



EUROCONTROL TECHNICS GROUP INC.

CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended December 31, 2012 and 2011

(in Canadian dollars)

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements of Eurocontrol Technics Group Inc. are the responsibility of management and the Board of Directors of the Company.

The consolidated financial statements have been prepared by management, on behalf of the Board of Directors, in accordance with the accounting policies disclosed in the notes to the consolidated financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the statement of financial position date. In the opinion of management, the consolidated financial statements have been prepared within acceptable limits of materiality and are in accordance with International Financial Reporting Standards using accounting policies consistent with International Financial Reporting Standards appropriate in the circumstances.

Management has established systems of internal control over the financial reporting process, which are designed to provide reasonable assurance that relevant and reliable financial information is produced.

The Board of Directors is responsible for reviewing and approving the consolidated financial statements together with other financial information of the Company and for ensuring that management fulfills its financial reporting responsibilities. An Audit Committee assists the Board of Directors in fulfilling this responsibility. The Audit Committee meets with management to review the financial reporting process and the consolidated financial statements together with other financial information of the Company. The Audit Committee reports its findings to the Board of Directors for its consideration in approving the consolidated financial statements together with other financial information of the Company for issuance to the shareholders.

Management recognizes its responsibility for conducting the Company's affairs in compliance with established financial standards, and applicable laws and regulations, and for maintaining proper standards of conduct for its activities.

"Bruce Rowlands"

Bruce Rowlands
Chief Executive Officer

"Andres Tinajero"

Andres Tinajero
Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Eurocontrol Technics Group Inc.

We have audited the accompanying consolidated financial statements of Eurocontrol Technics Group Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of operations and comprehensive loss, consolidated statements of changes shareholders' in equity and consolidated 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained 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 Eurocontrol Technics Group Inc. and its subsidiaries as at December 31, 2012 and 2011, and their financial performance and cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company had continuing losses during the year ended December 31, 2012. This condition along with other matters set forth in Note 1 indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

McGOVERN, HURLEY, CUNNINGHAM, LLP



Chartered Accountants
Licensed Public Accountants

TORONTO, Canada
April 26, 2013

EUROCONTROL TECHNICS GROUP INC.

Consolidated Statements of Financial Position (Expressed in Canadian dollars)

| As at December 31, | Notes | 2012 | 2011 |
|---|-------|---------------------|---------------------|
| ASSETS | | | |
| Current assets | | | |
| Cash | | \$ 1,582,030 | \$ 1,940,872 |
| Amounts receivable | 8 | 995,889 | 924,695 |
| Inventories | 9 | 626,955 | 456,669 |
| Prepaid expenses | | 89,325 | 30,789 |
| Loan receivable | 23 | 314,094 | - |
| Total current assets | | 3,608,293 | 3,353,025 |
| Non-current assets | | | |
| Equipment | 10 | 189,014 | 230,461 |
| Deferred development costs | 11 | 521,578 | 861,570 |
| Technology rights | 12 | 3,578,868 | 4,503,021 |
| Intellectual property | 6 | 349,568 | - |
| TOTAL ASSETS | | \$ 8,247,321 | \$ 8,948,077 |
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | 13 | \$ 1,489,013 | \$ 1,073,625 |
| Shareholder loans | 14 | 1,552,189 | 1,669,182 |
| Deferred income | | - | 24,505 |
| Total current liabilities | | 3,041,202 | 2,767,312 |
| Non-current liabilities | | | |
| Loan | | 34,127 | 51,954 |
| Total liabilities | | 3,075,329 | 2,819,266 |
| Shareholders' equity | | | |
| Issued capital | 15 | 14,260,341 | 13,912,428 |
| Warrants reserve | 16 | 866,379 | 989,895 |
| Commitment to issue shares | 17 | 430,000 | 430,000 |
| Share-based payment reserve | 18 | 296,736 | 640,100 |
| Deficit | | (10,681,464) | (9,843,612) |
| Total shareholders' equity | | 5,171,992 | 6,128,811 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | | \$ 8,247,321 | \$ 8,948,077 |

Nature of operations and going concern (note 1)
Contingencies (note 25)

APPROVED ON BEHALF OF THE BOARD:

Signed "W. BRUCE ROWLANDS" _____, Director

Signed "GADI GONEN" _____, Director

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

EUROCONTROL TECHNICS GROUP INC.

Consolidated Statements of Operations and Comprehensive Loss (Expressed in Canadian dollars)

| For the years ended December 31, | | 2012 | 2011 |
|--|--------|--------------------|--------------------|
| Revenue | 7 | \$ 5,008,040 | \$ 5,399,601 |
| Costs of sales | | (750,892) | (1,442,679) |
| Direct amortization | 11 | (339,980) | (339,991) |
| Gross profit | | 3,917,168 | 3,616,931 |
| Expenses | | | |
| Consulting and management | 20 | 1,518,962 | 1,502,901 |
| Depreciation and amortization | 10, 12 | 980,632 | 950,237 |
| Administration | | 1,078,772 | 1,235,070 |
| Sales and marketing expenses | | 743,687 | 862,444 |
| Research and development | | 559,610 | 673,012 |
| Public company costs | | 104,567 | 108,705 |
| Share-based expense | 18 | - | 462,240 |
| Total expenses | | 4,986,230 | 5,794,609 |
| Loss before the undernoted | | (1,069,062) | (2,177,678) |
| Other income and expense | | | |
| Finance income | | 67 | 334 |
| Provision for unrecoverable HST | | (300,000) | - |
| Foreign exchange gain (loss) | | 122,692 | (106,544) |
| Finance expense | 20 | (96,792) | (105,973) |
| | | (274,033) | (212,183) |
| Loss before income taxes | | (1,343,095) | (2,389,861) |
| Income tax expense | 24 | (24,637) | (19,809) |
| Loss and comprehensive loss for the year | | (1,367,732) | (2,409,670) |
| Basic and diluted loss per share | | \$ (0.02) | \$ (0.03) |
| Weighted average common shares outstanding - Basic and diluted | | 87,507,733 | 74,223,861 |

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

EUROCONTROL TECHNICS GROUP INC.

Consolidated Statements of Changes in Shareholders' Equity
(Expressed in Canadian dollars)

| | Number of Shares | Issued Capital (Note 15) | Warrants Reserve (Note 16) | Commitment to Issue Shares (Note 17) | Share-based Payment Reserve (Note 18) | Deficit | Total |
|-----------------------------------|---------------------|--------------------------------|----------------------------------|---|--|-----------------|--------------|
| Balance as at December 31, 2010 | 69,320,738 | \$ 12,483,730 | \$ 1,245,273 | \$ 430,000 | \$ 984,960 | \$ (8,513,120) | \$ 6,630,843 |
| Private placement: | | | | | | | |
| Shares issued | 14,840,000 | 1,484,000 | - | - | - | - | 1,484,000 |
| Value of finder's warrants issued | - | (16,700) | 16,700 | - | - | - | - |
| Share issue costs | - | (38,602) | - | - | - | - | (38,602) |
| Share-based expense | - | - | - | - | 462,240 | - | 462,240 |
| Expiry of stock options | - | - | - | - | (807,100) | 807,100 | - |
| Expiry of warrants | - | - | (272,078) | - | - | 272,078 | - |
| Loss for the year | - | - | - | - | - | (2,409,670) | (2,409,670) |
| Balance as at December 31, 2011 | 84,160,738 | \$ 13,912,428 | \$ 989,895 | \$ 430,000 | \$ 640,100 | \$ (9,843,612) | \$ 6,128,811 |
| Acquisition of XwinSys (note 6) | 5,000,000 | 350,000 | - | - | - | - | 350,000 |
| Share issue costs | - | (2,087) | - | - | - | - | (2,087) |
| Expiry of stock options | - | - | - | - | (343,364) | 343,364 | - |
| Expiry of warrants | - | - | (186,516) | - | - | 186,516 | - |
| Modification of warrants | - | - | 63,000 | - | - | - | 63,000 |
| Loss for the year | - | - | - | - | - | (1,367,732) | (1,367,732) |
| Balance as at December 31, 2012 | 89,160,738 | \$ 14,260,341 | \$ 866,379 | \$ 430,000 | \$ 296,736 | \$ (10,681,464) | \$ 5,171,992 |

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

EUROCONTROL TECHNICS GROUP INC.

Consolidated Statements of Cash Flows

(Expressed in Canadian dollars)

| For the years ended December 31, | Notes | 2012 | 2011 |
|---|-------|---------------------|---------------------|
| Cash provided by (used in): | | | |
| Operating activities | | | |
| Loss for the year | | \$ (1,367,732) | \$ (2,409,670) |
| Items not involving cash: | | | |
| Amortization of equipment | 10 | 55,997 | 56,409 |
| Amortization of deferred development costs | 11 | 339,992 | 339,991 |
| Amortization of technology right | 12 | 924,153 | 899,613 |
| Provision for unrecoverable HST | | 300,000 | |
| Modification of warrants | | 63,000 | - |
| Share-based expense | | - | 462,240 |
| Foreign exchange loss (gain) | | 15,822 | (20,004) |
| Foreign exchange gain on shareholder loans | | (12,732) | - |
| Accrued interest on shareholder loans | | 96,792 | 106,279 |
| Working capital adjustments | | | |
| Change in amounts receivable | | (66,067) | (123,508) |
| Change in inventories | | (170,286) | (265,253) |
| Change in prepaid expenses | | (58,536) | 361,522 |
| Change in accounts payables and accrued liabilities | | 110,693 | (108,081) |
| Change in deferred income | | (24,505) | (291,177) |
| Cash flows from operating activities | | 206,591 | (991,639) |
| Investing activities | | | |
| Equipment expenditures, net | | (8,333) | (125,731) |
| Loans provided | | (314,094) | - |
| Cash flows from investing activities | | (322,427) | (125,731) |
| Financing activities | | | |
| Shares issued - private placement | | - | 1,484,000 |
| (Decrease) Increase in loan | | (17,827) | 33,457 |
| Share issue costs | | (2,087) | (38,602) |
| Repayment of shareholder loans | | (201,053) | (233,316) |
| Cash flows from financing activities | | (220,967) | 1,245,539 |
| Effect of exchange rate changes on cash | | (22,039) | 32,730 |
| (Decrease) Increase in cash | | (358,842) | 160,899 |
| Cash, beginning of the year | | 1,940,872 | 1,779,973 |
| Cash, end of the year | | \$ 1,582,030 | \$ 1,940,872 |
| Supplementary cash flow information | | | |
| Interest paid | | \$ 96,792 | \$ 226,225 |
| Finders warrants issued | | - | 16,700 |
| Shares issued for acquisition | | 350,000 | - |

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

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

1. NATURE OF OPERATIONS AND GOING CONCERN

Eurocontrol Technics Group Inc. (the "Company") is a publicly listed limited liability company incorporated in British Columbia and Continued in the Province of Ontario. The Company participates in the energy security and authentication, verification and certification markets globally.

The Company's shares are listed on the TSX Venture Exchange under the symbol "EUO". The head office, principal and registered address and records office of the Company is located at 130 Adelaide Street West, Suite 1010, Toronto, Ontario, M5H 3P5.

The Company has a need for financing for working capital requirements. Because of continuing operating losses and a working capital deficiency, the Company's continuance as a going concern is dependent upon its ability to obtain adequate financing and to reach profitable levels of operation. It is not possible to predict whether financing efforts will be successful or if the Company will attain profitable levels of operations. These conditions indicate the existence of a material uncertainty that may cast significant doubt about the Company's abilities to continue as a going concern.

These consolidated financial statements were approved and authorized for issuance by the Board of Directors of the Company on April 26, 2013.

2. BASIS OF PRESENTATION

Statement of compliance

The Company's consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

Basis of measurement

The audited consolidated financial statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments, which are measured at fair value, as explained in the accounting policies set out in Note 5.

Adoption of new and revised standards and interpretations

At the date of authorization of these financial statements, the IASB and IFRIC had issued the following new and revised Standards and Interpretations which are not yet effective for the relevant reporting periods and which the Company has not early adopted. The Company is currently assessing what impact the application of these standards or amendments will have on the consolidated financial statements of the Company.

IFRS 9 *Financial Instruments* ("IFRS 9") was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet determined the impact of IFRS 9 on its financial statements.

IFRS 10 *Consolidated Financial Statements* ("IFRS 10") provides a single model to be applied in the control analysis for all investees, including entities that currently are special purpose entities in the scope of SIC 12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 *Consolidated and Separate Financial Statements*. The Company intends to adopt IFRS 10 in its financial statements for the annual period beginning on January 1, 2013. The Company has not yet determined the impact of IFRS 10 on its financial statements.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

2. BASIS OF PRESENTATION (continued)

IFRS 11 *Joint Arrangements* ("IFRS 11") replaces the guidance in IAS 31 *Interests in Joint Ventures*. Under IFRS 11, joint arrangements are classified as either joint operations or joint ventures. IFRS 11 essentially carves out of previous jointly controlled entities, those arrangements which although structured through a separate vehicle, such separation is ineffective and the parties to the arrangement have rights to the assets and obligations for the liabilities and are accounted for as joint operations in a fashion consistent with jointly controlled assets/operations under IAS 31. In addition, under IFRS 11 joint ventures are stripped of the free choice of equity accounting or proportionate consolidation; these entities must now use the equity method. Upon application of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation shall collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 *Investments in Associates* and IAS 36 *Impairment of Assets*. Any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented. The Company intends to adopt IFRS 11 in its financial statements for the annual period beginning on January 1, 2013. The Company has not yet determined the impact of IFRS 11 on its financial statements.

IFRS 12 *Disclosure of Interest in Other Entities* ("IFRS 12") sets out disclosure requirements for all forms of interests in other entities, including joint arrangement, associates, special purpose vehicles and other off statements of financial position vehicles. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. The Company has not yet determined the impact of IFRS 12 on its financial statements.

IFRS 13 *Fair Value Measurement* ("IFRS 13") converges IFRS and US GAAP on how to measure fair value and the related fair value disclosures. The new standard creates a single source of guidance for fair value measurements, where fair value is required or permitted under IFRS, by not changing how fair value is used but how it is measured. The focus will be on an exit price. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. The Company has not yet determined the impact of IFRS 13 on its financial statements.

There have been amendments to existing standards, including IAS 27, *Separate Financial Statements* ("IAS 27"), and IAS 28, *Investments in Associates and Joint Ventures* ("IAS 28"). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13. The Company has not yet determined the impact of these amendments on its financial statements.

IAS 1, *Presentation of Financial Statements* ("IAS 1"), has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012. The Company has not yet determined the impact of the amendments to IAS 1 on its financial statements.

IAS 32, *Financial Instruments, Presentation* – In December 2011, effective for annual periods beginning on or after January 1, 2014, IAS 32 was amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right of offset must be available on the current date and cannot be contingent on a future date.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

(Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

3. PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the financial position, results of operations and cash flows of the Company and its subsidiaries. The Company's subsidiaries are as follows:

| Name | Country of incorporation | Relationship | Economic interest | Basis of Accounting |
|---|--------------------------|--------------|-------------------|---------------------|
| Global Fluids International S.A. ("GFI") | Nevis | Subsidiary | 100% | Full consolidation |
| Xenemetrix Ltd. ("Xenemetrix") | Israel | Subsidiary | 100% | Full consolidation |
| XwinSys Technology Development Ltd. ("XwinSys") | Israel | Subsidiary | 100% | Full consolidation |

Subsidiaries

Subsidiaries are entities over which the Company has control, whereby control is defined as the power to govern financial and operating policies of an entity so as to obtain benefit from its activities. Control is presumed to exist where the Company has a shareholding of more than one half of the voting rights in its subsidiaries. The effects of potential voting rights that are currently exercisable are considered when assessing whether control exists. Subsidiaries are fully consolidated from the date control is transferred to the Company, and are de-consolidated from the date at which control ceases.

Business Combinations and Goodwill

On the acquisition of a subsidiary that meets the definition of a business, the purchase method of accounting is used to account for the acquisition as follows:

- cost is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange;
- directly attributable transaction costs are expensed rather than included in the acquisition purchase price;
- identifiable assets acquired and liabilities assumed are measured at their fair values as at the acquisition date except for non-current assets that are classified as held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value less costs to sell;
- the excess of acquisition cost over the fair value of the identifiable net assets acquired is recorded as goodwill;
- if the acquisition cost is less than the fair value of the net assets acquired, the difference is recognized directly in profit or loss;
- the interest of non-controlling shareholders in the acquiree is initially measured at the non-controlling shareholder's fair value; and
- the measurement of contingent consideration at fair value on the acquisition date is performed with subsequent changes in the fair value recorded through the statement of operations.

All material intercompany transactions between subsidiaries are eliminated in consolidation. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortized and is tested for impairment annually. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. The level at which goodwill is allocated shall represent the lowest level within the entity at which the goodwill is monitored for internal purposes, but shall not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

4. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of consolidated financial statements in conformity with IFRS requires the Company's management to make judgments, estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and related notes to the financial statements. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates.

The areas which require management to make significant judgments, estimates and assumptions in determining carrying values include, but are not limited to:

- **Assets' carrying values and impairment charges** - In the determination of carrying values and impairment charges, management looks at the higher of the recoverable amount or fair value less costs to sell in the case of assets and at objective evidence, significant or prolonged decline of fair value on financial assets indicating impairment. These determinations and their individual assumptions require that management make a decision based on the best available information at each reporting period.
- **Impairment of technology rights, deferred development costs and intellectual property** - While assessing whether any indications of impairment exist for technology rights, deferred development costs and intellectual property, consideration is given to both external and internal sources of information. Information the Company considers include changes in the market, economic and legal environment in which the Company operates that are not within its control and affect the recoverable of such assets. Internal sources of information include the manner in which technology rights and deferred development assets are being used or are expected to be used and indications of expected economic performance of the assets. Estimates include but are not limited to estimates of the discounted future after-tax cash flows expected to be derived from the Company's technology rights, deferred development costs and intellectual property, costs to sell the assets and the appropriate discount rate.
- **Share-based payments** – The Company determines costs for share-based payments using market-based valuation techniques. The fair value of the market-based and performance-based non-vested share awards are determined at the date of grant using generally accepted valuation techniques. Assumptions are made and judgment used in applying valuation techniques. These assumptions and judgments include estimating the future volatility of the stock price, expected dividend yield, future employee turnover rates and future employee stock option exercise behaviors and corporate performance. Such judgments and assumptions are inherently uncertain. Changes in these assumptions affect the fair value estimates.
- **Income taxes** - The Company must make significant estimates in respect of the provision for income taxes and the composition of its deferred income tax assets and deferred income tax liabilities. The Company's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question which may, on resolution in the future, result in adjustments to the amount of deferred income tax assets and deferred income tax liabilities, and those adjustments may be material to the Company's financial position and results of operations.
- **Contingencies** – refer to note 25.

5. SIGNIFICANT ACCOUNTING POLICIES

a) Presentation currency

The Company's presentation currency is the Canadian dollar. The functional currency of the Company and its subsidiaries is also the Canadian dollar.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

b) Foreign currency translation

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Foreign exchange gains and losses are presented in operations in the period in which they occur.

c) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

d) Revenue recognition

Revenue is recognized when all of the following conditions are satisfied:

- the specific risks and rewards of ownership have been transferred to the purchaser;
- the Company does not retain continuing managerial involvement to the degree usually associated with ownership or effective control over the product sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Company;
- and
- the costs incurred or to be incurred in respect of the sale can be measured reliably.

Revenue is measured at the fair value of the consideration received or receivable.

e) Share-based payments

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based transactions are set out in the share-based payment reserve note.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a graded vesting basis over the period during which the employee becomes unconditionally entitled to equity instruments, based on the Company's estimate of equity instruments that will eventually vest. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the share-based payments reserve.

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of the goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

For those options that expire after vesting, the recorded value is transferred to deficit.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

(Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

f) Finance costs

Finance costs comprise interest expense on borrowings calculated using the effective interest rate method.

g) Company as lessee

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

h) Taxation

Current income tax

Income tax expense represents the sum of the tax currently payable and deferred tax. The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of operations because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax

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

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

(Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

i) Equipment

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the rehabilitation obligation, and for qualifying assets, borrowing costs. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Equipment is amortized over its estimated useful life on a straight line basis as follows:

| | |
|---|-----------|
| Office furniture, computers and equipment | 7% to 33% |
| Machinery and spectrometer equipment | 30% |
| Vehicle | 15% |

An item of equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement when the asset is derecognised. The assets' residual values, useful lives and methods of depreciation/amortisation are reviewed at each reporting period, and adjusted prospectively if appropriate.

Major maintenance and repairs

Expenditures on major maintenance refits or repairs comprise the cost of replacement assets or parts of assets and overhaul costs. Where an asset or part of an asset that was separately depreciated and is written off is replaced, and it is probable that future economic benefits associated with the item will flow to the Company through an extended life, the expenditure is capitalized.

Where part of the asset was not separately considered as a component, the replacement value is used to estimate the carrying amount of the replaced assets, which is immediately written off. All other day-to-day maintenance costs are expensed as incurred.

j) Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost, which comprises its purchase price plus any directly attributable costs of preparing the asset for its intended use. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization on a straight-line basis over their useful lives and any accumulated impairment losses. Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognised in the statement of operations when the asset is derecognised.

Technology rights

Technology rights are amortized over their estimated useful lives on an annual straight-line basis as follows:

| | |
|---------------------------------|----------|
| Licence - markers and detectors | 10 years |
| Licence - XRF Systems | 7 years |

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

(Expressed in Canadian dollars)

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5. SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred development costs

Research costs are expensed as incurred. Development expenditures on an individual project are recognised as an intangible asset when the Company can demonstrate:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete and its ability to use or sell the asset;
- the ability to use or sell the intangible asset;
- how the asset will generate future economic benefits;
- the availability of resources to complete the asset; and
- the ability to measure reliably the expenditure during development.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be carried at cost less any accumulated amortization and accumulated impairment losses.

Amortization of the asset begins when development is complete and the asset is available for use. It is amortized over the period of expected future benefit. Amortization is recorded in cost of sales. During the period of development, the asset is tested for impairment annually.

Deferred development costs are amortized over their estimated useful life on a straight line basis as follows:

| | |
|--------------------------|---|
| Marker development costs | 10 years over the life of the technology rights |
| Equipment development | 3 years over the life of the equipment |

k) Impairment of non-financial assets

The Company conducts annual internal assessments of the carrying values of non-financial assets including equipment and intangible assets (technology rights, deferred development costs and intellectual property). The carrying values of capitalised equipment and intangible assets are assessed for impairment when indicators of such impairment exist. If any indication of impairment exists an estimate of the asset's recoverable amount is calculated. The recoverable amount is determined as the higher of the fair value less costs to sell for the asset and the asset's value in use.

Impairment is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, the individual assets of the Company are grouped together into cash generating units ("CGUs") for impairment purposes. Such CGUs represent the lowest level for which there are separately identifiable cash inflows that are largely independent of the cash flows from other assets or other group of assets. This generally results in the Company evaluating its non-financial assets on a geographical or licence basis.

If the carrying amount of the asset exceeds its recoverable amount, the asset is impaired and an impairment loss is charged to the statement of operations so as to reduce the carrying amount to its recoverable amount. Impairment losses related to continuing operations are recognised in the statement of operations in those expense categories consistent with the function of the impaired asset, except for property previously revalued where the revaluation was taken to other comprehensive income. In this case, the impairment is also recognised in other comprehensive income up to the amount of any previous revaluation.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

(Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

k) Impairment of non-financial assets (continued)

For assets excluding goodwill and indefinite life intangibles, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Company makes an estimate of the recoverable amount.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined, net of depreciation/amortisation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement. Impairment losses recognised in relation to goodwill or indefinite life intangibles are not reversed for subsequent increases in its recoverable amount.

l) Financial instruments

Financial assets

Financial assets within the scope of IAS 39, *Financial Instruments: Recognition and Measurement* are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or derivatives. The Company determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, (i.e., the date that the Company commits to purchase or sell the asset).

The Company's financial assets include cash, amounts receivable, and loan receivable.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

Financial assets at fair value through profit or loss includes financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. This category includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with changes in fair value recognised in finance income and finance costs in the statement of operations.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the statement of operations. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Financial instruments (continued)

Subsequent measurement (continued)

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method ("EIR"), less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in finance income in the statement of operations. The losses arising from impairment are recognised in the statement of operations.

Derecognition

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either:
 - (a) the Company has transferred substantially all the risks and rewards of the asset; or,
 - (b) the Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Company has transferred its rights to receive cash flows from an asset or has entered into a passthrough arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset.

In this case, the Company also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Company has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Impairment of financial assets

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

1) Financial instruments (continued)

For financial assets carried at amortized cost, the Company first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of operations. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income in the statement of operations. Loans, together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Company. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to finance costs in the statement of operations.

Financial liabilities

Initial recognition and measurement:

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

The Company's financial liabilities include accounts payable and accrued liabilities, shareholder loans and other loans.

Subsequent measurement:

The measurement of financial liabilities depends on their classification as follows:

Financial liabilities at fair value through profit or loss includes financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. This category includes derivative financial instruments entered into by the Company that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the statement of operations.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements (Expressed in Canadian dollars)

For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Financial instruments (continued)

Loans and borrowings:

After initial recognition, loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in the statement of operations when the liabilities are derecognised, as well as through the EIR amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in finance cost in the statement of operations.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged, is cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of operations.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

Fair value of financial instruments

The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

m) Cash

Cash comprises of cash at banks and on hand. For the purpose of the consolidated statement of cash flows, cash is net of outstanding bank overdrafts.

n) Inventories

Inventories consist of materials, work in process and finished goods, are stated at the lower of cost or net realizable value and are accounted for using the FIFO (first in, first out) method. Any provision for obsolescence is determined by reference to specific items of stock. A regular review is undertaken to determine the extent of any provision for obsolescence.

EUROCONTROL TECHNICS GROUP INC.

Notes to the Consolidated Financial Statements

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For the years ended December 31, 2012 and 2011

5. SIGNIFICANT ACCOUNTING POLICIES (continued)

o) Provisions

Provisions are recognised when (a) the Company has a present obligation (legal or constructive) as a result of a past event, and (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

p) Loss per share

Basic loss per common share has been computed by dividing the loss applicable to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted loss per common share reflects the potential dilution of common share equivalents such as outstanding options and warrants, in the weighted average number of common shares outstanding during the period, if dilutive. The diluted loss per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share. For the years ended December 31, 2012 and 2011, all options and warrants were excluded from the computation of diluted loss per share as they were anti-dilutive.

6. ACQUISITION OF XWINSYS TECHNOLOGY DEVELOPMENT LTD.

On May 1, 2012, the Company acquired all of the issued and outstanding common and preferred shares of XwinSys Technology Development Ltd. ("XwinSys"). XwinSys is a private company located in Israel that develops, manufactures and sells inspection systems for the semiconductor industry. The acquisition is classified as an asset acquisition as XwinSys did not meet the definition of a business under IFRS.

In connection with the acquisition, the Company issued an aggregate of 5,000,000 common shares of the Company. The purchase price of 100% of the outstanding shares of XwinSys was determined to be \$350,000 based on the fair value of the identifiable assets and liabilities acquired.

The purchase price consisted of the following:

| | |
|---------------------------------|------------|
| 5,000,000 shares of the Company | \$ 350,000 |
|---------------------------------|------------|

The net assets acquired and liabilities assumed consisted of the following:

| | |
|-----------------------|-------------------|
| Intellectual property | \$ 349,568 |
| Working capital | 432 |
| | <u>\$ 350,000</u> |

7. OPERATING SEGMENTS

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The Company conducts its business as a single operating segment.

EUROCONTROL TECHNICS GROUP INC.
Notes to the Consolidated Financial Statements
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7. OPERATING SEGMENTS (continued)

Geographical information

The Company's revenue from external customers and information about its non-current assets by geographical location are detailed below.

| For the years ended December 31, | Revenue from external customers | |
|---|--|---------------------|
| | 2012 | 2011 |
| Africa | \$3,528,421 | \$ 3,539,534 |
| North America | 359,654 | 913,508 |
| Asia | 633,579 | 462,176 |
| Europe | 397,191 | 385,628 |
| South America | 89,195 | 98,755 |
| | \$5,008,040 | \$ 5,399,601 |

As at December 31, 2012

| | South America | North America | Asia | Total |
|----------------------------|----------------------|----------------------|-------------|--------------|
| Equipment | | \$ 483 | \$ 188,531 | \$ 189,014 |
| Deferred development costs | 521,578 | - | - | 521,578 |
| Technology rights | 2,941,594 | - | 637,274 | 3,578,868 |
| Intellectual property | - | - | 349,568 | 349,568 |

As at December 31, 2011

| | South America | North America | Asia | Total |
|----------------------------|----------------------|----------------------|-------------|--------------|
| Equipment | \$ - | \$ 483 | \$ 229,978 | \$ 230,461 |
| Deferred development costs | 861,570 | - | - | 861,570 |
| Technology rights | 3,738,292 | - | 764,729 | 4,503,021 |

8. AMOUNTS RECEIVABLE

| As at December 31, | 2012 | 2011 |
|---------------------------|-------------------|-------------------|
| Trade receivables | \$ 924,304 | \$ 767,151 |
| Tax receivables | 1,023 | 144,106 |
| Other | 70,562 | 13,438 |
| | \$ 995,889 | \$ 924,695 |

EUROCONTROL TECHNICS GROUP INC.**Notes to the Consolidated Financial Statements****(Expressed in Canadian dollars)****For the years ended December 31, 2012 and 2011****9. INVENTORIES**

| As at December 31, | 2012 | 2011 |
|---------------------------|-------------------|-------------------|
| Materials | \$ 141,619 | \$ 172,357 |
| Work in process | 78,232 | 11,952 |
| Finished goods | 407,104 | 272,360 |
| | \$ 626,955 | \$ 456,669 |

Inventories are carried at the lower of cost and net realizable value. Materials, work in process, and finished goods are recorded at cost. For the years ended December 31, 2012 and 2011, the cost of inventories recognized as an expense and included in cost of sales was \$750,892 and \$1,442,679 respectively.

10. EQUIPMENT

| | Office furniture, computers and equipment | Vehicles | Total |
|---------------------------------|--|------------------|-------------------|
| Cost | | | |
| Balance as at December 31, 2010 | \$ 203,492 | \$ 12,877 | \$ 216,369 |
| Additions | 72,889 | 52,842 | 125,731 |
| Balance as at December 31, 2011 | 276,381 | 65,719 | 342,100 |
| Additions | 26,859 | - | 26,859 |
| Disposals | (71,558) | (1,428) | (72,986) |
| Balance as at December 31, 2012 | \$ 231,682 | 64,291 | 295,973 |
| Accumulated depreciation | | | |
| Balance as at December 31, 2010 | \$ 54,060 | \$ 1,170 | \$ 55,230 |
| Depreciation | 48,265 | 8,144 | 56,409 |
| Balance as at December 31, 2011 | 102,325 | 9,314 | 111,639 |
| Depreciation | 43,609 | 12,388 | 55,997 |
| Disposals | (60,475) | (202) | (60,677) |
| Balance as at December 31, 2012 | \$ 85,459 | \$ 21,500 | \$ 106,959 |
| Carrying amounts | | | |
| Balance as at December 31, 2011 | \$ 174,056 | \$ 56,405 | \$ 230,461 |
| Balance as at December 31, 2012 | \$ 146,223 | \$ 42,791 | \$ 189,014 |

EUROCONTROL TECHNICS GROUP INC.
Notes to the Consolidated Financial Statements
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11. DEFERRED DEVELOPMENT COSTS

| | <u>Marker</u> | <u>Equipment</u> | <u>Total</u> |
|---------------------------------|---------------|------------------|--------------|
| Cost | | | |
| Balance as at December 31, 2010 | \$ 920,137 | \$ 651,922 | \$ 1,572,059 |
| Additions | - | - | - |
| Balance as at December 31, 2011 | 920,137 | 651,922 | 1,572,059 |
| Additions | - | - | - |
| Balance as at December 31, 2012 | \$ 920,137 | \$ 651,922 | \$ 1,572,059 |
| Accumulated amortization | | | |
| Balance as at December 31, 2010 | \$ 214,697 | \$ 155,801 | \$ 370,498 |
| Amortization expense | 122,684 | 217,307 | 339,991 |
| Balance as at December 31, 2011 | 337,381 | 373,108 | 710,489 |
| Amortization expense | 122,684 | 217,308 | 339,992 |
| Balance as at December 31, 2012 | \$ 460,065 | \$ 590,416 | \$ 1,050,481 |
| Carrying amounts | | | |
| Balance as at December 31, 2011 | \$ 582,756 | \$ 278,814 | \$ 861,570 |
| Balance as at December 31, 2012 | \$ 460,072 | \$ 61,506 | \$ 521,578 |

12. TECHNOLOGY RIGHTS

The Company, through its wholly owned subsidiaries GFI and Xenemetrix, holds a licence to produce and sell fuel markers, detectors and XRF systems. The fuel markers and detectors are licensed under a 20 year licence agreement from the holder of the patents. The XRF systems are licensed until February 2018. Technology rights assets relating to markers and detectors and XRF Systems are being amortized over their estimated useful lives on a straight-line basis of 10 years (ending in fiscal 2016) and seven years (ending in fiscal 2018), respectively.

| | <u>Markers and Detectors</u> | <u>XRF Systems</u> | <u>Total</u> |
|---------------------------------|----------------------------------|--------------------|--------------|
| Cost | | | |
| Balance as at December 31, 2010 | \$ 7,844,267 | \$ 892,184 | \$ 8,736,451 |
| Additions | - | - | - |
| Balance as at December 31, 2011 | 7,844,267 | 892,184 | 8,736,451 |
| Additions | - | - | - |
| Balance as at December 31, 2012 | \$ 7,844,267 | \$ 892,184 | \$ 8,736,451 |
| Accumulated amortization | | | |
| Balance as at December 31, 2010 | \$ 3,333,817 | \$ - | \$ 3,333,817 |
| Amortization expense | 772,158 | 127,455 | 899,613 |
| Balance as at December 31, 2011 | 4,105,975 | 127,455 | 4,233,430 |
| Amortization expense | 796,698 | 127,455 | 924,153 |
| Balance as at December 31, 2012 | \$ 4,902,673 | \$ 254,910 | \$ 5,157,583 |
| Carrying amounts | | | |
| Balance as at December 31, 2011 | \$ 3,738,292 | \$ 764,729 | \$ 4,503,021 |
| Balance as at December 31, 2012 | \$ 2,941,594 | \$ 637,274 | \$ 3,578,868 |

EUROCONTROL TECHNICS GROUP INC.**Notes to the Consolidated Financial Statements****(Expressed in Canadian dollars)****For the years ended December 31, 2012 and 2011****13. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

| As at December 31, | 2012 | | 2011 | |
|---------------------------|------|-----------|------|-----------|
| Accounts payable | \$ | 450,727 | \$ | 694,586 |
| Accrued liabilities | | 1,038,286 | | 379,039 |
| | \$ | 1,489,013 | \$ | 1,073,625 |

14. SHAREHOLDER LOANS

| | | | December 31, 2012 | December 31, 2011 |
|-----------------------|----|---------|----------------------|----------------------|
| Euro loan | | | | |
| Principal | € | 500,000 | \$ 655,900 | \$ 659,626 |
| Interest | € | 320,059 | 419,853 | 347,861 |
| US dollar loan | | | | |
| Principal | \$ | 850,000 | 845,665 | 864,450 |
| Interest | \$ | 364,118 | 362,261 | 345,474 |
| | | | \$ 2,283,679 | \$ 2,217,411 |
| Repayments | | | (731,490) | (548,229) |
| | | | \$ 1,552,189 | \$ 1,669,182 |

The total payable includes the principal amount of €500,000 (\$655,900) (December 31, 2011 - €500,000 (\$659,626)) and accrued interest of €320,059 (\$419,853) (December 31, 2011 - €419,853 (\$347,861)) loaned by the former shareholders of GFI. These loans payable bear an annual interest rate of 7.2%. A recently appointed director of the Company is among recipients of such loans.

The remainder of the shareholder loans balance relates to the principal amount of US\$850,000 (\$845,665) (December 31, 2011 - US\$850,000 (\$864,450)) and accrued interest of US\$364,118 (\$362,261) (December 31, 2011 - US\$339,699 (\$345,474)) in loans payable to the former shareholders of GFI. The shareholder loans will be repaid through 25% of the income generated by contracts of GFI.

As at December 31, 2012, the Company repaid US\$735,239 (\$731,490), (December 31, 2011 - US\$539,065 (\$548,229)). This portion of the loans payable bears an annual interest rate of 5.0%.

The shareholder loans are unsecured. It is not possible to determine if the shareholder loans are at fair value as there is no comparable market value for such loans.

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15. ISSUED CAPITAL

Authorized: 100,000,000 common shares without par value

| | December 31, 2012 | December 31, 2011 |
|--------------------------|----------------------|----------------------|
| Issued capital | \$ 14,260,341 | \$ 13,912,428 |
| Fully paid common shares | 89,160,738 | 84,160,738 |

Commons shares issued:

| | Number of Shares | Value of shares |
|--|---------------------|-----------------|
| Balance as at December 31, 2010 | 69,320,738 | \$ 12,483,730 |
| Private placement before issue costs (i) | 14,840,000 | 1,484,000 |
| Private placement – warrant valuation (i) | - | (16,700) |
| Share issue costs (i) | - | (38,602) |
| Balance as at December 31, 2011 | 84,160,738 | \$ 13,912,428 |
| Shares issued on acquisition of XwinSys (note 6) | 5,000,000 | 350,000 |
| Share issue costs | - | (2,087) |
| Balance as at December 31, 2012 | 89,160,738 | \$ 14,260,341 |

(i) On September 26, 2011, the Company completed a private placement issuing 14,840,000 common shares of the Company at a price of \$0.10 per share for gross proceeds in the amount of \$1,484,000. The Company paid finder's fees of \$29,225 and issued 417,500 finder's warrants. Each finder's warrant was exercisable into one common share at a price of \$0.10 until September 27, 2012. The fair value of the finder's warrants was estimated at \$16,700 on the date of grant using the Black-Scholes pricing model with the following assumptions: expected dividend yield of 0%; expected volatility of 97%; risk-free interest rate of 0.96% and an expected average life of one year.

16. WARRANTS RESERVE

The following table summarizes information about warrants:

| | Number of Warrants | Value |
|--|-----------------------|--------------|
| Balance as at December 31, 2010 | 20,670,080 | \$ 1,245,273 |
| Warrants issued from private placement | 417,500 | 16,700 |
| Warants expired | (3,375,682) | (272,078) |
| Balance as at December 31, 2011 | 17,711,898 | \$ 989,895 |
| Warants expired | (2,557,233) | (186,516) |
| Modification of warrants | - | 63,000 |
| Balance as at December 31, 2012 | 15,154,665 | \$ 866,379 |

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16. WARRANTS RESERVE (continued)

The following warrants were outstanding as of December 31, 2012:

| Number of warrants | Grant date fair value of warrants | Exercise Price | Expiry Date |
|-----------------------|--------------------------------------|-------------------|--------------------|
| 12,036,332 | \$ 702,358 | \$ 0.15 | September 27, 2013 |
| 3,118,333 | 164,021 | 0.15 | December 10, 2013 |
| 15,154,665 | \$ 866,379 | \$ 0.15 | |

17. COMMITMENT TO ISSUE SHARES

| | Number of Shares | Value of shares |
|--|---------------------|-----------------|
| Shares to be issued – warrants exercised | 1,000,000 | \$ 260,000 |
| Shares to be issued – warrant valuation | - | 170,000 |
| Balance as at December 31, 2010, December 31, 2011 and December 31, 2012 | 1,000,000 | \$ 430,000 |

18. SHARE-BASED PAYMENT RESERVE

Employee share option plan

The Board of Directors of the Company adopted a stock option incentive plan (the "Plan") whereby the aggregate number of common shares reserved for issuance under the Plan, including common shares reserved for issuance under any other share compensation arrangement granted or made available by the Company from time to time, may not exceed 10% of the Company's issued and outstanding common shares. The Plan is administered by the Board of Directors and grants made pursuant to the Plan must at all times comply with the policies of the TSX Venture Exchange (the "Exchange") and the Plan.

The terms of any options granted under the Plan are fixed by the Board of Directors and may not exceed a term of five years. The exercise price of the options granted under the Plan is determined by the Board of Directors, provided that it is not less than the lowest price permitted by the Exchange.

Each employee share option converts into one common share of the Company on exercise. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of their expiry.

The following table summarizes information about share-based payment reserve:

| | | |
|---------------------------------|----|-----------|
| Balance as at December 31, 2010 | \$ | 984,960 |
| Share-based payments | | 462,240 |
| Expiry of stock options | | (807,100) |
| Balance as at December 31, 2011 | \$ | 640,100 |
| Expiry of stock options | | (343,364) |
| Balance as at December 31, 2012 | \$ | 296,736 |

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18. SHARE-BASED PAYMENT RESERVE (continued)

The following share-based payment arrangements were in existence as at December 31, 2012:

| Number of options outstanding | Number of exercisable options | Grant date | Expiry date | Exercise price | Fair value at grant date |
|-------------------------------|-------------------------------|--------------------|--------------------|----------------|--------------------------|
| 200,000 | 200,000 | May 12, 2008 | May 12, 2013 | \$ 0.30 | \$ 35,960 |
| 100,000 | 100,000 | September 15, 2008 | September 15, 2013 | \$ 0.30 | 9,420 |
| 1,700,000 | 1,700,000 | February 23, 2011 | February 23, 2016 | \$ 0.16 | 244,856 |
| 50,000 | 50,000 | March 30, 2011 | March 30, 2016 | \$ 0.18 | 6,500 |
| 2,050,000 | 2,050,000 | | | | \$ 296,736 |

The share options outstanding as at December 31, 2012 had a weighted exercise price of \$0.18 (December 31, 2011: \$0.19) and a weighted average remaining contractual life of 3.0 years (December 31, 2011: 2.8 years).

All options vested on their date of issue and expire within 5 years of their issue, or 30 days after the resignation of the director, officer, employee or consultant.

Fair value of share options granted in the year ended December 31, 2012

During the year ended December 31, 2012, no share options were granted.

Fair value of share options granted in the year ended December 31, 2011

On February 23, 2011, 3,160,000 share options were granted to directors, officers and consultants of the Company to acquire the Company's shares at an exercise price of \$0.16 until February 23, 2016. These share options had an estimated fair value of \$455,740 at grant date. Of the 3,160,000 share options, 2,960,000 vested immediately with the remaining 200,000 share options vesting in four installments over a twelve month period from the grant date.

On March 30, 2011, 50,000 share options were granted to a consultant of the Company to acquire the Company's shares at an exercise price of \$0.18 until March 30, 2016. These options vested immediately and had an estimated fair value of \$6,500 at grant date.

The share options were priced using the Black-Scholes option-pricing model as at the date of the grant assuming a five year term to maturity with an expected volatility, an expected dividend yield, and a risk free interest rate, as noted in the table below. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions, and behavioral considerations.

| | Number of Options Granted | |
|-------------------------|---------------------------|---------|
| | 3,160,000 | 50,000 |
| Grant date share price | \$ 0.16 | \$ 0.18 |
| Exercise price | \$ 0.16 | \$ 0.18 |
| Expected volatility | 139% | 139% |
| Expected dividend yield | 0% | 0% |
| Risk-free interest rate | 2.61% | 2.71% |

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18. SHARE-BASED PAYMENT RESERVE (continued)

Movements in shares options during the period:

The following reconciles the share options outstanding during the years ended December 31, 2012 and December 31, 2011:

| | Number of options | Weighted average exercise price |
|---------------------------------|----------------------|---------------------------------------|
| Balance as at December 31, 2010 | 3,700,000 | \$ 0.44 |
| Granted | 3,210,000 | \$ 0.16 |
| Expired | (2,800,000) | \$ 0.47 |
| Balance as at December 31, 2011 | 4,110,000 | \$ 0.19 |
| Expired | (2,060,000) | \$ 0.20 |
| Balance as at December 31, 2012 | 2,050,000 | \$ 0.18 |

19. FINANCIAL INSTRUMENTS

Financial assets and financial liabilities as at December 31, 2012 and December 31, 2011 were as follows:

| | Loans and receivables | Other financial liabilities | Total |
|--|--------------------------|--------------------------------|--------------|
| As at December 31, 2012 | | | |
| Cash | \$ 1,582,030 | - | \$ 1,582,030 |
| Amounts receivable | 924,304 | - | 924,304 |
| Loans receivable | 314,094 | - | 314,094 |
| Accounts payable and accrued liabilities | - | 1,489,013 | 1,489,013 |
| Shareholder loans | - | 1,552,189 | 1,552,189 |
| Loans | - | 34,127 | 34,127 |

| | Loans and receivables | Other financial liabilities | Total |
|--|--------------------------|--------------------------------|--------------|
| As at December 31, 2011 | | | |
| Cash | \$ 1,940,872 | - | \$ 1,940,872 |
| Amounts receivable | 767,121 | - | 767,121 |
| Accounts payable and accrued liabilities | - | 1,073,625 | 1,073,625 |
| Shareholder loans | - | 1,669,182 | 1,669,182 |
| Loans | - | 51,954 | 51,954 |

As at December 31, 2012, there are no significant concentrations of credit risk for loans as the Company currently transacts with highly rated counterparties. The carrying amount reflected above represents the Company's maximum exposure to credit risk for such loans and receivables. As at December 31, 2012, the Company did not hold financial instruments recorded at fair value that would require classification within the fair value hierarchy.

The carrying value of cash, amounts receivable, loan receivable, accounts payable, accrued liabilities and loans classified as long term approximate fair value because of the limited terms of these instruments. It is not possible to determine if the shareholder loans are at fair value as there is no comparable market value for such loans.

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20. RELATED PARTY DISCLOSURES

The Company entered into the following transactions in the ordinary course of business with related parties:

- For the year ended December 31, 2012, the Company was charged \$nil (2011 - \$50,000) by a corporation for which a director of the Company is the Executive Chairman. This company provides administrative and promotional services, which were recorded in consulting and management services.
- Prior to September 1, 2012, the Company shared its premises with other corporations that had former directors and officers in common. The Company reimburses the related corporations for its proportional share of the expenses. At as December 31, 2012, an amount of \$nil (December 31, 2011 - \$25,425) was included in accounts payable and accrued liabilities. These amounts are non-interest bearing, unsecured with no fixed terms of repayment.
- For the year ended December 31, 2012 \$96,792 (2011 - \$106,279) in interest was charged on the shareholder loans as described in note 14.
- In connection with the September 2011 private placement, 100,000 common shares were sold to a certain director and officer of the Company (see note 15(i)).

Compensation of key management personnel of the Company

The remuneration of directors and other members of key management personnel during the year were as follows:

| For the years ended December 31, | 2012 | 2011 |
|---|-------------------|-------------------|
| Short-term compensation and benefits | \$ 623,310 | \$ 645,551 |
| Share-based payments | - | 314,000 |
| | \$ 623,310 | \$ 959,551 |

In accordance with IAS 24, key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company directly or indirectly, including any directors (executive and non-executive) of the Company.

The remuneration of directors and key executives is determined by the compensation committee.

21. CAPITAL MANAGEMENT

The Company manages and adjusts its capital structure based on available funds in order to support its operations. The capital of the Company consists of common shares, warrants and options. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company has entered into commercial operations and has begun to generate cash flows to support the ongoing and longer term strategy of the Company. However, the Company may continue to rely on capital markets to support continued growth.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management in the years ended December 31, 2012 and 2011. The Company and its subsidiaries are not subject to externally imposed capital requirements.

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22. FINANCIAL RISK FACTORS

The Company's risk exposure and the impact on the Company's financial instruments are summarized below. There have been no changes in the risks, objectives, policies and procedures from the previous period.

Credit risk:

The Company's credit risk is primarily attributable to cash, amounts receivable and loan receivable. Financial instruments included in amounts receivable consist primarily of receivables due from customers. The Company currently transacts with highly rated counterparties for the sale of its marking systems. Management believes that the credit risk concentration with respect to these financial instruments is minimal.

Liquidity risk:

Liquidity risk is the risk that the Company will not have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to the capital market is hindered, whether as a result of a downturn in stock market conditions generally or related to matters specific to the Company. The Company generates cash flow primarily from its financing activities. As at December 31, 2012, the Company had a cash balance of \$1,582,030 (December 31, 2011 - \$1,940,872) to settle current liabilities of \$3,041,202 (December 31, 2011 - \$2,767,312). This amount includes \$1,552,189 (December 31, 2011 - \$1,669,182) in shareholder loans (note 14).

All of the Company's financial liabilities have contractual maturities of less than 365 days and are subject to normal trade terms. The Company can't ensure there is sufficient capital in order to meet short term business requirements, after taking into account cash flows from operations and the Company's holding cash. The Company is currently seeking sources of funding to meet short term liabilities, and short term cash requirements.

Market risk:

(a) Interest rate risk

The Company carries shareholder loans with interest and repayment terms as described in note 14. Management believes that interest rate risk is remote as the Company currently does not carry interest-bearing debt at floating rates.

(b) Foreign currency risk

The functional and reporting currency of the Company and its subsidiaries is the Canadian dollar. The Company undertakes transactions denominated in foreign currencies, including US dollars and Euros, and as such is exposed to price risk due to fluctuations in foreign exchange rates against the Canadian dollar. The Company does not use derivative instruments to reduce exposure to foreign exchange risk.

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22. FINANCIAL RISK FACTORS (continued)

The exposure of the Company's financial assets and liabilities to foreign currency risk as at December 31, 2012 is as follows:

| | CDN Dollar | US Dollar | Euro | Total (in CDN dollars) |
|--|-----------------------|----------------------|---------------------|-----------------------------------|
| Financial assets | | | | |
| Cash | \$ (6,174) | \$ 1,588,204 | \$ - | \$ 1,582,030 |
| Amounts receivable | - | \$ 995,889 | - | 995,889 |
| Loan receivable | - | \$ 314,094 | - | 314,094 |
| | \$ (6,174) | \$ 2,898,187 | \$ - | \$ 2,892,013 |
| Financial liabilities | | | | |
| Accounts payable and accrued liabilities | \$ 411,269 | \$ 1,077,744 | \$ - | \$ 1,489,013 |
| Shareholder loans | - | 476,436 | 1,075,753 | 1,552,189 |
| Loan | - | 34,127 | - | 34,127 |
| | \$ 411,269 | \$ 1,588,307 | \$ 1,075,753 | \$ 3,075,329 |

A 10% change in foreign exchange rates between the Canadian dollar and these foreign currencies over the next year would affect net loss by approximately \$51,000 (December 31, 2011 - \$70,000) based on the foreign currency balances at December 31, 2012.

(c) Price risk

The Company is engaged in the development and implementation of marking systems for various types of oil. As a result, the Company is exposed to price risk with respect to commodity prices, specifically oil. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company. The Company's future operations will be significantly affected by changes in the market prices for oil. Oil prices fluctuate on a daily basis and are affected by numerous factors beyond the Company's control. The supply and demand for oil, the level of interest rates, the rate of inflation, investment decisions by large holders of oil, and stability of exchange rates can all cause significant fluctuations in oil prices. Such external economic factors are in turn influenced by changes in international investment patterns, and monetary systems and political developments.

23. LOAN RECEIVABLE

On September 20, 2012, the Company, through its wholly owned subsidiary Global Fluids International S.A., loaned USD \$200,000 and paid for various expenses amounting to USD \$114,094 on behalf of GFI U Ltd., a non-related company, pursuant to a five year contract extension with the Ministry of Energy and Mineral Development, Government of the Republic of Uganda for the continued deployment of the Company's Petromark™ technology in the territory. The loan carries an interest rate of 10% and is without fixed terms of repayment. As management expects the loan to be repaid within one year it is classified as a current asset. As at December 31, 2012, the balance of principal and interest outstanding amounts to CDN \$314,094 (December 31, 2011 - \$nil).

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24. INCOME TAXES

a) Provision for income taxes

Major items causing the Company's income tax rate to differ from the Canadian statutory rate of approximately 27% (December 31, 2011 – 29%) are as follows:

| | December 31, 2012 | December 31, 2011 |
|--|----------------------|----------------------|
| Loss before income taxes | \$ (1,343,095) | \$ (2,389,861) |
| Expected income tax recovery based on statutory rate | (362,636) | (703,616) |
| Adjustments to benefit resulting from: | | |
| Share-based compensation | 17,010 | 139,345 |
| Change in tax rates | (101,000) | 72,637 |
| Other | (55,537) | 28,505 |
| Expiry of non-capital losses | 911,000 | - |
| Share issue costs | - | (11,362) |
| Benefit of tax losses not recognized | (384,200) | 494,300 |
| Provision for income taxes | \$ 24,637 | \$ 19,809 |

The statutory rate has decreased due to a decrease in the provincial rate of 1.75%.

b) Deferred tax balance

Deferred tax assets have not been recognized in respect of the following items:

| | December 31, 2012 | December 31, 2011 |
|-----------------------------|----------------------|----------------------|
| Deferred income tax assets: | | |
| Non-capital losses | \$ 2,014,700 | \$ 2,418,600 |
| Share issue costs | 18,900 | 27,600 |
| Temporary differences | 30,400 | 16,100 |
| Other | 27,700 | 13,600 |
| | \$ 2,091,700 | \$ 2,475,900 |

Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the Company will be able to use these benefits.

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24. INCOME TAXES (continued)

c) Non-capital loss balance

As at December 31, 2012, the Company has non-capital losses in Canada, which under certain circumstances can be used to reduce the taxable income of future years. The non-capital losses, stated in Canadian dollars, expire as follows:

| | |
|------|---------------------|
| 2013 | 48,000 |
| 2014 | 57,000 |
| 2025 | 380,000 |
| 2026 | 803,000 |
| 2027 | 875,000 |
| 2028 | 817,000 |
| 2029 | 624,000 |
| 2030 | 1,490,000 |
| 2031 | 1,336,000 |
| 2032 | 1,060,000 |
| | <u>\$ 7,490,000</u> |

25. COMMITMENT AND CONTINGENCIES

- a) In January 2012, a lawsuit for approximately US\$100,000 was filed against the Company by a supplier for services it alleges were received by the Company but not paid for. In the opinion of management, this lawsuit has no merit and the ultimate disposition of this lawsuit will not have a material adverse effect on the Company's consolidated financial condition, results of operations or future cash flows. As a result, this amount has not been reflected in these consolidated financial statements.
- b) The Company is party to certain management contracts. These contracts require that payments of up to approximately \$162,000 be made upon the occurrence of certain events such as a change of control. As a triggering event has not taken place, the contingent payments have not been reflected in these consolidated financial statements. Additional minimum management contractual commitments remaining under these contracts approximate \$253,000 due within one year.