of Financial Position 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.

(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:

The Company accrues for the estimated obligations 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”.

2. Significant accounting policies (continued):

- 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 comprehensive income. 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.

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

At each date of the statement of financial position, 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) Use of estimates:

The preparation of these financial statements in conformity with IFRS requires management to make sufficient judgements, estimates and assumptions that affect the reported amounts of assets and liabilities, application of accounting policies and the reporting of assets and liabilities at the dates of the financial statements and the reported revenue and expenses during the years.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which estimates are revised and any future periods affected.

2. Significant accounting policies (continued):

Significant items subject to such assumptions and estimation uncertainties that have a significant risk of a material adjustment are as follows:

i) The Company makes estimates and utilizes assumptions in determining the fair value for stock based options and warrants.

ii) The Company makes estimates related to the recovery of deferred development costs based on the expectation and assumption of realizing revenues from future commercial agreements that it anticipates will develop with companies for whom these projects have been untaken. Changes in these expectations and assumptions could result in a change in the recoverable amount calculated.

iii) The Company makes estimates related to the useful lives of property and equipment, patents, and intangible assets and related amortization. The Company also periodically assesses the recoverability of long lived assets. The recoverability analysis requires the Company to make assumptions about future operations. Changes to one or more assumptions would result in a change in the recoverable amount calculated and/or amortization expensed.

iv) The Company maintains an allowance for doubtful accounts for estimated losses that may occur if parties are unable to pay balances owing to the Company. This allowance is determined based on a review of specific parties' historical experience and economic circumstances. Non-Canadian export trade customers are covered by Export Development Canada (EDC) receivables insurance up to a maximum of USD $1,500,000. Consequently, the estimates of allowance are primarily based on Canadian customers, none of whom are not covered by EDC insurance, but also include estimates for any EDC receivables insurance deductable amounts.

v) The company makes estimates related to inventory. Inventory is valued at the lower of cost or net realizable value. However, the valuation of allowances for slow or obsolete inventory requires management to make estimates.

vi) The Company makes estimates related to warranty provision. This provision is based on a periodic review of historical experience of warranty claims.

vii) Deferred income tax assets are recognized for all deductable temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that probable that future taxable profit will be available against which the deductable temporary differences and carry-forward of unused tax assets and unused tax losses can be utilized. In addition, the valuation of tax credits receivable requires management to make judgements on the amount and timing of recovery.

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.

3. Accounting standards issued but not yet effective:

IFRS 7, Financial Instruments: Disclosures

The amendments to disclosure requirements in IFRS 7 emphasize the interaction between quantitative and qualitative disclosures and the nature and extent of risks and amends credit risk disclosures. The Company is currently evaluating the impact to its financial statements.

IFRS 10, Consolidated financial statements

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation-Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements. The Company is currently evaluating the impact the final standard is expected to have on its financial statements.

IAS 19, Employee Benefits

In June 2011, the IASB issued an amended IAS 19. The Standard requires recognition of changes in the net defined benefit liability (asset) including immediate recognition of defined benefit cost, disaggregation of defined benefit cost into components, recognition of re-measurements in other comprehensive income, plan amendments, curtailments and settlements. In addition there are modifications in accounting for termination benefits, including distinguishing benefits provided in exchange for service and benefits provided in exchange for the termination of employment and affect the recognition and measurement of termination benefits. The Company does not anticipate a significant impact on its financial statements.

IAS 28, Investments in Associates

The standard was amended to include joint ventures in its scope and to address the changes in IFRS 10 to IFRS 12. This amendment is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted. The Company does not anticipate the application of IAS 28 to have a significant impact on its financial statements.

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

IFRS 11, Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements, which supersedes IAS 31, Interests in Joint Ventures and SIC 13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers. The standard requires the Company to classify its interest in a joint arrangement as a joint venture or joint operation. This standard will eliminate the use of proportionate consolidation when accounting for joint ventures, as they will be accounted for using the equity method, whereas joint operations will be accounted for by recognizing the venturer's share of the assets, liabilities, revenue and expenses. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning January 1, 2013. The Company is currently evaluating the impact IFRS 11 is expected to have on its financial statements.

IFRS 12, Disclosure of Interests in Other Entities

The IASB has issued IFRS 12 Disclosure of Interest in Other Entities, which includes disclosure requirements about subsidiaries, joint ventures, and associates, as well as unconsolidated structured entities and replaces existing disclosure requirements. This standard will become effective for annual periods beginning on or after July 1, 2013. Earlier adoption is permitted. The Company will adopt this new standard as of its effective date. The Company is currently analyzing the possible impact of this standard on its financial statements.

IFRS 13, Fair Value Measurement

IFRS 13, Fair Value Measurement: effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, sets out in a single IFRS a framework for measuring fair value and new required disclosures about fair value measurements. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning January 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 13.

IAS 32, Financial Instruments: Presentation – Offsetting financial assets and financial liabilities

In December 2011, the IASB issued an amendment to IAS 32. The amendment clarifies the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The Company does not anticipate a significant impact to its financial statements.

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

IFRS 9, Financial instruments

IFRS 9 *Financial Instruments: Classification and Measurement* will replace IAS 39 *Financial Instruments: Recognition and Measurement*. On December 16, 2011, the IASB amended the effective date of IFRS 9 to annual periods beginning on or after January 1, 2015, with early adoption permitted.

IFRS 9 introduces new requirements for the impairment of financial assets measured at amortized cost and classification and measurement of financial instruments. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning January 1, 2015, and has not yet considered the potential impact of the adoption of IFRS 9.

4. Inventory:

As at December 31	2012	2011
Raw materials	$ 835,208	$ 1,345,355
Work in process	232,281	254,062
Finished goods	375,110	447,796
	$ 1,442,599	$ 2,047,213

For the twelve months ended December 31, 2012, inventory recognized as an expense in cost of sales amounted to $3,933,659 (2011 - $4,326,807). Included in the above amounts were inventory write downs of $88,769 (2011 - $109,905). There were no reversals of previously recorded inventory write downs for 2012 (2011 - $nil). As of December 31, 2012, 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 January 1, 2011	$	317,153	307,403	333,057	370,184	**1,327,797**
Additions		29,293	3,695	3,193	1,226	**37,407**
Balance December 31, 2011		**346,446**	**311,098**	**336,250**	**371,410**	**1,365,204**
Additions		-	2,486	2,000	14,985	**19,471**
Disposals		-	-	-	-	-
Balance December 30, 2012	**$**	**346,446**	**313,584**	**338,250**	**386,395**	**1,384,675**
Accumulated Amortization						
Balance January 1, 2011	$	201,603	178,458	247,555	297,218	**924,834**
Amortization for period		22,495	25,900	26,141	74,192	**148,728**
Balance December 31, 2011		**224,098**	**204,358**	**273,696**	**371,410**	**1,073,562**
Amortization for period		22,440	21,391	19,068	2,530	**65,429**
Disposals		-	-	-	-	-
Balance December 30, 2012	**$**	**246,538**	**225,749**	**292,764**	**373,940**	**1,138,991**
Carrying Amounts						
At January 1, 2011	$	115,550	128,945	85,502	72,966	**402,963**
At December 31, 2011	$	122,348	106,740	62,554	-	**291,642**
At December 30, 2012	$	99,908	87,835	45,486	12,455	**245,684**

6. Intangible assets:

		Patents	Trademarks	Computer software	Computer system (SW)	Total
Asset Cost						
Balance January 1, 2011	$	363,450	28,602	90,573	98,888	**581,513**
Additions		13,568	-	-	46,264	**59,832**
Balance December 31, 2011		**377,018**	**28,602**	**90,573**	**145,152**	**641,345**
Additions		1,035	-	-	-	**1,035**
Balance December 31, 2012	**$**	**378,053**	**28,602**	**90,573**	**145,152**	**642,380**
Accumulated Amortization						
Balance January 1, 2011		192,060	22,436	90,573	-	**305,069**
Amortization for period		44,077	1,541	-	34,865	**80,483**
Balance December 31, 2011	**$**	**236,137**	**23,977**	**90,573**	**34,865**	**385,552**
Amortization for period		35,216	1,200	-	33,084	**69,500**
Balance December 31, 2012	**$**	**271,353**	**25,177**	**90,573**	**67,949**	**455,052**
Carrying Amounts						
At January 1, 2011	$	171,390	6,166	-	98,888	**276,444**
At December 31, 2011	$	140,881	4,625	-	110,287	**255,793**
At December 31, 2012	$	106,700	3,425	-	77,203	**187,328**

Note: Above dos not include any internally generated assets (see Note 2 (h)).

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
Shares issued in 2012	-	-
Issued and outstanding as at December 31, 2012	102,909,518	$ 28,246,173

Contributed Surplus:

	Amount
Balance, December 31, 2010	$ 1,951,100
Stock-based compensation to employees in 2011	46,803
Balance, December 31, 2011	$ 1,997,903
Stock-based compensation to employees	101,894
Fair value of options exercised	-
	-
Balance, December 31, 2012	$ 2,099,797

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, 2012, there was no change in either the number of shares or the reserved 10,290,952 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 share options		Weighted average exercise price
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
Granted	2,820,000		0.10
Cancelled	(142,500)		0.10
Cancelled	(10,000)		0.13
Expired	(690,000)		0.10
Exercised	-		0.00
Outstanding, December 31, 2012	5,510,000	$	0.10

2,820,000 stock options were granted during the year ended December 31, 2012 (the year ended December 31, 2011 – 50,000)

7. Share capital (continued):

(c) Stock options (continued):

The following table summarizes the stock options outstanding at December 31, 2012:

	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	5,470,000	3.11	$ 0.100	3,315,000	$ 0.100
$0.105	10,000	2.75	$ 0.105	5,000	$ 0.105
$0.11	20,000	3.10	$ 0.110	7,500	$ 0.110
$0.115	10,000	2.95	$ 0.115	5,000	$ 0.115
	5,510,000	3.11	$ 0.100	3,332,500	$ 0.100

The options outstanding at December 31, 2012 expire between September 22, 2013 and October 25, 2017.

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:

	2012	2011
Expected option lives	5 years	5 years
Risk-free interest rate	1.28% to 2.59%	1.44% to 2.59%
Dividend yield	0%	0%
Volatility	123% to 380%	150% to 370%

During the twelve months ended December 31, 2012, the Company recorded $101,893 (2011 - $46,803) of compensation expense representing the fair value of the options and shares vesting during the year with a corresponding increase to contributed surplus.

(d) Net earnings (loss) per share:

The weighted average number of shares outstanding as at December 31, 2012 of 102,909,518 (December 31, 2011 - 102,909,518) was used in the calculation of basic earnings per share for the twelve months ended December 31, 2012 and 107,052,455 (December 31, 2011 - 103,074,296) was used in the calculation of diluted earnings per share for the twelve months ended December 31, 2012.

8. Adoption of IFRS:

The Company's financial statements have been prepared to comply with IFRS (International Financial Reporting Standards) for the twelve months ending December 31, 2012.

The year ending December 31, 2011 were the first annual financial statements to be IFRS compliant.

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. and DCD Management 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. DCD Management Ltd. provides financial, payroll and IT services. The Company subleases space to Photon Control R&D Ltd. and DCD Management Ltd. at the same facility. The Company charges Photon Control R&D Ltd. and DCD Management Ltd. premises and related expenses to recover the Company's costs. Amounts outstanding with Photon Control R&D Ltd. and DCD Management Ltd. are non-interest bearing, unsecured and due on demand. These accounts are 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	2012	2011
Statement of Financial Position		
Accounts receivable	$ 833,522	$ 965,190
Note receivable	167,664	188,786
Accounts payable and accrued liabilities	169,400	340,365
Statement of Comprehensive Income		
Recovery of premises and related expenses	$ 235,977	$ 234,064
Payroll reimbursement	1,317,368	1,096,254
Engineering, research and development services expenses	284,672	394,847
Royalty expenses	423,642	354,382
Revenue from sales of products and services	159,728	206,907
Management services	156,268	209,695

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 March 31, 2010.

9. Related party balances and transactions (continued):

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, 2012, $24,025 (2011 - $15,861) in accretion was recognized in interest income.

As at December 31	2012	2011
Promissory note receivable – face value	$ 315,000	$315,000
Less: discount	(97,513)	(97,513)
	217,487	217,487
Accretion	24,025	15,861
Principal repayment	(73,848)	(44,727)
Carrying amount	167,664	188,621
Current portion	(24,711)	(29,248)
Long-term portion	$142,953	$ 159,373

(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 the Chairman. (Compensation for 2012 below reflects departure of Chief Technology Officer.)

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

As at December 31	2012	2011
Short term benefits	$ 192,820	$ 444,092
Termination benefits	-	223,077
Share-based compensation	31,139	10,959
Carrying Amount	$223,959	$678,128

10. Commitments and contingencies:

(a) Leases:

The Company has entered into premises leases requiring the following minimum lease payments and related costs (applicable sales taxes extra) as follows:

2013	$ 658,926
2014	701,044
2015	743,281
2016	785,643
	$ 2,888,894

For the twelve months ended December 31, 2012, lease payments and related costs recognized as an expense amounted to $472,260 (2011 - $529,488)

(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 Company’s News Release dated August 2, 2011, the Supreme Court of British Columbia decided 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.

10. Commitments and contingencies (continued):

As announced in the Company's News Release dated September 12, 2011, Photon Control filed a Notice of Appeal from the decision of the Supreme Court of British Columbia in respect of 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.

As announced in the Company's News Release dated August 16, 2012, the Court of Appeal dismissed the Company's appeal and upheld the trial decision. The Company is considering its options of further appeal regarding the decision.

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 contingent liability (dependent upon the results of the appeal in the current fiscal 2012) per IAS 37. Related to this issue, the Company has provided a $850,000 standby irrevocable letter of credit as a guarantee against this lawsuit (included in restricted cash). Appropriate adjustments to the charge will be made in the Company's future 2013 financial statements to reflect the decision of the Court.

11. Supplementary information:

As at December 31	2012	2011
General and administrative:		
Salaries and fees	$ 597,809	$ 569,756
Stock option compensation expense (Non-directors)	42,077	16,111
Office premises expenses and rent	252,995	218,183
Travel	17,523	30,553
Supplies and postage	39,977	63,776
Audit	61,705	107,399
Insurance	132,728	163,987
Legal, filing fees	200,753	741,099
Legal judgements (Contingent)	-	539,501
Communications	22,138	24,425
Dues and subscriptions	425	5,668
Directors Fees including applicable stock option expense	56,916	18,918
Depreciation and amortization	57,004	134,959
Bad debt expense	14,000	35,000
Other expenses	52,059	35,133
	$ 1,548,109	$ 2,704,468
Engineering expenses:		
Salaries and fees	$ 6,526	$ 341,698
Certification and testing	17,543	1,230
Travel and entertainment	9,093	12,103
Consulting fees	284,672	393,622
Depreciation and amortization	35,216	43,560
Other expenses	863	12,333
	$ 353,913	$ 804,546
Business development and marketing:		
Salaries and consulting fees	$ 167,600	$ 100,032
Travel expenses	21,736	8,569
Trade shows	69,914	77,566
Promotion	21,209	35,143
Depreciation and amortization	1,201	2,057
Other expenses	-	2,503
	$ 281,660	$ 225,870

12. Financial instruments:

Fair Value of Financial Assets and Liabilities:

The Company has no financial instruments recorded at fair value as at December 31, 2012, nor as at December 31, 2011.

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, 2012 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, 2012 the maximum credit risk, which is the total of its uninsured trade receivables (primarily Canadian based customers and intercompany), was $928,184 or 42% (December 31, 2011 - $1,039,651 or 41%) of the total outstanding accounts receivable balances.

The following table provides information regarding the aged trade receivables as at December 31, 2012:

Current	31-60 days	61-90 days	91 days +
42%	39%	8%	11%

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

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

The Company holds its cash and cash equivalents at a major Canadian banking institution. As at December 31, 2012, the Company was not exposed to significant credit or interest rate risk.

12. Financial instruments (continued):

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	Dec. 31, 2012	Dec. 31, 2011
Balance, beginning of the year	$ 143,135	$ 108,130
Write-offs of specific accounts	(9)	-
Change in provision	14,000	35,005
Balance, as at December 31	$ 157,126	$ 143,135

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

	2012	2011
Customer A	50%	41%
Customer B	14%	16%
Customer C	11%	0%
Customer D	7%	11%
Customer E	2%	12%

(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, 2012, 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	2012	2011
Cash	$ 2,119,663	$ 423,669
Trade accounts receivable	1,174,431	1,402,714
Trade accounts payable	89,851	3,202

12. Financial instruments (continued):

The estimated impact on net earnings at December 31, 2012 with a +/- 10% change in foreign exchange rates is $320,424 (December 31, 2011 - $182,958).

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, 2012, the Company's accounts trade payable and accrued liabilities were $718,872 (December 31, 2011 - $814,717) which fall due for payment within twelve months of the balance sheet date. As at December 31, 2012, the Company had an unutilized maximum credit facility of $1,000,000 (unutilized as at December 31, 2011). This credit facility currently remains unutilized. The Company has recorded a provision (contingent liability) of $850,000 (December 31, 2011 - $850,000) which may become due in 2013. However, an $850,000 standby irrevocable letter of credit has been provided as a guarantee against this lawsuit (included in restricted cash).

Significant cash commitments in years subsequent to December 31, 2012 are as follows:

	1 year	2 years	3 years	4 years	5 years	Total
Accounts trade payable and accrued liabilities	$ 718,872	$ -	$ -	$ -	$ -	$ 718,872
Due to related party	169,400	-	-	-	-	169,400
Lease obligation	658,926	701,044	743,281	785,643	-	2,888,894

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.

13. Capital disclosure (continued):

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, 2012, the Company's capital is as follows:

As at December 31	2012	2011
Cash and cash equivalents	$ 3,607,507	$ 975,108
Credit Facility (debt)	-	-
Shareholders' equity	12,334,753	9,196,091
	$ 15,942,260	$ 10,171,119

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, 2011, and as at December 31, 2012.

14. Bank credit facility and restricted cash:

In November 2007, the Company secured a bank operating line of credit facility of up to $500,000 under the Export Development Canada's Master Accounts Receivable Guarantee (MARG) program. This credit facility was secured by 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. In September 2012, this bank operating line of credit facility was further increased up to maximum of $1,000,000. This facility bears interest at the bank's prime plus 1.50% per annum. Formerly, this credit facility was additionally secured by a cash deposit of $50,000 but this is no longer required and the deposit was returned plus interest earned thereon during Q2 2012.

14. Bank credit facility and restricted cash (continued):

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.)

As at December 31	2012	2011
Bank operating line of credit cash deposit	$ -	$ 50,000
Credit card cash deposit	53,744	53,744
Change in provisions	850,000	850,000
Balance as at December 31	$ 903,744	$ 953,744

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, 2012	For the year ended Dec. 31, 2011
Revenue:		
Canada	$ 391,301	$ 476,580
United States	7,014,304	8,552,547
Europe	10,646	30,460
Taiwan	3,430	14,043
China	2,412,258	1,972,537
Russia	163,366	114,808
Other	372,974	324,908
	$ 10,368,279	$ 11,485,883

15. Segmented information (continued):

(b) Assets and liabilities.

The Company has only one operation in Burnaby, British Columbia, Canada. All of the Company's assets (including cash, inventory, property plant and equipment, intangible assets) and liabilities and are located in Canada.

(c) Major customers:

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

As at December 31	2012	2011
Entity A	43%	39%
Entity B	23%	17%
Entity C	11%	13%
	77%	69%

16. Trade payables and accrued liabilities

As at December 31	2012	2011
Trade payables	$ 326,895	$ 183,273
Accrued liabilities	261,846	493,652
Warranty provision	130,131	137,792
	$ 718,872	$ 814,717

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

Reconciliation of warranty provision as at December 31	2012	2011
Provision as at December 31, 2011, beginning of the year	$ 137,792	$ 193,851
Warranty costs incurred	(139,661)	(172,113)
Warranty provision - additions or changes	132,000	116,054
Balance as at December 31	$ 130,131	$ 137,792

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

17. Income Tax

We confirm that we believe our deferred tax assets to be realizable and, as such, have given full recognition to these assets. Furthermore, the Company's income taxes are fairly summarized as follows:

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

	2012	2011
Income (loss) before income taxes	$ 1,659,816	$ 702,333
Canadian statutory income tax rate	25.0%	26.5%
Computed "expected" income tax expense	414,954	186,118
Differences resulting from:		
Permanent differences	25,473	12,279
Effect of change in tax rates	(140,632)	(11,380)
Deferred tax assets not previously recognized		(4,116,556)
Changes in estimates	(1,676,748)	2,651
Provision for (recovery of) income taxes	(1,376,953)	(3,926,888)

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

	2012	2011
Property and equipment	530,173	485,196
Intangible assets	48,116	39,257
Non-capital loss carry-forwards	1,124,524	1,429,181
Reserves	143,788	251,082
Investment tax credits	1,647,400	-
Note receivable	18,830	-
Scientific research and development expenses	1,791,011	1,722,126
Share issuance costs	-	46
Total gross deferred tax assets	5,303,841	3,926,888
Deferred tax assets not recognized	-	-
Net deferred tax assets	5,303,841	3,926,888

17. Income Tax (continued):

As at December 31, 2012, the Company has non-capital loss carry forwards for income tax purposes of approximately $4,325,093 (2010 - $5,716,722) available to reduce taxable income of future years. These losses expire as follows:

	Canadian
EXPIRY	2012 FS
2026	857,388
2027	2,434,172
2028	1,036,015
TOTAL	*4,325,093*

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 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:

No subsequent events to report.