SMARTCOOL™

Smartcool Systems Inc. (TSX-V: SSC)
Consolidated Financial Statements

For the year ended December 31, 2011 and 2010
Expressed in Canadian Dollars

www.smartcool.net

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Independent Auditor's Report

To the Shareholders of Smartcool Systems Inc.

We have audited the accompanying consolidated financial statements of Smartcool Systems Inc., which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of operations, comprehensive loss, cash flows, and shareholders' equity for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Smartcool Systems Inc. as at December 31, 2011, December 31, 2010 and January 1, 2010, and the results of its operations and its cash flows for the years ended December 31, 2011 and December 31, 2010 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 incurred a net loss of $5,217,928 during the year ended December 31, 2011 and, as of that date, had a deficit of $32,377,744. These conditions, along with other matters as 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.

(Signed) Deloitte & Touche LLP

Chartered Accountants
Vancouver, British Columbia
April 30, 2012

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Smartcool Systems Inc.
Consolidated statements of financial position
(Expressed in Canadian dollars, unless otherwise stated)

	December31 2011	December 31 2010	January 1 2010
	$	$	$
ASSETS		(note 22)	(note 22)
Current assets			
Cash and cash equivalents (note 4)	498,874	610,261	147,051
Short-term investments	-	-	101,646
Trade and other receivables (note 5)	1,058,348	1,019,861	657,840
Inventory (note 6)	525,093	509,585	717,844
Prepaid expenses and deposits	146,786	75,487	242,302
	2,229,101	2,215,194	1,866,683
Capitalized development costs	-	-	39,961
Property and equipment (note 7)	172,504	111,629	203,617
Intangible assets (note 8)	4,964,075	3,016,449	3,507,008
Total assets	7,365,680	5,343,272	5,617,269
LIABILITIES			
Current liabilities			
Trade payables and accruals	1,210,170	657,969	552,034
Current portion of obligations under acquistion contracts (note 10)	2,311,351	371,937	263,190
Current portion of finance leases (note 11)	38,717	-	9,144
Current portion of debentures (note 12)	318,716	386,290	-
Current portion of deferred tenant inducement	2,673	12,379	10,820
	3,881,627	1,428,575	835,188
Obligations under acquisition contracts (note 10)	-	250,734	582,602
Finance leases (note 11)	20,748	-	-
Debentures (note 12)	178,292	228,978	-
Deferred tenant inducement	48,782	51,455	63,834
Deferred tax liability (note 14)	613,110		
Total liabilities	4,742,559	1,959,742	1,481,624
SHAREHOLDERS' EQUITY			
Share capital (note 13(a))	29,465,469	26,036,145	25,639,345
Reserve for equity settled share based transactions (note 13(b)(c))	5,589,386	4,477,547	4,036,345
Foreign currency translation adjustment	(53,990)	29,654	-
Deficit	(32,377,744)	(27,159,816)	(25,540,045)
	2,623,121	3,383,530	4,135,645
Total liabilities and shareholders' equity	7,365,680	5,343,272	5,617,269

Nature of operations and going concern (note 1)
Commitments (note 15)
Subsequent events (note 21)

Approved and authorized for issue by the Board of Directors on April 30, 2012

"George Burnes" "Jeffrey Lowe"
George Burnes Jeffrey Lowe

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statements of operations
(Expressed in Canadian dollars, unless otherwise stated)

	2011 $	2010 $ (note 22)
Revenue	3,943,794	4,209,645
Cost of sales	1,607,805	1,264,220
Gross profit	2,335,989	2,945,425
Operating Expenses		
General and administrative expenses	4,355,436	3,272,909
Stock-based compensation	274,969	368,960
Research and development	32,173	51,509
Amortization and depreciation	1,118,206	560,102
	5,780,784	4,253,480
Operating loss	(3,444,795)	(1,308,055)
Impairment of intangible assets (note 8)	1,854,428	-
Finance expense	326,142	211,165
Finance income	(1,428)	(4,777)
Foreign exchange (gain) loss	(18,430)	77,133
Acquisition transaction costs	68,805	-
	2,229,517	283,521
Income taxes (note 14)	(456,384)	28,195
Net loss for the period	**(5,217,928)**	**(1,619,771)**
Net loss per share		
Basic	(0.09)	(0.04)
Diluted	(0.09)	(0.04)
Weighted average number of common shares outstanding (basic and diluted)	**58,682,257**	**45,787,149**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statements of comprehensive loss
(Expressed in Canadian dollars, unless otherwise stated)

	2011	2010
	$	$
		(note 22)
Net loss for the period	**(5,217,928)**	**(1,619,771)**
Foreign currency translation adjustment	(83,644)	29,654
Total comprehensive loss	**(5,301,572)**	**(1,590,117)**
Net loss per share		
Basic	**(0.09)**	**(0.03)**
Diluted	**(0.09)**	**(0.03)**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statement of cash flows

(Expressed in Canadian dollars, unless otherwise specified)

	2011 $	2010 $ (note 22)
Cash flows from operating activities		
Loss for the period	(5,217,928)	(1,619,771)
Items not affecting cash:		
Depreciation of property and equipment	82,820	104,568
Amortization of intangible assets	1,035,386	455,534
Amortization of capitalized development costs	-	39,961
Impairment of intangible assets	1,854,428	-
Stock-based compensation	274,969	368,960
Deferred tax liability	(460,834)	
Deferred tenant inducement	(12,379)	(10,821)
Foreign exchange (gain) loss	(12,850)	11,098
Accrued interest on debentures	54,541	70,618
Accrued interest of obligation under acquisition contract	37,085	17,389
Accretion of obligation under acquisition contract	154,129	66,546
	(2,210,633)	(495,918)
Changes in non-cash working capital items:		
Trade and other receivables	(33,720)	(362,020)
Inventory	(15,651)	208,108
Prepaid expenses and deposits	(71,255)	166,815
Trade payables and accruals	554,086	105,933
Net cash flows used in operating activities	(1,777,173)	(377,082)
Cash flows from investing activities		
Proceeds from sale of short-term investments	-	101,646
Purchase of property and equipment	(50,724)	(12,338)
Business acquisitions, net of cash acquired	(2,131,483)	-
Net cash (used in) provided by investing activities	(2,182,207)	89,308
Cash flows from financing activities		
Shares and warrants issued for cash, net of issue costs	4,038,518	460,941
Debenture issued for cash	-	552,750
Decrease in debentures	(172,756)	-
Decrease in acquisition contract obligation	-	(246,425)
Increase (decrease) in finance leases	(29,711)	(9,144)
Net cash provided by financing activities	3,836,051	758,122
Net increase in cash and cash equivalents	(123,329)	470,348
Effects of exchange rates changes on cash	11,942	(7,139)
Cash and cash equivalents, beginning of period	610,261	147,051
Cash and cash equivalents, end of period	498,874	610,260

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Consolidated statement of shareholders' equity
(Expressed in Canadian dollars, unless otherwise stated)

	Share capital	Reserve for equity settled share based transactions	Foreign currency translation adjustment			Deficit	Total Shareholders' Equity
	$		$			$	$
Balance at January 1, 2010 (note 22)	25,639,345	4,036,345	-			(25,540,045)	4,135,645
Net loss						(1,619,771)	(1,619,771)
Foreign currency translation adjustment			29,654				29,654
Total comprehensive loss for the period			29,654			(27,159,816)	2,545,528
Share issued for:							-
Private placement	440,286						440,286
Finder's fee	(37,500)						(37,500)
Warrants		75,953					75,953
Share issue costs	(5,986)	(3,711)					(9,697)
Stock based compensation		368,960					368,960
Balance at December 31, 2010	**26,036,145**	**4,477,547**	**29,654**	**-**	**-**	**(27,159,816)**	**3,383,530**
Net loss						(5,217,928)	(5,217,928)
Foreign currency translation adjustment			(83,644)				(83,644)
Total comprehensive loss for the period			(53,990)			(32,377,744)	(5,301,572)
Share issued for:	-						
Private placement	3,440,016						3,440,016
Exercised options	210,298						210,298
Finder's fees	(157,981)	(33,518)					(191,499)
Warrants		930,518					930,518
Share issue costs	(63,009)	(13,532)					(76,541)
Stock based compensation		228,371					228,371
Balance at Decemer 31, 2011	**29,465,469**	**5,589,386**	**(53,990)**			**(32,377,744)**	**2,623,121**

See accompanying notes to the consolidated financial statements

Notes
For the year ended December 31, 2011

1. Nature of Operations and Going Concern

Smartcool Systems Inc. ("Smartcool" or the "Company"), which was incorporated on August 31, 2000 under the Canada Business Corporations Act as 378211 Canada Inc., changed its name to Citotech Systems Inc. on October 16, 2000, and changed its name again to Smartcool Systems Inc. on July 20, 2004.

In 2004, the Company incorporated a wholly owned subsidiary, Smartcool Systems (USA) Inc. ("Smartcool USA"), under the laws of Nevada. Smartcool International Inc. ("Smartcool International"), another wholly owned subsidiary, was incorporated in Barbados in June 2006. In April 2008, the Company completed the incorporation of its subsidiary, Smartcool Systems (EMEA) Ltd. ("Smartcool EMEA"), headquartered in Alton, England. In February 2011, Smartcool EMEA acquired all the outstanding shares of Smartcool Systems UK ("Smartcool UK"), also headquartered in Alton, England.

The Company's shares are listed on the TSX Venture Exchange and the head office, principal address, and registered office is located at 1620 – 401 West Georgia Street, Vancouver, BC, V6B 5A1.

Smartcool and its subsidiaries are focused on acquiring, commercializing, and marketing energy saving technologies for commercial and retail businesses. Currently the Company has two principal revenue streams: the sale and installation of the ESM™ & ECO3™ to end customers and to distributors worldwide.

The ESM™ is manufactured by a third party in Australia and is designed specifically to reduce the electricity consumption and maximum demand of refrigeration and air conditioning compressors by improving their performance and maintaining temperature control. The ESM™ uses microprocessor technology and software algorithms.

Introduced in early 2009, the ECO3™ is manufactured in China and is a simple retrofit product that can be installed on any air conditioning, heat pump or refrigeration unit with one or two compressors, achieving the same energy efficiency gains as the ESM™ for these smaller systems.

These consolidated financial statements are prepared on a historical cost basis, except for certain financial assets and liabilities which are measured at fair value through profit or loss.

During the year ended December 31, 2011, the Company incurred a loss of $5,217,928 (2010 - $1,619,771) and the Company had a deficit of $32,377,744 as at December 31, 2011 (December 31, 2010 - $27,159,816, January 1, 2010 - $25,540,045). As at December 31, 2011, the Company had negative working capital of ($1,652,526). The Company was unable to make scheduled payments under the TECC agreement and the first quarterly payment in relation to its acquisition obligations for the purchase of Smartcool UK during 2011 and exercised its option to defer two quarterly payments under the acquisition agreement with Smartcool UK.

To ensure that the Company continues to be a going concern with adequate working capital through 2012 steps have been taken to reduce expenses, secure more predictable revenue generation, collect outstanding receivables and receive an income tax recovery by filing Smartcool UK 2011 tax return which provides for tax loss carry back to recover all taxes paid in 2010.

The Company also has received confirmation from the holders of TECC and Smartcool UK purchase obligations that they will not require settlement of outstanding amounts through 2012.

In addition management will consider securing capital from its investor base if required, which management has demonstrated in the past to be a successful strategy. An equity financing was completed in first quarter of 2012 (note 21).

Management is in the final steps of approval with its major banking relationship to provide accounts receivable factoring for select accounts that will smooth out the Company's cash flow.

The Company's ultimate success and the recoverability of its assets will depend on the Company's ability to successfully execute its business plan which includes a growing market for its products, achieving profitable operations, meeting its business acquisition obligations, the continued support of the Company's shareholders and employees, and the continued support from creditors with whom negotiations have been made and waivers obtained.

These material uncertainties may cast significant doubt on the Company's ability to continue as a going concern. These financial statements do not reflect adjustments to the carrying value of assets and liabilities which may be required should the Company be unable to raise adequate financing or meet current obligations and therefore be unable to continue as a going concern.

2. Significant Accounting Policies

Basis of Presentation and Statement of Compliance

The Company has adopted International Financial Reporting Standards ("IFRS") as of January 1, 2011, with a transition date of January 1, 2010. The Company's audited financial statements for the year ended December 31, 2011 are in compliance with IFRS.

These consolidated financial statements represent the first annual financial statements of the Company and its subsidiaries prepared in accordance with International Accounting Standards as issued by the International Accounting Standards Board ("IASB") and IFRS 1, *First-time Adoption of International Financial Reporting Standards* ("IFRS 1"). In accordance with IFRS 1, the Company has:

- Provided comparative financial information
- Applied the same accounting policies throughout all periods presented;
- Retrospectively applied all effective IFRS standards as of January 1, 2010, as required;
- Applied certain optional exemptions and certain mandatory exceptions as applicable for first-time IFRS adopters (Note 22).

The Company's consolidated financial statements were previously prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). Canadian GAAP differs in some areas from IFRS. In preparing these financial statements, management has amended certain accounting, measurement, and consolidation methods previously applied under Canadian GAAP financial statements to comply with IFRS.

Use of Estimates and Judgments

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are outlined below. Actual results may differ from those estimates.

Significant estimates are used for, but not limited to, assessment of impairment of intangible assets and recoverability of long-lived assets, determination of present value of obligations under acquisition contract, determination of fair value of debentures, allocation of purchase price of business acquisitions, valuation of stock options and warrants, recoverability of trade and other receivables, determination of valuation allowance for income tax assets, and amortization rates and methods.

Judgments made by management in the application of IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the current and following fiscal years are discussed below:

- Useful lives – the useful lives of intangible assets and the related depreciation
- Impairment- the assessment of impairment of intangible assets and goodwill
- Inventory valuation – the provision for obsolescence of inventory and net realizable value
- Receivable valuation – the recoverability of account receivables
- Share-based payments – the inputs used in accounting for share-based payment
- Debentures – discount rate used in fair value calculation of the debenture
- Contingencies – any future contingencies and commitments
- Going concern – the assessment of the Company's ability to continue as a going concern

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.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Smartcool USA, Smartcool International, Smartcool EMEA and Smartcool UK from February 28, 2011, the date of acquisition. All inter-company transactions, balances, revenues and expenses, have been eliminated.

Business Combinations and Goodwill

A business combination is defined as an acquisition of assets and liabilities that constitute a business. A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return to the Company and its shareholders in the form of dividends, lower costs, or other economic benefits. A business consists of inputs, including non-current assets, and processes, including operational processes, that when applied to those inputs, have the ability to create outputs that provide a return to the Company and its shareholders. A business also includes those assets and liabilities that do not necessarily have all the inputs and processes required to produce outputs, but can be integrated with the inputs and processes of the Company to create outputs.

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interests issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.

Where the fair value of the identifiable net assets acquired exceeds the cost of the acquisition, the surplus, which represents the discount on the acquisition, is recognized directly in the statement of operations in the period of acquisition. Where the fair value of consideration paid exceeds the fair value of net identifiable tangible and intangible assets, goodwill is recognized.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates.

Foreign Currency

The functional currency of Smartcool Systems Inc. and Smartcool International has been determined to be the Canadian dollar. The functional currency of Smartcool USA is the United States dollar. The functional currency of Smartcool EMEA and Smartcool UK is the British pound. The consolidated financial statements have been translated to the Canadian dollar in accordance with IAS 21, *The Effects of Changes in Foreign Exchanges Rates*.

Financial statements of subsidiaries where the functional currency is other than the Canadian dollar are translated to Canadian dollars using the current rate method.   Assets and liabilities are translated at the exchange rate at period end and revenues and expenses are translated using the exchange rates at the date of the transactions. All resulting exchange differences are reported as a separate component of shareholders' equity titled "Foreign Currency Translation Adjustment".

For foreign subsidiaries where the Canadian dollar is the functional currency, non-monetary assets and liabilities are translated to Canadian dollars using the exchange rate in effect at the original transaction date. Monetary balances are translated at rates of exchange at the period end date. The translation difference resulting from translating the foreign currencies to Canadian dollars is recorded as a component of foreign exchange gain and loss.

Revenue Recognition

Revenue from the sale and installation of the ESM™ and ECO3™ is recognized when the ESM™ & ECO3™ have been installed, significant risks and rewards of ownership of the equipment have been transferred to the customer, the Company does not retain continuing managerial involvement or effective control over the equipment, the sales price can be determined and collection is probable, and the cost of the transaction can be measured reliably.

Revenue from the international distribution of the ESM™ & ECO3™ is recognized when the equipment has been shipped, title has been transferred, the sales price has been determined and the cost of the equipment can be measured reliably. Revenue is also recognized when equipment has been ordered and laid away as instructed by the customer, the sales price has been determined and a significant portion of it has been paid. Provisions are established for estimated warranty costs at the time revenue is recognized. The Company records deferred revenue when cash is received in advance of the above revenue recognition criteria being met.

Warranty

The Company provides for future warranty costs based on management's best estimates of such costs, taking into account past experience and warranty provisions of distribution and sale agreements.

Share-based Payments

The fair value of all stock options granted to employees is determined using the Black-Scholes option pricing model, and the resulting value is charged to operations over the vesting period. Volatility rate is determined based on the trading history of the Company's shares for the relevant period and interest rate is based on Canadian bond rates.

The fair value of options granted to non-employees is determined using fair value of the goods or services received. The resulting value is charged to operations when a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest, and the expense is recognized over the period in which the goods or services from the non-employees are received. To estimate the fair value of options granted to non-employees, management considers primarily the fees management would be willing to pay in cash for the service if no options were granted.

A corresponding increase in equity reserve is recorded when stock options are expensed. When stock options are exercised, share capital is credited by the sum of the consideration paid and the related portion previously recorded in equity reserve. At the time of grant, the expense is determined based on estimated forfeiture rate. The expense will be adjusted to recognize the effect of actual forfeitures as they occur. The fair value of warrants issued to agents for their finder's fee is based on the fair value of the services provided and charged to share issuance costs.

Inventory

Inventory is recorded at the lower of cost and net realizable value. Costs of inventories are determined using the weighted average cost method. Cost of inventory includes invoiced cost from the manufacturer and other costs in bring the inventory to their present location and condition and net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Amortization is computed using the straight line method over the assets' estimated useful lives, less their estimated residential value, at the following rates:

Computer hardware	33%
Computer software	20%
Testing and demonstration equipment	40%
Office equipment and furniture	20%
Motor vehicles	25%
Leasehold improvements	Shorter of Term of the lease and useful life

Residual value and estimated useful lives are reviewed at least annually.

Intangible Assets

a. *Research and development*

Research costs are expensed as incurred. Development costs are expensed as incurred unless they can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use the asset. The Company has determined that as at September 30, 2008, development costs of $106,561 have met these criteria. The costs were fully amortized during 2010.

b. *Goodwill*

Goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized in the statement of operations.

c. *Other intangible assets*

Intangible assets are recorded at cost and include the ESM™ brand, ESM™ intellectual property, distribution rights, distribution agreements, supplier agreements and customer relationship. The ESM™ brand has been determined to have an indefinite life and is not amortized. The remaining intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives as follows:

ESM™ Intellectual property	10 years
North American distribution rights	10 years
United Kingdom distribution rights	9 years
Distribution agreements	5 - 15 years
Supplier agreements	10 years
Customer relationship	5 years

Total amortization for the year ended December 31, 2011 of $1,035,386 (December 31, 2010 - $455,534) was included under net loss for the period on the statement of operations.

Impairment

a. *Property, equipment and intangible assets with a finite useful life*

Property, equipment and intangible assets with a finite life are assessed for indications of impairment at the end of each reporting period. If such indications exist, then the recoverable amount of the asset or cash-generating unit ("CGU") is estimated.

An impairment loss is recognized when the carrying amount of the asset or CGU exceeds its recoverable amount. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. 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 risks specific to the asset or CGU.

Impairment losses are recognized in respects to CGU's are first allocated to reduce the carrying amount of any goodwill allocated to the CGUs, and then to reduce the carrying amount of the other assets in the unit on a pro-rata basis. Impairment losses are recognized in profit and loss for the period it is identified.

b. *Intangible assets with an indefinite useful life*

Intangible assets with an indefinite life are reviewed for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. The asset is written down when the carrying amount exceeds its recoverable amount. The ESM™ brand is considered to have an indefinite life as the Company has a global market and there is no direct competition for its instinctive green technology.

Reversal of Impairment

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss has been recognized. An impairment loss with respect to goodwill is never reversed.

c. *Financial assets*

Financial assets, other than those at fair value through profit and loss ("FVTPL"), are assessed for indicators of impairment at each period end. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Impairment of financial assets carried at amortized cost, is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of all financial assets, excluding trade and other receivables, is directly reduced by the impairment loss. Uncollectible amounts in trade and other receivables are written off against the allowance account.

Available-for-sale financial assets are impaired if the cost (net of any principal payment and amortizations) is greater than the current fair value, less any impairment previously recognized in profit and loss. The impairment amount is transferred from equity to the statement of operations. Reversals of available-for-sale financial assets are not recognized in profit.

For all other financial assets carried at amortized cost in which impairment was previously recognized, if subsequent measurement indicates that the recorded impairment has decreased, and the decrease can be related objectively to an event occurring after the impairment was recognized, then the reversal of the impairment is recognized in the statement of operations. On the date of the impairment reversal, the carrying value of the financial asset cannot exceed its amortized cost had impairment not been recognized.

Financial Instruments

a. ***Financial assets***

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

i. Financial assets at fair value through profit or loss ("FVTPL")

Financial assets are classified as FVTPL when the financial asset is held for trading or is designated as FVTPL on initial recognition.

A financial asset is classified as held for trading when it is purchased and incurred with the intention of generating profits in the near term, part of an identified portfolio of financial instruments that the Company manages and has actual pattern of short-term profit-taking; or is a derivative that is not designated and effective as a hedging instrument.

Financial assets classified as FVTPL are stated at fair value with any resulting gain or loss recognized in profit or loss. Transaction costs are expensed in the period in which the costs are incurred.

The Company's only financial asset classified as fair value through profit or loss is cash and cash equivalents.

Cash and cash equivalents consist of cash on deposit and highly liquid investments that are readily convertible into cash with maturities of three months or less when purchased.

ii. Held to maturity investments

Held to maturity investments are measured at amortized cost using the effective interest rate method. Transaction costs are added and amortized to the statement of operations over the life of the financial instrument on an effective yield basis.

The Company classified short-term investments of interest bearing term deposits with maturity dates of more than three months as held to maturity investment. Interest on these term deposits is recognized in the consolidated statement of operations using the effective interest method.

The Company does not hold any held-to-maturity investments as at December 31, 2011 (December 31, 2010 - $0, January 1, 2010 - $101,646).

iii. Available-for-sale financial assets

Financial assets classified as available-for-sale are carried at fair value (where determinable based on market prices of actively traded securities) with changes in fair value recorded in other comprehensive income. Available-for-sale securities are written down to fair value through earnings whenever it is necessary to reflect other-than temporary impairment.

The Company did not hold any available-for-sale financial assets as of December 31, 2011, December 31, 2010 and January1, 2010.

iv. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment.

The Company classifies trade and other receivables as loans and receivables.

v. Derecognition of financial assets

A financial asset is derecognized when the contractual right to the asset's cash flows expires or if the Company transfers the financial asset and substantially all risks and rewards of ownership to another entity.

b. *Financial Liabilities*

Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities.

i. Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs, and subsequently measured at amortized cost, with any resulting premium or discount from the face value being amortized to income or expense using the effective interest method.

The Company classifies trade payables and accruals, obligations under acquisition contracts, finance leases, and debentures as other financial liabilities.

ii. Derecognition of financial liabilities

The Company derecognizes financial liabilities when, and only when, the Company's obligations are discharged, cancelled, or expired.

Share Purchase Warrants

The Company issued common shares and share purchase warrants as a unit as well as units of debenture and share purchase warrants. The unit price is allocated to common shares and warrants based on their relative fair values. The residual method is used to allocate the value of debentures and warrants. The fair value of common shares is the market price on the date of issue and the fair value of warrants is determined using the Black-Scholes option pricing model. Because the Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share price, changes in subjective input assumptions can materially affect the fair value estimate.

The Company also issued warrants to agents as compensation for services. The fair value of these warrants was determined to be the difference between agent's standard all-cash compensation and compensation with warrants. Warrants were also issued as non-cash consideration for business acquisitions. The fair value of these warrants was determined based on Black Scholes model.

Loss per Share

Basic loss per share is computed using the weighted average number of common shares outstanding during the year. Diluted loss per share amounts are calculated giving effect to the potential dilution that would occur if warrants and stock options were exercised or converted to common shares using the treasury stock method. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate. The outstanding warrants and options to purchase common shares were excluded from the calculation of diluted loss per share, because their impact would have been anti-dilutive.

Income Taxes

Income tax expense in the statement of operations for the periods presented comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is calculated using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profit; the initial recognition of goodwill or a transaction, other than a business combination, that affects neither accounting profit nor taxable profit; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. To the extent that the Company does not consider it probable that a future tax asset will be recovered, the tax assets will be classified as unrecognized tax assets.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset 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.

As at December 31, 2011, unrecognized tax assets from net operating losses carried forward and temporary differences amounted to $4,963,000 (December 31, 2010 - $4,125,000, January 1, 2010 - $3,668,000).

Accounting Standards Issued but not yet Effective

Standards issued but not yet effective up to the date of issuance of the Company's consolidated financial statements are listed below:

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

- Deferred Taxes – Recovery of Underlying Assets: The IASB has issued an amendment to IAS 12, "Income Taxes" (the "IAS 12 amendment") that introduces an exception to the general measurement requirements of IAS 12 in respect of investment properties measured at fair value. This amendment is effective for annual periods beginning on or after January 1, 2012. The Company will apply the amendment at the beginning of the 2012 financial year and does not expect the implementation to have a material impact on the Company's consolidated financial statements.

- Financial Instruments: The IASB has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9") which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement ("IAS 39") . The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting of financial instruments and the issuance of IFRS 9 is part of the first phase of this project. This standard becomes effective on January 1, 2013. The Company has not assessed the impact of this new standard.

- Consolidated Financial Statements: The IASB has issued a new standard, IFRS 10, which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes IAS 27 "Consolidated and Separate Financial Statements" and SIC-12 "Consolidation—Special Purpose Entities" and is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

- Fair value measurements: The IASB has issued IFRS 13, which defines fair value and sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. The IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. IFRS 13 is to be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

The IASB has issued an amendment to IAS 1 "Presentation of financial statements" ("IAS 1 amendment"), which requires the presentation of items of other comprehensive income ("OCI"), classified by nature, to be grouped into items that will not be reclassified subsequently to profit or loss; and items that will be reclassified subsequently to profit or loss when specific conditions are met. The IAS 1 amendment is effective for annual periods beginning on or after July 1, 2012. IAS 1 amendment and has no impact on the Company's consolidated financial statements.

3. Business Combination

On February 28, 2011, the Company acquired all the outstanding shares of the third party distributor Smartcool Systems UK Ltd., which held the exclusive rights for sale of ESM™ products to customers in the UK and Ireland.

The main reason for the acquisition was to access existing customer relationships. Prior to the acquisition Smartcool EMEA sold equipment to Smartcool Systems UK Ltd. at wholesale prices, who then in turn charged customers retail prices. After the acquisition Smartcool EMEA, doing business as Smartcool Systems UK Ltd., will directly manage these customer accounts improving gross revenue and profitability. Another significant factor in the acquisition is accessing enhanced technical abilities and knowledge transfer from the UK team's large database of installations. This allows the merged entity to leverage this knowledge to grow the business through expanding direct selling and distribution opportunities. The main area for growth in the upcoming years is in this geographic region and the acquisition allows for a stronger platform to build from.

Consideration Transferred and Purchase Price Allocation

In consideration, the Company agreed to pay cash consideration of $4,410,745 (£2,840,438) and non-cash consideration of $227,675 (£143,891) in the form of 1,000,000 share purchase warrants. $2,922,622 (£1,840,438) was paid in cash upon closing. The remaining balance of $1,582,200 (£1,000,000) will be paid in four equal payments quarterly with the last one on March 1, 2012.
Total discounted consideration was $4,638,420 (£2,924,822).

The Company was unable to make the first quarterly payment as scheduled and deferred two quarterly payments at its discretion as outlined in the acquisition agreement and at December 31, 2011, $1,579,900 (£1,000,000) was still outstanding. Under the purchase agreement the outstanding balance will become due and payable upon default of payment. However, the Company has received confirmation from the holders of these obligations that they will not require settlement of outstanding amounts through 2012.

With the exception of the first quarterly payment, Smartcool had at its discretion the option to defer the three remaining quarterly payments. The deferral will incur an interest charge equal to Royal Bank of Canada prime rate for the first three months and prime rate plus 5% after that period. At the acquisition date, the fair value of these scheduled payments was determined to be $1,488,049(£940,494) based on discounting the future payments at a rate of 10%.

The warrants have an exercise price of $0.30 and vesting period of 12 months. They will expire two years from the vesting date. The fair value of these warrants has been determined to be $227,675 (note 13(d)).

The allocation of the purchase price is based on management's estimates and certain assumptions with respect to the fair value increment associated with the assets acquired and the liabilities assumed.

The finalized, discounted purchase price allocation is summarized as follows:

	CAD
Purchase of all outstanding shares of Smartcool UK	4,410,745
Fair value of warrants issued	227,675
	4,638,420
Allocation of the purchase price	
Net working capital	850,484
Property and equipment	103,230
Distribution rights	2,570,862
Customer relationship	1,058,584
Goodwill	1,213,285
Finance leases	(79,460)
Deferred tax liability	(1,078,565)
	4,638,420

From the acquisition date, February 28, 2011, to December 31, 2011, revenue of $2,081,491 and net loss of $595,833 from Smartcool UK were included in the consolidated statement of comprehensive loss of the Company.

The consolidated revenue of the Company would have increased by $8,485 and net loss increased by $137,505 if the revenue and net loss for the period from January 1 to February 28, 2011 of Smartcool UK had been included in the consolidated statement of comprehensive loss for the year ended December 31, 2011.

4. Restricted Cash

In 2010, the Company issued units of participation subordinated secured debentures and warrants through a private placement. Under the terms of the debenture, the holders are entitled to receive quarterly payments towards the principal amount. The total of quarterly payments is equal to 5% of the gross cash revenue received by the Company in each quarter. The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. When such payments are delayed, the Company is required to deposit into a separate trust account, on a quarterly basis, an amount equal to any first year quarterly principal payment that would otherwise have been payable.

As of December 31, 2011, total cash of $66,833 has been designated as restricted cash (December 31, 2010 - $166,289, January 1, 2010 - $0).

5. Trade Receivables

	December 31, 2011	December 31, 2010	January 1, 2010
[1]Trade receivables, net of allowances for doubtful accounts	$1,042,580	$971,316	$622,192
Other receivables	15,768	48,545	35,648
	1,058,348	**1,019,861**	**657,840**

[1] Allowance for doubtful accounts December 31, 2011: $566,599 (December 31, 2010: $24,209, January 1, 2010 - $0). This allowance consists primarily of receivables from Colt Technology Services $532,817 (£337,247). The Company has been in negotiations with Colt and expects to have the issue resolved in the second quarter of 2012. This expense has been recorded in General and Administrative Expenses.

At December 31, 2011, the analysis of trade receivables that were past due but not impaired is as follows:

	Dec. 31, 2011	Dec. 31, 2010	Jan. 1, 2010
Neither past due nor impaired	$868,128	$411,193	$487,705
< 30 days	3,318	7,832	49,075
30-60 days	124,422	134,366	279
60-90 days	1,490	297,969	45,635
90-120 days	356	13,156	5,627
> 120 days	44,866	106,800	33,871
	1,042,580	**971,316**	**622,192**

All trade and other receivables are classified as current assets. In determining the recoverability of a trade or other receivable, the Company performs a risk analysis considering the type and age of the outstanding receivable, as well as the Company's exposure to credit and currency risks as disclosed in Note 18.

6. Inventory

	December 31, 2011	December 31, 2010	January 1, 2010
ESM™ ECO3™	$454,675	$497,216	$698,814
Other products	70,418	12,369	19,030
Total inventory	**525,093**	**509,585**	**717,844**

During the year ended December 31, 2011, total inventories of $836,607 were recognized as costs of sales (December 2010 - $767,791).

7. Property and Equipment

Cost

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor Vehicles	Leasehold improvement	Total
Balance at January 1, 2010	**$158,160**	**$216,579**	**$44,883**		**$116,318**	**$535,940**
Additions	-	12,338	-	-	-	12,338
Disposals	-	-	(3,307)	-	-	(3,307)
Effect of change in foreign exchange rates	(1,679)	(7,578)	(1,662)	-	-	(10,919)
Balance at December 31, 2010	**156,481**	**221,339**	**39,914**	**-**	**116,318**	**534,052**
Additions	22,258	8,460	16,931	93,033	-	140, 682
Disposals	(1,381)	-	(5,222)		-	(6,603)
Effect of change in foreign exchange rates	2,497	3,948	638	(134)	-	6,949
Balance at December 31, 2011	**179,855**	**233,747**	**52,261**	**92,899**	**116,318**	**675,080**

Accumulated depreciation and impairment

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor Vehicles	Leasehold improvement	Total
Balance at January 1, 2010	**$101,113**	**$155,878**	**$22,017**	**-**	**$53,314**	**332,322**
Depreciation	29,979	55,725	7,232	-	11,632	104,568
Disposals	-	-	-	-	-	-
Effect of change in foreign exchange rates	(1,424)	(11,905)	(1,139)	-	-	(14,468)
Balance at December 31, 2010	**129,668**	**199,698**	**28,110**	**-**	**64,946**	**422,422**
Depreciation	22,083	19,327	7,228	22,550	11,632	82,820
Disposals	(1,318)	-	(2,652)	-	-	(3,970)
Effect of change in foreign exchange rates	53	1,740	(100)	311	-	2,004
Balance at December 31, 2011	150,486	220,765	32,586	22,861	76,578	503,276

Carrying Value

	Computers	Testing and demonstration equipment	Office equipment and furniture	Motor Vehicles	Leasehold improvement	Total
Balance at January 1, 2010	$57,047	$60,701	$22,865	-	$63,004	203,617
Balance at December 31, 2010	26,813	21,641	11,803	-	51,372	111,629
Balance at December 31, 2011	29,369	12,982	20,375	70,038	39,740	172,504

As at December 31, 2011, assets under capital lease with total cost of $103,749 and accumulated amortization of $23,946 (December 31, 2010 - $49,543, January 1, 2010 - $41,286) are included in property and equipment for net book value of $79,803 (2010 - $0, January 1, 2010 - $8,257).

Amortization expense for assets under capital lease recorded in the statement of comprehensive loss for the year December 31, 2011 was $23,635 (2010 - $8,257).

8. Intangible Assets

Definite Lives

Cost	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2010	266,288	124,100	1,861,842	113,651	2,149,749		4,515,630
Acquisition							
Effect of change in foreign exchange	(9,360)	-	-	-	(66,434)		(75,794)
Balance at December 31, 2010	256,928	124,100	1,861,842	113,651	2,083,315		4,439,836
Acquisition (note 3)					2,570,862	1,058,584	3,629,446
Disposal			(100)				(100)
Effect of change in foreign exchange rates	4,032	-	-	-	2,390	(5,494)	928
Balance at December 31, 2011	**260,960**	**124,100**	**1,861,742**	**113,651**	**4,656,567**	**1,053,090**	**8,070,110**

Indefinite lives

As at January 1, 2010, December 31, 2010 and December 31, 2011, ESM™ brand (b) had a carrying amount of $56,100 and is not subject to amortization due to having an indefinite useful life. Goodwill arising on the acquisition of Smartcool UK amounted to $1,213,283. The balance of goodwill outstanding at December 31, 2011 was nil as an impairment was assessed for the full amount during 2011.

Amortization and impairment losses	North American distribution rights (a)	ESM™ intellectual property (b)	Distribution agreements (b)	Supplier agreements (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Total
Balance at January 1, 2010	**99,776**	**43,435**	**523,458**	**39,779**	**358,274**		**1,064,722**
Amortization period	27,985	12,410	148,315	11,366	255,458		455,534
Effect of change in foreign exchange rates	(5,721)	-	-	-	(35,048)		(40,769)
Balance at December 31, 2010	**122,040**	**55,845**	**671,773**	**51,145**	**578,684**		**1,479,487**
Amortization period	25,758	12,410	148,414	11,365	661,200	176,239	1,035,386
Impairment					452,659	188,484	641,143
Effect of change in foreign exchange rate	2,261	-	-	-	4,624	(766)	6,119
Balance at December 31, 2011	**150,059**	**68,255**	**820,187**	**62,510**	**1,697,167**	**363,957**	**3,162,135**

Carrying amounts	North American distribution rights (a)	ESM™ intellectual property (b	Distribution agreements (b)	Supplier agreement (b)	EMEA & UK distribution rights (c)(d)	Customer relationship (d)	Goodwill (d)	Total
Balance at January 1, 2010	166,512	80,665	1,338,384	73,872	1,791,475			3,450,908
As at December 31, 2010	134,888	68,255	1,190,069	62,506	1,504,631			2,960,349
Balance at December 31, 2011	110,901	55,845	1,041,555	51,141	2,959,400	689,133	-	4,907,975

The Company also have ESM brand, an indefinite life asset. As at December 31, 2011, the value of this asset was $56,100.

a. *North American distribution rights*

On March 27, 2006, the Company acquired the exclusive rights to distribute the ESM™ throughout North America from Abbotly Technologies Inc. ("Abbotly USA"). Pursuant to the acquisition, Abbotly USA agreed to assign all of its rights and obligations, and the Company agreed to assume all of Abbotly USA's obligations, under a license agreement between Abbotly USA and Abbotly, and the Company became the master distributor of the ESM™ in North America.

Consideration paid for the acquisition was $201,953 (US$180,000), 500,000 share purchase warrants with an exercise price of $0.27 and a 20% royalty on certain products purchased from Abbotly as long as Smartcool Systems USA still holds the distribution rights.

b. *ESM™ Intellectual Property and worldwide distribution rights*

The Company acquired $2,278,350 of intangible assets in relation to the acquisition of Abbotly.

Management has performed a review of the carrying value of its distribution agreements. As a result of its assessment, in 2008 the Company recognized an impairment of $116,914 related to distribution agreements. As a result of this impairment recognition, the total cost of distribution agreements was reduced by $148,799 to $1,835,701. As at December 31, 2011, cost of distribution agreements consisted of:

ESM™ Distribution agreements (b)	$1,835,702
Other distribution rights	$26,040
Total	**$1,861,742**

No impairments were recorded in 2011 and 2010 and the impairment loss recognized in 2008 was not reversed upon transition to IFRS.

c. *Distribution Rights from TECC Services*

On July 11, 2008, the Company acquired the exclusive rights to distribute the ESM™ in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. Services Ltd. ("TECC"). Consideration of $1,738,750 (£1,035,000) was payable in cash and $532,067 (£265,000) was payable in the form of common shares of the Company. Upon closing, payment of $873,393 (£435,000) was made and 743,709 shares were issued. The share price was based on the average closing price of the Company's shares on the TSX Exchange for 20 consecutive trading days, with the last of such trading days being the second day preceding the date of closing as prescribed by trading regulations.

The remaining balance of $1,204,680 (£600,000) is due in scheduled instalments over four years with the last payment due on July 16, 2012. These instalments are non-interest bearing. At the acquisition date, the fair value of consideration was determined to be $2,270,800 based on discounting the future payments at a rate of 16%. Transaction costs of $28,300 were also incurred.

The purchase agreement was amended on December 21, 2009 where payments were rescheduled with the first payment due on January 16, 2010 and the last one on July 16, 2012. The parties also agreed that interest would accrue on $118,493 (£75,000) at Royal Bank of Canada prime rate plus 4% from January 16, 2009 and additionally on $118,493 (£75,000) from July 16, 2009 until these amounts are fully paid. The amendment had no material impact on the company's financial position and no gain or loss was recognized in 2009. The Company was unable to make scheduled payments under the amended agreement. As at December 31, 2011, the balance of $750,861 (£475,259), including accrued interest of $39,906 (£25,259) remained outstanding. Under the purchase agreement the outstanding balance will become due and payable upon default of payment. However, the Company has received confirmation from the holders of these obligations that they will not require settlement of outstanding amounts through 2012.

d. *Intangible assets from Smartcool UK*

On February 28, 2011, the Company acquired $4,842,731of intangible assets in relation to the acquisition of Smartcool UK as described in note 3.

These intangible assets include the following definite lived intangible assets: distribution rights of the ESM™ in the United Kingdom, the distribution right related to sales to a major customer and a customer relationship. The remaining balance of the intangible assets acquired related to goodwill which is an indefinite life intangible asset. The expected life of the definite life intangible assets has been determined to be 5 years.

Distribution rights-General	$595,884
Distribution rights-Major customer	1,974,978
Customer relationship	1,058,584
Goodwill	1,213,285
Total	**$4,842,731**

During the year, total amortization of $837,439 was recorded against the asset costs and deferred tax liability.

Management has performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011have resulting in significant uncertainty in future cash generation of these assets, an impairment loss was recorded as at December 31, 2011 based on cash flow projections at this time. The value of goodwill was written off and the other assets were impaired as follows:

	Impairment
Distribution rights-General	$104,919
Distribution rights-Major customer	347,740
Customer relationship	188,484
Goodwill	1,213,285
Total impairment for year ended December 31, 2011	**$1,854,428**

9. Capitalized Development Costs

During the year ended December 31, 2011, the Company incurred $32,173 of research and development costs that were fully expensed (2010 - $11,549). No research and development costs were deferred in the period (2010 – Nil).

Development costs of $106,561 incurred in 2008 have been capitalized and amortized over a two year period, starting October 1, 2008 when the new products' commercial production was complete and they became available for sale. These deferred costs were fully amortized during 2010.

10. Obligations Under Acquisition Contracts

TECC Services

At December 31, 2011, the Company owed $750,861 (£475,259) related to its 2008 acquisition of distribution rights from TECC Services. The obligation amount of $1,204,680 (£600,000) was originally non-interest bearing and has been recorded at its present value using a discount rate of 16%. The purchase agreement was then amended on December 21, 2009 to accrue interest on $236,985 (£150,000) at Royal Bank of Canada prime rate plus 4% and adjust timing and amount of repayments (note 8(c)).

	$
Balance – July 11, 2008	**865,358**
Accretion	40,853
Foreign exchange	(97,102)
Balance - December 31, 2008	**809,109**
Accretion	75,227
Accrued interest	9,420
Foreign exchange	(47,964)

Balance – December 31, 2009	**845,792**
Payment	(246,425)
Accretion	66,546
Accrued interest	17,389
Foreign exchange	(60,631)
Balance – December 31, 2010	**622,671**
Accretion	66,671
Accrued interest	16,571
Foreign exchange	11,582
Balance – December 31, 2011	**717,495**
Less: Current portion	(717,495)
Balance	-

The obligations under the acquisition contract are being accreted to their face value over their term. The accretion charge for the period is recorded within interest expense in the consolidated statement of operations.

Smartcool UK

On February 28, 2011, the Company acquired the business of Smartcool UK for total cash consideration of $4,410,745 (£2,840,438) and some non-cash consideration (note 3). Upon closing, $2,922,622 (£1,840,438) was settled in cash with the remaining balance of $1,582,200 (£1,000,000) due in four equal installments over the next 12 months.

Balance – February 28, 2011	**$1,488,049**
Accretion	$87,458
Accrued interest	20,514
Foreign exchange	(2,165)
Balance, December 31, 2011	**$1,593,856**
Less: Current portion	(1,593,856)
Balance	-

The Company was unable to make the first quarterly payment as scheduled. As at December 31, 2011, principal balance of $1,579,900 (£1,000,000) and accrued interest of $20,380 (£12,900) remained outstanding. Principal balance consists of 4 installments of $394,975 (£250,000). Under the purchase agreement the outstanding balance will become due and payable upon default of payment. However, the Company has received confirmation from the holders of these obligations that they will not require settlement of outstanding amounts through 2012.

TECC and Smartcool UK Acquisitions Obligations	**TECC**	**UK**	**Total**
	$	$	$
Balance – December 31, 2009	**845,792**		**845,792**

Payment	(246,425)		(246,425)
Accretion	66,546		66,546
Accrued interest	17,389		17,389
Foreign exchange	(60,631)		(60,631)
Balance – December 31, 2010	**622,671**	**-**	**622,671**
Acquisition, February 28, 2011		1,488,049	1,488,049
Accretion	66,671	87,458	154,129
Accrued interest	16,571	20,514	37,085
Foreign exchange	11,582	(2,165)	9,417
Balance – December 31, 2011	**717,495**	**1,593,856**	**2,311,351**
Less: Current portion	(717,495)	(1,593,856)	(2,311,351)
Balance	-	-	-

11. Finance Leases

Under the agreement of Smartcool UK acquisition, the Company assumed Smartcool UK's liabilities including five vehicle leases. These leases expire in April 2012, December 2012 and January 2013. They have implied annual interest rate ranging from 5% to 10%.

Required undiscounted repayments are as follows:

Finance lease payments:	**$**
2012	38,717
2013	26,152
2014	3,288
2015	2,187
Balance of the obligations	70,344
Less interest	(10,879)
	59,465
Less current portion	(38,717)
	20,748

12. Debentures

In May 2010, the Company completed its offer of 122 units of debenture and share purchase warrants for aggregate proceeds of $610,000. The debenture is not redeemable by the holder.

Each unit comprises of a debenture in the principal amount of $5,000 plus 8,600 warrants, issued at a price of $5,000 per unit. They are for a term of three years and entitle the holder to receive interest payment of $150 each quarter per $5,000 of principal amount with an additional interest payment of $150 if the debenture is repaid by December 31, 2011 and two additional interest payments (for a total of $300) if the debenture is repaid after December 31, 2011, but before maturity. The debentures receive 5% of gross cash revenue as principal repayment each quarter. The debentures are secured by a general security agreement over the assets of the Company.

The payment of quarterly principal payments owing during the first twelve-month period commencing from the closing date, however, may be delayed and paid on a date that is 13 months from the closing date. When such payments are delayed, the Company is required to deposit into a separate trust account, on a quarterly basis, an amount equal to any first year quarterly principal payment that would otherwise have been payable. As at December 31, 2011, total principal payments of $66,833 have been deferred. The debenture holders have not expressed an intention to demand payment.

One whole warrant entitles the holder to purchase one common share at the price of $0.50 per share for a period of three years from the date of issuance. If the Company's share trade at an average price of $0.80 per share for a period of 60 days, the Company, at its election, may force exercise or cancellation of the warrants. If the Company repays any portion of the principal amount of the debentures prior to January 1, 2011, the number of common shares purchasable pursuant to the warrants shall be decreased proportionately to the amount of principal so repaid.

Finder's fees equal to 10% of the aggregate proceeds from the offerings of the units were payable to the brokers.

On February 9, 2010, the Company closed the first tranche of its debenture offering for gross proceeds of $250,000. On March 19, 2010, the Company closed the second tranche for gross proceeds of $85,000. On April 29, 2010, the Company closed the third tranche for gross proceeds of $200,000 and on May 4, 2010, closed the last tranche of its debenture offering for gross proceeds of $75,000.

The net proceeds received from the issue of debentures have been split between the financial liability component and an equity component using the residual method. The fair values of debentures and share purchase warrants are as follows:

Net proceeds of issue	$ 552,751
Equity component	$ 8,101
Liability component at date of issue	$ 544,650

The equity component of $8,101 has been credited to equity, Share Purchase Warrants (note 13(d)).

The liability component is measured at amortized cost. Interest expenses for the year ended December 31, 2011 were $127,741 (2010 - $115,306), calculated by applying weighted average effective interest rate of 26% to the liability component. Interest payments totaling $73,200 and principal payments totaling $172,755 were paid during the year ended December 31, 2011.

As at December 31, 2011, the outstanding principal balance was $437,245 and the carrying amount of these debentures was $497,008.

Maturity date	**Feb. 9, 2013**	**March 19, 2013**	**April 29, 2013**	**May 4, 2013**	**Total**
Debenture principal	$250,000	$85,000	$200,000	$75,000	$610,000
Balance on issuance date	223,165	75,550	178,830	67,105	544,650

Accrued interest	54,555	16,193	32,588	11,970	115,306
Interest payment	(21,750)	(6,290)	(12,198)	(4,450)	(44,688)
Balance Dec. 31, 2010	**255,970**	**85,453**	**199,220**	**74,625**	**615,268**
Accrued interest	48,884	18,068	44,123	16,620	127,695
Principal payment	(108,039)	(31,671)	(24,033)	(9,012)	(172,755)
Interest payment	(30,000)	(10,200)	(24,000)	(9,000)	(73,200)
Balance Dec. 31, 2011	**$166,815**	**$61,650**	**$195,310**	**$73,233**	**$497,008**
Less: current portion	(103,230)	(35,099)	(131,191)	(49,196)	(318,716)
Balance	**$63,585**	**$26,551**	**$64,119**	**$24,037**	**$178,292**

13. Issued Capital and Equity Reserve

Authorized

Unlimited common shares without par value
100,000,000 Class A preferred shares
100,000,000 Class B preferred shares

a) Issued common shares

	Shares	Amount
Balance, January 1, 2010	**44,321,396**	**$25,639,345**
Private placement (i)	2,500,000	440,286
Share issuance costs	-	(43,486)
Balance, December 31, 2010	**46,821,396**	**26,036,145**
Issued for cash via private placements (iii)	14,133,330	3,440,016
Options exercised (c)	654,000	210,298
Share issuance costs (iv)	-	(220,990)
Balance, December 31, 2011	**61,608,726**	**29,465,469**

i. On June 1, 2010 the Company issued 2,500,000 Units at $0.20 per unit pursuant to a non-brokered private placement for gross proceeds of $500,000. Each Unit consists of one common share and one-half warrant. Issuance costs were $47,196, consisting of cash share issuance costs of $39,059 and non-cash issuance costs of $8,137. 93% of total issuance cost ($43,486) was allocated to common shares and 7% ($3,710) to warrants.

ii. On February 22, 2011 the Company issued 13,333,330 Units at $0.30 per unit pursuant to a non-brokered private placement for gross proceeds of $3,999,999. Each Unit consists of one common share and one-half warrant. Pursuant to the private placement agreement, the Company also issued 626,667 share purchase warrants as non-cash compensation to agents. Cash issuance costs of $179,080 and non-cash issuance costs of $38,690 were allocated to common shares.

iii. On December 6, 2011 the Company issued 800,000 Units at $0.20 per unit pursuant to a non-brokered private placement for gross proceeds of $160,000. Each Unit consists of one common share and one-half warrant. Cash issuance costs of $3,220 were allocated to common shares.

b) Stock options

Under the Company's stock option plan, the Company may grant stock options to employees, directors, officers and consultants. The maximum number of shares to be awarded under the plan is 12,161,745.

In October 2010, the stock option plan was amended to extend the option term to a maximum period of ten years. This amendment was approved by shareholders at 2010 annual general meeting and accepted for filing by the TSX Venture Exchange.

As at December 31, 2011, all outstanding options have vesting periods of up to 5 years. A summary of the Company's stock option activity for employees, directors, officers and consultants is as follows:

	Number of share options	**Weighted avg. exercise price**
Balance, January 1, 2010	5,719,000	$0.33
Granted	1,640,000	0.27
Cancelled	(25,625)	0.28
Forfeited	(126,875)	0.40
Expired or exercised	(680,000)	0.33
Balance, December 31, 2010	6,526,500	0.31
Granted	1,462,500	0.30
Cancelled	(76,250)	0.27
Forfeited	(88,750)	0.26
Expired or exercised	(2,214,000)	0.32
Balance, December 31, 2011	5,610,000	$0.31

During the year ended December 31, 2011, the Company granted 607,500 options with weighted average fair value of $0.20 (2010 –1,560,000, weighted average fair value $0.19) to officers and employees and 855,000 options with weighted average fair value of $0.10 (2010 – 80,000, weighted average fair value $0.19) to consultants. None of these options had an exercise price lower than the stock price at the date of grant (2010 – Nil).

Stock-based compensation expense for the year ended December 31, 2011, was $274,969 (2010 - $368,960), of which $211,658 (2010 – $314,860) was related to employees and $63,311 (2010 - $54,100) was related to consultants

Additional information regarding share options outstanding at December 31, 2011, is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise prices $	Number of Options	Weighted average remaining contractual life (years)	Weighted average exercise price $	Number	Weighted average exercise price $
0.10 - 0.15	175,000	2.56	0.14	175,000	0.14
0.16 - 0.29	1,785,000	4.17	0.25	1,053,750	0.25
0.30 - 0.33	2,895,000	2.09	0.31	2,842,500	0.31
0.34 - 0.48	505,000	4.12	0.40	305,000	0.41
0.49- 0.96	250,000	1.29	0.62	250,000	0.62
	5,610,000	2.92	0.31	4,626,250	0.31

The Company used the Black-Scholes option pricing model to determine the fair value of the options at the date of grant with the following assumptions:

	2011	2010
Risk-free interest rate	2.14% - 2.64%	1.71%-2.45%
Dividend yield	0%	0%
Volatility	91.89% - 92.99%	93.57%- 98.60%
Expected life	4.60-4.62 years	3.8 – 5 years

c) Share purchase warrants

i. On June 1, 2010 the Company issued 2,500,000 units of common shares and warrants pursuant to a non-brokered private placement, for gross proceeds of $500,000. Each Unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.35 until June 1, 2011. These warrants are not transferable. A total value of $67,852 was attributed to the warrants. Issuance costs of $3,710 were allocated to these warrants.

ii. On June 1, 2010 the Company issued 125,000 warrants as part of the private placement commission to agents. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.35 until June 1, 2011. The fair value of $8,137 of these warrants has been reflected within share issuance costs.

iii. On February 22, 2011 the Company issued 13,333,330 Units of commons shares and warrants pursuant to a non-brokered private placement. Each Unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.45 until February 22, 2013. These warrants are not transferable. A total value of $707,333 was attributed to the warrants. Cash issuance costs of $38,461 and non-cash issuance costs of $8,310 were allocated to these warrants.

iv. Pursuant to the February 22, 2011 private placement agreement the Company also issued 626,667 share purchase warrants as non-cash compensation to agents. Each warrant entitles the holder to purchase one common share at a price of $0.30 until February 22, 2012. A total value of $47,000 was attributed to these warrants.

v. On February 28, 2011 the Company issued 1,000,000 share purchase warrants as non-cash consideration for Smartcool UK acquisition. Each warrant entitles the holder to purchase one common share at a price of $0.30. These warrants will vest 25% on the issuance date and 25% every six months thereafter. They will expire two years from the vesting date. A total value of $227,675 was attributed to the warrants.

vi. On December 6, 2011 the Company issued 800,000 Units of commons shares and warrants pursuant to a non-brokered private placement. Each Unit consists of one common share and one-half warrant. Each full share purchase warrant entitles the holder to purchase one common share at a price of $0.30 until December 6, 2013. These warrants are not transferable. A total value of $12,650 was attributed to the warrants.

A summary of the Company's reserve for equity settled share based transactions is as follows:

	Number outstanding	Amount $
Balance, January 1, 2010	**1,732,375**	**52,514**
Expired warrants	(1,732,375)	(52,514)
Issued in private placement	2,424,200	75,953
Warrant issue costs	-	(3,711)
Balance, December 31, 2010	**2,424,200**	**72,242**
Expired warrants	(1,375,000)	(64,140)
Issued in private placement	7,693,332	766,983
Issued in UK acquisition	1,000,000	227,675
Warrant issue costs	-	(47,050)
Balance, December 31, 2011	**9,742,532**	**955,710**

For the year ended December 31, 2011, $766,983 (2010 - $75,953) of the monies raised and commission for agents has been allocated to these share purchase warrants with the corresponding amounts charged to share capital.

Share purchase warrants outstanding as at December 31, 2011, were as follows:

	Number of warrants	Weighted average share price
Balance, January 1, 2010	1,732,375	0.30
Expired, exercised or cancelled	(1,732,375)	030
Issued	2,424,200	0.41
Balance, December 31, 2010	2,424,200	0.41
Expired, exercised or cancelled	(1,375,000)	0.35
Issued	8,693,332	0.42
Balance, December 31, 2011	9,742,532	0.42

Expiry date	Number of shares	Exercise price $	Weighted average contractual life
			Years
February 9, 2013	430,000	0.50	1.11
March 19, 2013	146,200	0.50	1.22
April 29, 2013	344,000	0.50	1.33
May 4, 2013	129,000	0.50	1.34
February 22, 2013	6,666,665	0.45	1.14
February 22, 2012	626,667	0.30	0.14
February 28, 2013	250,000	0.30	1.16
August 28, 2013	250,000	0.30	1.66
December 6, 2013	400,000	0.30	1.93
February 28, 2014	250,000	0.30	2.16
August 28, 2014	250,000	0.30	2.66
Total issued and outstanding, Dec 31, 2011	**9,742,532**	**0.42**	**1.20**

14. Income Taxes

Income tax recognized in the statement of operations:

Deferred income tax recovery	$465,455
Current income tax expense	(17,100)
Prior year tax adjustment	8,029
Total income tax recovery	$456,384

A reconciliation of expected tax recovery based on accounting loss at statutory tax rates to actual income tax recovery recorded:

	2011 $	2010
Expected tax recovery (2011 – 26.5%; 2010 - 28%)	(1,503,705)	(411,140)
Permanent and other differences	(140,321)	293,223
Effect of foreign tax rates	239,696	(310,888)
Change in unrecognized tax assets	947,946	457,000
Income tax (recovery) expense	(456,384)	28,195

Unrecognized income tax assets comprise the following:

	2011 $	2010 $
Deferred income tax assets		
Non-capital losses	4,771,000	3,944,000
Share issuance costs	105,000	42,000
Other timing differences	197,000	139,000
Unrecognized tax assets	5,073,000	4,125,000

The Company's operations are conducted in a number of countries with complex tax legislation and regulations pertaining to the Company's activities. Any reassessment of the Company's tax filings by the tax authorities may result in material adjustments to net income or loss, tax assets and operating loss carry-forwards.

In assessing the ability to realize deferred tax assets, management considers whether it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. As management believes there is uncertainty regarding the realization of these deferred tax assets, they have been classified as unrecognized tax assets as at December 31, 2011 (December 31, 2011 - $4,125,000, January 1, 2010 - $3,668,000).

At December 31, 2011, the Company has unused non-capital losses of approximately $17,467,000 available to offset taxable income of future years. The non-capital losses will expire as follows:

	Canada	USA	UK	UK	Total
Tax rate	25%	34%	22%	28%	
2004	507,000				507,000
2005	979,000				979,000
2006	1,023,000	130,000			1,153,000
2007	1,733,000	966,000			2,699,000
2008	1,128,000	1,648,000	303,000		3,079,000
2009	2,501,000	840,000	517,000		3,858,000
2010	911,000	835,000	312,000		2,058,000
2011	1,788,000	389,000	386,000	571,000	3,134,000
	10,570,000	**4,808,000**	**1,518,000**	**571,000**	**17,467,000**

Deferred Tax Liabilities

The company recorded deferred tax liabilities of $1,078,565 as a result of the acquisition of Smartcool UK assets in February 2011. During the year, these liabilities were reduced by $464,773 upon the recognition of amortization and impairment costs of these assets.

As at December 31, 2011, deferred tax liability was $613,110.

Deferred income tax liabilities, February 28, 2011	$1,078,565
Amortization of intangible assets	(157,136)
Impairment of intangible assets	(303,698)
Effect of foreign exchange rate	(4,621)
Deferred income tax liabilities, December 31, 2011	613,110

15. Commitments

Premise Lease

The Company has entered into three lease agreements to lease office facilities in Vancouver and Alton, Hampshire. These leases will expire in five years. The future minimum lease payments commitments for the Company's office premises are:

	$
2012	106,597
2013	108,172
2014	109,296
2015	77,796
2016	9,216
	411,077

For the year ended December 31, 2011, the Company's rent expense including certain operating expenses and property taxes was $194,615 (2010 - $167,273) and its sublease revenue was $12,000 (December 2010 - $16,467).

Abbotly USA

Under the terms of the North American distribution rights acquisition, the Company is required to pay a 20% royalty on products identified in the Assignment and Assumption agreement dated March 27, 2006 and purchased from Abbotly Pty for North American sales. The initial term of the agreement was to expire on March 3, 2008. Smartcool, under its rights in the Assignment and Assumption agreement, has renewed the licensing agreement for another five year term. The Company has purchased the entire remaining inventory from Abbotly USA, as required under this agreement, and is now required to pay a minimum of US$40,000 in royalty annually. The Company recorded royalty expense of US$40,000 for the year ended December 31, 2011. As at December 31, 2011, royalties of $20,340 (US$20,000) were payable to Abbotly USA (December 30, 2010 – $11,934, US$12,000).

16. Segmented Information

The Company installs, distributes, markets and sells the ECO3 and ESM™ products and peripherals. Revenue from the ECO3 for the year was $727,676 and revenue for the ESM™ solution was $3,216,118.

The Company operates in one segment. Revenue was derived from customers located in the following geographical regions:

	2011		**2010**	
	Amount	**%**	**Amount**	**%**
Europe, Middle East, Africa	2,783,935	71	2,582,723	61
Australia	406,626	10	473,387	11
South East Asia	301,417	8	511,708	12

Americas	451,816	11	641,827	16
Total revenue	**3,943,794**	**100**	4,209,645	**100**

Revenue per region was determined based on the location of the customer or their billing address.

During the year ended December 31, 2011, revenue from two customers exceeded 10% of the Company's total revenue. These customers contributed 34% (2010 – 0% of total revenue) and 10% (2010 – 11% of total revenue) respectively.

During the previous year, revenue from three customers exceeded 10% of the Company's total revenue. These customers contributed 14%, 12% and 11% respectively.
Property and equipment are located in:

	2011		**2010**	
	Amount	**%**	**Amount**	**%**
Canada	$64,521	37%	$76,018	68%
UK	105,400	61%	20,471	18%
USA	1,049	1%	14,214	13%
Other	1,554	1%	926	1%
Total	**172,524**	**100%**	**111,629**	**100%**

17. Related Party Transactions

Trading transactions

The Company's related parties consist of companies owned by executive officers and directors and key management as follows:

	Nature of Transaction
384518 BC Ltd.	Consulting
Windstone Financial Corp.	Consulting
Key Management	Consulting/General administrative
Richards Buell Sutton LLP	Legal Services
TECC	Rent

Rossair	Installation tools and materials
Magnum Energy Inc.	Rental income

The Company incurred the following expenses in connection with the companies owned by key management and directors. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

	Note	2011	2010
		$	$
Consulting fees	(i)	216,802	251,649
Legal fees	(ii)	20,584	36,644
Rent expense	(iii)	13,701	35,418
Lease Income	(iv)	(12,000)	(16,467)
Tools and Materials	(v)	8,021	16,955

i. During the year ended December 31, 2011, consulting fees of $114,802 were charged by directors of the Company (2010 - $120,149). Consulting fees of $102,000 were charged by two companies with common directors during the above period (2010 - $131,500). As at December 31, 2011, $34,309 was owed to these related parties (December 31, 2010 - $11,635).

ii. The Company uses the services of a law firm of which a director is a partner. During the year ended December 31, 2011, fees in the amount of $20,584 were charged to the Company for legal services provided. As at December 31, 2011, $7,571 was owed to this related party (December 31, 2010 - $55,006).

iii. The Company rented its office in the United Kingdom from a company with a common director. During the year ended December 31, 2011, rent expense was $13,701 (2010 – $35,418). These transactions have been charged to general and administrative in the statement of operations, comprehensive loss and deficit. At December 31, 2011, no amounts were owed to this related party (December 31, 2010 - $0).

iv. The Company subleases its Vancouver office and other facilities to a company with a common officer. During the year ended December 3, 2011, sublease income was $12,000 (2010 - $16,467). At December 31, 2011, $1,000 was owed from this related parties (December 31, 2010 - $1,000).

v. The Company purchased installation materials from a company with a common director. During the year ended December 31, 2011, materials purchases from this related party were

$8,021 (2010 - $16,955). These transactions have been charged to cost of sales in the statement of operations. At December 31, 2011, $300 was owed to this related party (December 31, 2010 - $0).

Compensation of Key Management Personnel

The Company incurred the following expenses in connection with compensation of key management personnel. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, and consist of the Directors, Chief Executive Officer, Chief Financial Officer, Executive Vice-President, Vice-President Operations and Vice-President Sales.

	2011	**2010**
Salaries	656,360	595,300
Short-term benefits	94,737	74,104
Share-based payments	142,011	205,728
Total	**893,108**	**875,132**

18. Financial Instruments

Financial Instruments

The Company has classified its financial instruments as follows:

	December 31, 2011	**December 31, 2010**	**January 1, 2010**
Financial assets:	**$**	**$**	**$**
Fair value through profit or loss , measured at fair value:			
Cash and cash equivalents	498,874	610,261	147,051
Loans and accounts receivable, recorded at amortized cost:			
Trade and other receivables	1,058,348	1,019,861	657,840
Other Financial liabilities, recorded at amortized cost:			
Trade payables and accruals	1,210,170	657,967	552,034
Acquisition obligations and debentures	2,808,359	1,237,939	845,792

Interest income from FVTPL and held-to-maturity short-term investments and interest expense from acquisition obligations, debentures and other financial liabilities are recognized in finance income and expense.

Financial instruments recorded at fair value are measured using a three-level fair value hierarchy:

- Level 1: fair value is determined by reference to quoted prices in active markets for identical assets and liabilities.

- Level 2: fair value is determined based on inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly.

- Level 3: fair value is determined based on inputs that are unobservable and significant to the overall fair value measurement.

The carrying value of cash and cash equivalents, short-term investments, trade and other receivables, the current portion of obligations under acquisition contract, current portion of debentures, tenant inducements, and trade payables and accruals approximates the fair value because of the short-term nature of these instruments.

Financial Risk Management

The Company is exposed to certain financial risks, including credit risk, liquidity risk, and market risk.

a. *Credit risk*

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash and cash equivalents, short-term investments and trade and other receivable. The Company limits its exposure to credit loss by placing its cash and cash equivalents and short-term investments with high credit quality financial institutions. To mitigate credit risk with respect to trade and other receivables the Company subjects all major customer accounts to its credit evaluation process.

The Company has $1,042,580 (2010 - $971,316) in trade receivables which are subject to credit risk.

b. *Liquidity risk*

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk results from the Company's inability to meet its financial obligations when they become due. As part of the risk management process, the Board approves the Company's annual operating and capital budgets as well as any material transactions outside the ordinary course of business. To ensure that the Company has sufficient liquidity to meet its current obligations in the next 12 months, measures have been taken to increase cash resources (note 1).

The timing of future payments related to financial liabilities is outlined in the table below:

	Total	**1 year**	**1-2 years**
	$	$	$
Trade payables and accruals	1,210,170	1,156,677	53,493
Finance leases	64,869	38,717	26,152
Abbotly minimum royalties	80,000	40,000	40,000
Premises leases	214,769	106,597	108,172

Debentures	573,595	391,916	181,679
Obligations under acquisition	2,311,351	-	2,311,351
Total	**4,494,544**	**1,733,907**	**2,760,637**

c. *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or valuation of its financial instruments.

d. *Foreign currency risk*

The Company is exposed to fluctuations in foreign currency as most of its international distribution transactions are settled in U.S. dollars, Australian dollars and British pounds. The Company's net income and cash flow will therefore be affected by fluctuations in foreign exchange rates. None of these risks has been mitigated through the use of foreign currency forward contracts.

As at December 31, 2011, the Company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	**AUD**	**GBP**	**Euro**
Assets				
Cash and cash equivalents	153,240	784	-	64,986
Trade and other receivables	251,416	-	-	302,026
Total	**404,656**	**784**	**-**	**367,012**
Liabilities				
Total payables and accruals	55,310	6,842	12,500	24,206
Finance lease obligations	-	-	-	-
Acquisition obligations, current	-	-	296,333	-
Acquisition obligations, balance	-	-	-	-
Total	**55,310**	**6,842**	**308,833**	**24,206**

The following table demonstrates the effect of exchange rate movement on net income due to gains and losses on the revaluation of monetary assets and liabilities denominated in foreign currencies:

Gain (loss) on $0.10 increase in CAD	**USD**	**AUD**	**GBP**	**Euro**
Monetary Assets	(40,466)	(78)	-	(36,701)
Monetary Liabilities	5,531	684	30,883	2,421
Net gain (loss)	**(34,935)**	**606**	**30,883**	**(34,280)**

Gain (loss) on $0.10 decrease in CAD	USD	AUD	GBP	Euro
Monetary Assets	40,466)	78)	-	36,701
Monetary Liabilities	(5,531)	(684)	(30,883)	(2,421)
Net gain (loss)	**34,935**	**(606)**	**(30,883)**	**34,280**

e. *Interest rate risk*

The Company is exposed to this risk as late payments under TECC acquisition obligations are subject to interest based on Royal Bank of Canada prime rate plus 4%. As at December 31, 2011, the total of such payments was $236,985 (£150,000).

The Company is exposed to this risk as late payments under Smartcool UK acquisition obligations are subject to interest based on Royal Bank of Canada prime rate As at December 31, 2011, the total of such payments was $1,184,925 (£750,000).

f. *Sensitivity analysis*

Assuming a 100-basis point increase in RBC prime rate, as at December 31, 2011, the impact on income before income taxes would be a negative adjustment of $14,219 (£9,000).

19. Capital Management

The Company's capital structure includes debentures and shareholders' equity consisting of share capital, reserve for equity settled share based transactions and deficit. As at December 31, 2011, the principal amount of debenture component was $437,245 (December 31, 2010 - $610,000, January 1, 2010 - $0) and shareholders' equity was $4,412,634 (December 2010 - $3,383,530, January 1, 2010 - $4,135,645). The decrease in debentures was attributable to principal payments made during the year 2011, and the increase in shareholders' equity was attributable to February 22, 2011 and December 6, 2011 private placements, partially offset by net loss.

The Company's objectives when managing capital are:

- to effectively finance its operations and growth by meeting its operating and capital expenditure budgets;
- to maintain financial flexibility in order to meet financial obligations, including obligations under acquisition contracts;
- to ensure its ability to carry out its strategic plans and take advantage of acquisition opportunities;
- to provide an appropriate investment return to its shareholders and maintain investor, creditor and market confidence.

For more effective capital management, the Company has taken steps to reduce expenses, secure more predictable revenue generation, and collect outstanding receivables.

Management is in the final steps of approval with its major banking relationship to provide accounts receivable factoring for select accounts that will smooth out the Company's cash flow. In addition management will consider securing capital from its investor base if required, which management has demonstrated in the past to be a successful strategy. An equity financing was completed in first quarter of 2012.

The Company is not subject to any external capital restrictions.

20. Supplementary cash flow information

	2011	2010
Interest paid in cash	80,834	58,737
Interest income received in cash	376	6,423
Issuance of warrants for share issue costs and business combination	274,725	8,137

21. Subsequent Events

On January 23, 2012 the Company announced that further to its news release dated January 17, 2012, it had completed a non-brokered private placement consisting of 2,678,571 common shares at a price of $0.14 per share for gross proceeds of $375,000.

The common shares issued pursuant to this private placement are subject to four-month resale restriction that expires on May 21, 2012. The proceeds raised will be used for general working capital and purchase of inventory.

22. IFRS

First-Time Adoption of IFRS

IFRS Exemptions selected

The Company adopted IFRS on January 1, 2011, with a transition date of January 1, 2010. IFRS 1, *First Time Adoption of International Financial Reporting Standards*, provides guidance for the initial adoption of IFRS. IFRS 1 requires retrospective application of the standards in the transition statement of financial position, with all adjustments to assets and liabilities taken to retained earnings unless certain exemptions are applied.

In preparing the consolidated financial statements in accordance with IFRS the Company has applied mandatory exceptions and selected some of the optional exemptions from full retrospective application of IFRS. Below are the exemptions applied by the Company:

a. Business Combinations

IFRS 1 indicates that a first-time adopter may apply IFRS 3 prospectively. The Company has taken advantage of this exemption and has applied IFRS 3 to all business combinations that occurred after the transition date.

b. Share-Based Payments

IFRS 1 encourages, but does not require, first-time adopters to apply IFRS 2, *Share-Based Payments*, to equity instruments that were granted subsequent to November 7, 2002 and vested before the date of transaction to IFRS. The Company has elected not to apply IFRS 2 to awards that vested prior to January 1, 2010, which has been accounted for in accordance with Canadian GAAP.

c. Cumulative Translation Difference

IFRS 1 allows a first-time adopter to deem cumulative translation differences that existed at the date of transition to IFRS to be zero. The Company has chosen to apply this exemption and has eliminated the cumulative translation difference and adjusted retained earnings by the same amount at the date of transition to IFRS.

d. Estimates

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

IFRS employs a conceptual framework that is similar to Canadian GAAP; however, significant differences exist in certain areas of recognition, measurement and disclosure. While the adoption of IFRS has not changed the actual cash flows of the Company, the adoption has resulted in changes to the Company's reported consolidated statement of operations and financial position. In order to allow financial statement users to better understand these changes, the Company's Canadian GAAP opening statement of financial position at January 1, 2010, statement of comprehensive (loss) income, statement of changes in equity, and statement of cash flows for the year ended December 31, 2010, and statement of financial position at December 31, 2010 have been reconciled to IFRS, along with explanations of the resulting differences.

The January 1, 2010, Canadian GAAP statement of financial position has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
		$	$	$
Assets				
Cash and cash equivalents		147,051		147,051
Short-term investments		101,646		101,646
Trade and other receivables		657,840		657,840
Inventories	IAS 21[a]	717,857	(12)	717,845
Prepaid expenses and deposits		242,302		242,302
Current assets		**1,866,696**	**(12)**	**1,866,684**
Capitalized development costs		39,961		39,961
Property and equipment	IAS 21[a]	207,720	(4,103)	203,617
Intangible assets	IAS 21[a]	3,639,843	(132,835)	3,507,008
Total Assets		**5,754,220**	**(136,950)**	**5,617,270**
Liabilities				
Trade payable and accruals		552,034		552,034
Current portion of obligations under contracts		263,190		263,190
Current portion of capital leases		9,144		9,144
Current portion of deferred tenants inducement		10,820		10,820
Current liabilities		**835,188**		**835,188**
Obligations under acquisition contract		582,603		582,603
Deferred tenant inducement		63,834		63,834
Total Liabilities		**1,481,625**		**1,481,625**
Shareholders' Equity				
Share capital		25,639,345		25,639,345
Reserve for equity settled share based transaction		4,036,345		4,036,345
Foreign currency translation adjustment		-		-
Deficit	IAS 21[b]	(25,403,095)	(136,950)	(25,540,045)
Total Shareholders' Equity		**4,272,595**	**(136,950)**	**4,135,645**
		5,754,220	**(136,950)**	**5,617,270**

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

b) IFRS 1- The Company has applied the exemption available under IFRS1 to deem cumulative translation differences to be equal to zero at the date of transition.

The Company's Canadian GAAP statement of changes in equity at December 31, 2010, has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
		$	$	$
Balance, January 1, 2010	IAS 21[a]	**4,272,595**	**(136,950)**	**4,135,645**
Total comprehensive loss for the period	IAS 21[a]	(1,555,180)	(34,937)	(1,590,117)
Shares issued for private placement		440,286		440,286
Share purchase warrants		75,953		75,953
Finder's fees		(37,500)		(37,500)
Share issue costs		(9,697)		(9,697)
Reserve for equity settled share based transaction		368,960	-	368,960
Balance, December 31, 2010	IAS 21[a]	**3,555,417**	**(171,887)**	**3,383,530**

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

The Company's Canadian GAAP statement of operations for the twelve month period ended December 31, 2010, has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
		$	$	$
Sales		4,209,645		4,209,645
Cost of sales		1,264,220		1,264,220
Gross margin		2,945,425		2,945,425
Operating expenses				
General and administrative expenses		3,272,909		3,272,909
Stock-based compensation		368,960		368,960
Research and development		51,509		51,509
Amortization		560,102		560,102
		4,253,480		4,253,480
Operating loss		(1,308,055)		(1,308,055)
Other items				
Finance costs		211,165		211,165
Finance Income		(4,777)		(4,777)
Foreign exchange loss (gain)	IAS 21[a]	12,542	64,591	77,133
		218,930	64,591	283,521
Income loss before income taxes		(1,526,985)	(64,591)	(1,591,576)
Income tax expense		(28,195)	-	(28,195)
Net (loss) income for the period		(1,555,180)	(64,591)	(1,619,771)

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

The Company's Canadian GAAP statement of comprehensive (loss) income for the twelve month period ended December 31, 2010 has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
		$	$	$
Net loss for the period	IAS 21[a]	(1,555,180)	$(64,591)	(1,619,771)
Foreign currency translation adjustment	IAS 21[a]	-	29,654	29,654
Comprehensive loss		(1,555,180)	(34,937)	(1,590,117)

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

The Company's Canadian GAAP statement of financial position at December 31, 2010, has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS
		$	$	$
Assets				
Current assets				
Cash and cash equivalents		443,972		610,261
Restricted cash		166,289		-
Trade and other receivables		1,019,861		1,019,861
Inventories	IAS 21[a]	509,749	(164)	509,585
Prepaid expenses and deposits		75,487	-	75,487
		2,215,358	(164)	2,215,194
Property and equipment	IAS 21[a]	115,490	(3,861)	111,629
Intangible assets	IAS 21[a]	3,184,309	(167,862)	3,016,447
		$5,515,157	$(171,887)	$5,343,270
Liabilities				
Current liabilities				
Trade payable, accruals and provisions		$657,967		$657,967
Current portion of obligations under contracts		371,937		371,937
Current portion of debentures		386,290		386,290
Current portion of deferred tenants inducement		12,379		12,379
		1,428,573		1,428,573
Obligations under acquisition contract		250,734		250,734
Debentures		228,978		228,978
Deferred tenant inducement		51,455		51,455
		1,959,740		1,959,740
Shareholders' Equity				
Share capital		26,036,145		26,036,145
Reserve for equity settled share based transactions		4,477,547		4,477,547
Foreign currency translation adjustment	IAS 21[a]	-	29,654	29,654
Deficit	IAS 21[a]	(26,958,275)	(201,541)	(27,159,816)
		3,555,417	(171,887)	3,383,530
		$5,515,157	$(171,887)	$5,343,270

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

The Company's Canadian GAAP consolidated statement of cash flows for the twelve month period ended December 31, 2010, has been reconciled to IFRS as follows:

	Note	Canadian GAAP	Effect of Transition to IFRS	IFRS

		$	$	$
Cash flows from operating activities				
Net loss for the period	IAS 21[a]	(1,555,180)	(64,591)	(1,619,771)
Items not involving cash				
Amortization of property and equipment		104,568		104,568
Amortization of intangible assets		455,534		455,534
Amortization of capitalized development costs		39,961		39,961
Stock-based compensation		368,960		368,960
Deferred tenant inducement		(10,821)		(10,821)
Accrued interest on debentures		70,618		70,618
Unrealized foreign exchange loss	IAS 21[a]	-	71,730	71,730
Accrued interest on obligation under acquisition contracts		17,389		17,389
Accretion of obligations under acquisition contract		66,546		66,546
Foreign exchange gain on obligations under acquisition contract		(60,632)		(60,632)
		(503,057)	7,139	(495,918)
Change in non-cash working capital balances				
Trade and other receivables		(362,020)		(362,020)
Inventories		208,108		208,108
Prepaid expenses and deposits		166,815		166,815
Trade payable, accruals and provisions		105,933		105,933
Net cash used in operating activities		(384,221)	7,139	(377,082)
Cash flows used in investing activities				
Proceeds from sale of short-term investments		101,646		101,646
Purchase of property and equipment		(12,338)		(12,338)
Restricted cash		(166,289)		(166,289)
Net cash used in investing activities		(76,981)	-	(76,981)
Cash flows from financing activities				
Shares and warrants issued for cash, net of issue costs		460,941		460,941
Debentures issued for cash		552,751		552,751
Decrease in acquisition contract obligations		(246,425)		(246,425)
Decrease of capital lease obligations		(9,144)		(9,144)
Net cash flows provided by financing activities		758,123	-	758,123
Net increase in cash and cash equivalents		296,921		304,060
Effect of exchange rate changes on cash	IAS 7[b]	-	(7,139)	(7,139)
Cash and cash equivalents, beginning of period		147,051	-	147,051
Cash and cash equivalents , end of period		443,972	-	443,972

a) IAS 21 - The Company determined that under IFRS the functional currency of Smartcool Systems and Smartcool International was the Canadian dollar, the functional currency of Smartcool USA was the United States dollar and the functional currency of Smartcool EMEA and Smartcool UK was the British Pound. Previously, the functional currency of all the entities was the Canadian dollar. As a result of the change in functional currency, the Company has changed the method of translation of foreign subsidiaries' financial statements from the temporal method to the current method. Non-monetary assets and liabilities are now translated from their historical functional currency amounts to Canadian dollars at the exchange rate at period end while previously they were translated using the rate in effect at the date of the transaction. In addition, all resulting exchange differences are reported as a separate component of shareholders' equity tilted "Foreign currency translation adjustment" while previously they were recorded as a component of foreign exchange gain and loss within the consolidated statements of operation.

b) IAS-7 - Financial instruments disclosure – to present the effect of exchange rate changes on cash held in a foreign currency separately from operating, investing, and financing activities.