SMARTCOOL™

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

For the three months ended June 30, 2014 and 2013
Expressed in Canadian Dollars

www.smartcool.net

Smartcool Systems Inc.
7155 Kingsway
PO Box 54523 Highgate PO
Burnaby, BC
V5E 4J6 Canada

TEL +1 604 669 1388
TOLL-FREE +1 888 669 1388
FAX +1 604 602 0674
EMAIL officeCanada@smartcool.net

SMARTCOOL™

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

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SMARTCOOL™

Smartcool Systems Inc.

Condensed consolidated statements of financial position

(Expressed in Canadian dollars, unless otherwise stated)
(unaudited)

	June 30 2014	December 31 2013
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	38,382	28,036
Trade and other receivables (note 3)	318,580	247,496
Inventory (note 4)	178,520	223,642
Prepaid expenses and deposits	118,338	91,120
	653,820	590,294
Property and equipment (note 5)	71,745	83,834
Intangible assets (note 6)	3,237,521	3,503,047
Total assets	3,963,086	4,177,175
LIABILITIES		
Current liabilities		
Trade payables and accruals	888,554	801,077
Short-term loan (note 7)	65,038	131,111
Current portion of obligations under acquistion contracts (note 8)	173,116	166,295
Current portion of vehicle finance (note 9)	4,251	-
Current portion of debentures (note 10)	235,560	149,712
Current portion of deferred tenant inducement	14,826	16,166
	1,381,345	1,264,361
Obligations under acquisition contracts (note 8)	214,235	235,712
Vehicle finance (note 9)	11,680	-
Debentures (note 10)	-	99,371
Deferred tenant inducement	-	6,744
Deferred tax liability (note 12)	424,326	445,754
Total liabilities	2,031,586	2,051,942
SHAREHOLDERS' EQUITY		
Share capital (note 11(a))	30,733,413	30,309,075
Reserve for equity settled share based transactions (note 11(b)(c))	5,970,194	5,847,515
Foreign currency translation adjustment	(61,149)	(129,636)
	36,642,458	36,026,954
Deficit	(34,710,958)	(33,901,721)
	1,931,500	2,125,233
Total liabilities and shareholders' equity	3,963,086	4,177,175

Approved and authorized for issue by the Board of Directors on August 26, 2014

"George Burnes" — George Burnes

"Jeffrey Lowe" — Jeffrey Lowe

See accompanying notes to the consolidated financial statements

SMARTCOOL™

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

	Three months ended June 30		Six months ended June 30	
	2014 $	**2013** $	**2014** $	**2013** $
Revenue	199,545	491,253	693,739	634,855
Cost of sales	38,269	80,992	108,493	126,722
Gross profit	161,276	410,261	585,246	508,133
Operating Expenses				
General and administrative expenses (note 16)	503,888	553,449	1,029,530	1,183,552
Stock-based compensation (note 11(b))	26,486	35,408	67,592	42,575
Research and development	-	-	7,227	21,376
Amortization and depreciation (note 5 and 6)	182,497	261,706	366,487	521,161
	712,871	850,563	1,470,836	1,768,664
Operating loss	(551,595)	(440,302)	(885,590)	(1,260,531)
Rental income	29,002	29,136	58,004	57,757
Finance expense	(26,344)	(58,702)	(57,029)	(127,218)
Finance income	-	-	-	1
Foreign exchange gain (loss)	(8,919)	3,086	1,071	(11,625)
Inventory received from third party (note 4 and 18)			25,378	-
Gain on sale of property and equipment (note 5)	9,258	446	10,171	446
	2,997	(26,034)	37,594	(80,639)
Income tax recovery (note 12)	19,429	36,431	38,759	72,508
Net loss for the period	**(529,169)**	**(429,905)**	**(809,237)**	**(1,268,662)**
Net loss per share				
Basic	(0.01)	(0.01)	(0.01)	(0.02)
Diluted	(0.01)	(0.01)	(0.01)	(0.02)
Weighted average number of common shares outstanding (basic and diluted)	**86,451,143**	**64,616,967**	**82,889,010**	**64,452,132**

See accompanying notes to the consolidated financial statements

SMARTCOOL™

Smartcool Systems Inc.
Condensed consolidated statements of comprehensive income

(Expressed in Canadian dollars, unless otherwise stated)
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2014	**2013**	**2014**	**2013**
	$	**$**	**$**	**$**
Net income (loss) for the period	**(529,169)**	**(429,907)**	**(809,237)**	**(1,268,662)**
Foreign currency translation adjustment	17,445	(47,226)	68,487	(5,948)
Total comprehensive income (loss)	**(511,724)**	**(477,133)**	**(740,750)**	**(1,274,610)**
Net income (loss) per share				
Basic	**(0.01)**	**(0.01)**	**(0.01)**	**(0.02)**
Diluted	**(0.01)**	**(0.01)**	**(0.01)**	**(0.02)**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.
Condensed consolidated statement of cash flows

(Expressed in Canadian dollars, unless otherwise specified)
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2014	**2013**	**2014**	**2013**
	$	$	$	$
Cash flows from operating activities				
Loss for the period	(529,169)	(429,905)	(809,237)	(1,268,662)
Items not affecting cash:				
Depreciation of property and equipment	12,257	16,296	26,498	35,857
Amortization of intangible assets	170,240	245,410	339,990	485,304
Inventory acquired at no charge	-	-	(25,378)	-
Gain on sale of property and equipment	(9,258)	(446)	(10,171)	(446)
Stock-based compensation	26,486	35,408	67,592	42,575
Deferred tax liability	(23,435)	(21,932)	(21,428)	(80,627)
Deferred tenant inducement	(4,042)	(3,596)	(8,084)	(6,969)
Unrealzied foreign exchange (gain) loss	14,228	16,295	(60,633)	3,746
Accrued interest on short-term loans	1,427	833	3,927	833
Accrued interest on debentures	4,178	(2,754)	18,672	3,350
Accrued interest of obligation under acquisition contract	-	43,864	-	86,164
Accretion of obligation under acquisition contract	12,089	-	25,692	-
	(325,000)	(100,527)	(452,561)	(698,875)
Changes in non-cash working capital items:				
Trade and other receivables	(41,650)	(57,065)	(71,084)	470,281
Inventory	31,264	(52,305)	70,500	(20,231)
Prepaid expenses and deposits	(25,038)	97,780	(27,218)	(19,797)
Trade payables and accruals	(24,737)	(72,915)	87,477	(150,675)
Net cash flows (used in) provided by operating activities	(385,161)	(185,032)	(392,886)	(419,297)
Cash flows from investing activities				
Disposal of property and equipment	13,172	1,470	14,084	1,470
Purchase of property and equipment	-	(595)	(17,224)	(2,499)
Net cash (used in) provided by investing activities	13,172	875	(3,141)	(1,029)
Cash flows from financing activities				
Shares and warrants issued for cash net of issue costs	479,424	235,568	479,425	235,568
Short-term loan	(70,000)	125,833	(70,000)	125,833
Decrease in debentures	(20,344)	-	(32,195)	(41,062)
Decrease in acquisition contract obligation	(41,269)	(41,062)	(55,148)	-
Increase (decrease) in motor finance	(1,067)	-	15,804	-
Increase (decrease) in finance leases	-	(7,128)	-	(14,067)
Net cash (used in) provided by financing activities	346,744	313,211	337,886	306,272
Net increase (decrease) in cash and cash equivalents	(25,245)	129,054	(58,141)	(114,054)
Effects of exchange rates changes on cash	17,445	(47,226)	68,487	(5,948)
Cash and cash equivalents, beginning of period	46,182	45,320	28,036	247,150
Cash and cash equivalents, end of period	38,382	127,148	38,382	127,148

Supplemental cash flow information (note 18)

See accompanying notes to the consolidated financial statements

SMARTCOOL™

Smartcool Systems Inc.
Condensed consolidated statement of shareholders' equity

(Expressed in Canadian dollars, unless otherwise stated)

(unaudited)

	Share capital	Reserve for equity settled share based transactions	Foreign currency translation adjustment	Deficit	Total Shareholders' Equity
	$	$	$	$	$
Balance at January 1, 2013	29,835,392	5,712,544	(131,138)	(34,310,016)	1,106,782
Net loss				(1,268,662)	(1,268,662)
Foreign currency translation adjustment			(5,948)		(5,948)
Total comprehensive loss for the period			(5,948)	(1,268,662)	(1,274,610)
Share issued for:					
Private placement	250,000				250,000
Warrants		16,180			16,180
Share issue costs	(14,432)				(14,432)
Stock based compensation		42,575			42,575
Balance at June 30, 2013	**30,070,960**	**5,771,299**	**(137,086)**	**(35,578,678)**	**126,495**
Net income				1,676,957	1,676,957
Foreign currency translation adjustment			7,450		7,450
Total comprehensive loss for the period			7,450	1,676,957	1,684,407
Share issued for:					
Private placement	250,000				250,000
Warrants		36,513			36,513
Share issue costs	(11,885)				(11,885)
Stock based compensation		39,703			39,703
Balance at December 31, 2013	**30,309,075**	**5,847,515**	**(129,636)**	**(33,901,721)**	**2,125,233**
Net loss				(809,237)	(809,237)
Foreign currency translation adjustment			68,487		68,487
Total comprehensive loss for the period			68,487	(809,237)	(740,750)
Share issued for:					
Private placement	430,600				430,600
Warrants		55,900			55,900
Share issue costs	(6,262)	(814)			(7,076)
Stock based compensation		67,592			67,592
Balance at June 30, 2014	**30,733,413**	**5,970,193**	**(61,149)**	**(34,710,958)**	**1,931,500**

See accompanying notes to the consolidated financial statements

Smartcool Systems Inc.

Notes to the Condensed Consolidated Financial Statements
For the three months ended June 30, 2014
(expressed in Canadian dollars, unless otherwise stated)
(unaudited)

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 1196 Marine Drive, North Vancouver, BC, V7P 1S8.

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.

During the three months ended June 30, 2014, the Company had a net loss of $529,169 (June 30, 2013 - $429,905) and a deficit of $34,710,958 as at June 30, 2014 (December 31, 2013 - $33,901,721). As at June 30, 2014, the Company had negative working capital of $727,525 (December 31, 2013 - $674,067).

To ensure that Smartcool continues to be a going concern in the next 12 months, a non-brokered private placement was completed in April 2014 for gross proceeds of $486,500. The

Company is planning on obtaining additional capital. Management also expects the software licensing agreement made in 2013 will result in more predictable revenue generation.

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.

Management is aware, in making its assessment, that these material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. These consolidated 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 condensed consolidated interim financial statements of the Company for the three month ended June 30, 2014 comprise the Company and its subsidiaries. These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards 34, Interim Financial Reporting. They do not include all the necessary annual disclosures as prescribed by International Financial Reporting Standards and should be read in conjunction with the annual audited consolidated financial statements as of December 31, 2013.

The Company's condensed consolidated interim financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value, as explained in Note 15, and are presented in Canadian dollars except where otherwise indicated.

Use of Estimates and Judgments

The preparation of these consolidated 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 consolidated 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, valuation of stock options and warrants, recoverability of trade and other receivables, inventory valuation, determination of valuation allowance for income tax assets, amortization rates and methods and ability to continue as a going concern.

Judgments made by management in the application of IFRS that have a significant effect on the consolidated 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 trade receivables
- Share-based payments – the inputs used in accounting for share-based payments
- Debentures – discount rate used in fair value calculation of the debentures
- 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 the 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. The financial statements of the subsidiaries are prepared for the same reporting period as the parent Company, using consistent accounting policies, in all material aspects.

Foreign Currency

The functional currency of Smartcool 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".

The assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rate at period end and income statement items are translated using the exchange rates at the date of the transactions. All resulting exchange differences are taken directly to a separate component of the foreign currency translation reserve. On disposal of a foreign operation, the deferred cumulative amount recognized in the foreign currency translation reserve relating to that particular foreign operation is recognized in foreign exchange gain and loss.

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 is reversed. 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.

When the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee as measured at the date of modification.

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 bringing 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 residual value, at the following rates:

Computer hardware	2-3 years
Computer software	1-5 years
Testing and demonstration equipment	2-3 years
Office equipment and furniture	4-5 years
Motor vehicles	4 years
Leasehold improvements	Shorter of term of the lease and useful life

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on the disposal of the asset is calculated as the difference between the net disposal proceeds and the carrying value of the asset, and recognized in profit or loss.

Residual value and estimated useful lives are reviewed 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. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. 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. During the year ended 31 December 2013, management re-assessed the useful lives of the remaining intangible assets as follows:

	2013	2012
ESM™ Intellectual property	13.5 years	10 years
North American distribution rights	10 years	10 years
TECC and United Kingdom distribution rights	9.5 - 12 years	5 - 9 years
Distribution agreements	13.5 - 15 years	10 - 15 years
Supplier agreements	13.5 years	10 years
Customer relationship	12 years	5 years

Total amortization of $170,240 (June 30, 2013 - $245,410) for the three months ended June 30, 2014 and $339,990 (June 30, 2013 - $485,304) for the six months ended June 30, 2014 were included under net loss for the period on the statement of operations (note 6).
Residual value and estimated useful lives are reviewed annually. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates.

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 and tested 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.

Share Purchase Warrants
The Company issues 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 issues warrants to agents as compensation for services. The fair value of these warrants is determined to be the difference between agent's standard all-cash compensation and compensation with warrants. Warrants are also issued as non-cash consideration for business acquisitions. The fair value of these warrants is determined based on Black-Scholes Option Pricing Model.

Changes in Accounting Policies

A number of standards and amendments were issued effective for accounting periods beginning on or after January 1, 2014. Many of these updates are not applicable to the Company. As of January 1, 2014, the Company adopted the following IFRS standards and amendments:

- Amendments to IAS 32 - Offsetting Financial Assets and Financial Liabilities clarifies that an entity currently has a legally enforceable right to set-off if that right is:
  a) not contingent on a future event; and

b) enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

- IFRS 10 (Amendment), “Consolidated Financial Statements” includes an exception to specific consolidation requirements for investment entities.

The adoption of the above standards did not have a significant impact on the Company’s consolidated financial statements.

Accounting Standards Issued but not yet Effective

At the date of authorization of these consolidated financial statements, the IASB and IFRIC have issued the following new and revised standard and amendments which are not yet effective:

- IFRS 9, “Financial Instruments”, is a new financial instruments standard effective for annual periods beginning on or after January 1, 2015 that replaces IAS 39 and IFRIC 9 for classification and measurement of financial assets and financial liabilities.
  IFRS 9 was amended in November 2013, to include guidance on hedge accounting, allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity’s own credit risk in other comprehensive income without having to adopt the remainder of IFRS 9, and to remove the previous mandatory effective date for adoption of January 1, 2015. The new mandatory effective date will be determined once the classification and measurement and impairment phases of IFRS 9 are finalized. In February 2014, the IASB tentatively decided that IFRS 9 would be mandatorily effective for fiscal years beginning on or after January 1, 2018.

- IFRS 15 – Revenue from Contracts with Customers. This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers, and SIC 31Revenue – Barter Transactions Involving Advertising Services.
  IFRS 15 contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine the timing and amount of revenue recognized. The new standard applies to contracts with customers. It does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other IFRSs. The new standard is effective for fiscal years ending on or after December 31, 2017 and is available for early adoption.

3. Trade Receivables

	June 30, 2014	December 31, 2013
[1]Trade receivables, net of allowances for doubtful accounts	$ 307,118	$240,719
Other receivables	11,462	6,777
	$318,580	**$247,496**

[1] Allowance for doubtful accounts as at June 30, 2014 was $641,857 (December 31, 2013 - $619,342). This allowance consists primarily of receivables from Colt Technology Services ("Colt") of $615,847 (£337,247) (December 31, 2013 - $594,466 (£337,247)). The Company has been in negotiations with Colt. This expense has been recorded in General and Administrative Expenses.

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 15.

4. Inventory

	June 30, 2014	December 31, 2013
ESM™ ECO3™	$139,370	$184,170
Other products	39,150	39,472
	$178,520	**$223,642**

For the three and six months ended June 30, 2014, total inventories of $49,715 (June 30, 2013 - $80,089) and $105,022 (June 30, 2013 - $122,058), respectively, were recognized as costs of sales.

During the period, the Company received $25,378 in inventory from a third party for no consideration. This amount has been recorded as other income in the statement of operations for the period.

5. Property and Equipment

The Company leased certain assets under finance lease agreements. As at June 30, 2014, assets under capital lease with total cost of $ 40,130 (December 31, 2013 - $75,410) and accumulated amortization of $38,399 (December 31, 2013 - $64,227) are included in property and equipment for net book value of $1,731 (December 31, 2013 - $11,183). These leases expired in April 2012 and August 2013.

Amortization expense for assets under capital lease recorded in the statement of comprehensive loss for the three months ended June 30, 2014 was $2,644 (June 30, 2013 - $4,951) and for the six months ended June 30, 2014 was $5,291 (June 30, 2013 - $12,302).

During the six months ended June 30, 2014, the Company sold property and equipment for proceeds of $14,084 (June 30, 2013 – $1,470) resulting in a gain of $10,171 (June 30, 2013 – $446).

6. Intangible Assets

Indefinite Lives

As at June 30, 2014, 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 June 30, 2014 was $Nil as an impairment was assessed for the full amount during 2011.

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, 2012	**$260,960**	**$124,100**	**$1,861,742**	**$113,651**	**$4,656,567**	**$1,053,090**	**$8,070,110**
Effect of change in foreign exchange rates	(3,978)	-	-	-	77,122	25,001	98,145
Balance at December 31, 2012	**256,982**	**124,100**	**1,861,742**	**113,651**	**4,733,689**	**1,078,091**	**8,168,255**
Effect of change in foreign exchange rates	12,366	-	-	-	303,091	96,560	412,017
Balance at December 31, 2013	**$269,348**	**$124,100**	**$1,861,742**	**$113,651**	**$5,036,780**	**$1,174,651**	**$8,580,272**
Effect of change in foreign exchange rates	720				132,570	42,249	175,539
Balance at June 30, 2014	**$270,068**	**$124,100**	**$1,861,742**	**$113,651**	**$5,169,350**	**$ 1,216,900**	**$8,755,811**

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, 2012	**$150,059**	**$68,255**	**$820,187**	**$62,510**	**$1,697,167**	**$363,957**	**$3,162,135**
Amortization	25,780	12,410	148,332	11,363	637,182	166,276	1,001,343
Impairment	83,787	-	-	-	-	-	83,787
Effect of change in foreign exchange rate	(2,644)	-	-	-	35,563	10,078	42,997
Balance at December 31, 2012	**256,982**	**80,665**	**968,519**	**73,873**	**2,369,912**	**540,311**	**4,290,262**
Amortization	-	6,205	113,288	5,685	396,996	76,494	598,668
Impairment	-	-	-	-	-	-	-
Effect of change in foreign exchange rate	12,366	-	-	-	176,445	55,584	244,395
Balance at December 31, 2013	**$269,348**	**$86,870**	**$1,081,807**	**$79,558**	**$2,943,353**	**$672,389**	**$5,133,325**
Amortization		3,102	74,200	2,842	216,375	43,471	339,990
Impairment	-	-	-	-	-	-	-
Effect of change in foreign exchange rate	720				76,259	24,096	101,075
Balance at June 30, 2014	**$270,068**	**$ 89,972**	**$ 1,156,007**	**$82,400**	**$ 3,235,987**	**$ 739,956**	**$ 5,574,390**

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)	Total
As at January 1, 2012	$110,901	$55,845	$1,041,555	$51,141	$2,959,400	$689,133	$4,907,975
Balance at December 31, 2012	$ -	$43,435	$893,223	$39,778	$2,363,777	$537,780	$3,877,993
Balance at December 31, 2013	$ -	$37,230	$779,935	$34,093	$2,093,427	$502,262	$3,446,947
Balance at June, 2014	**$ -**	**$34,128**	**$$705,735**	**$31,251**	**$1,933,363**	**$476,944**	**$3,181,421**

The Company also has the ESM brand, an indefinite life asset. As at June 30, 2014, 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 the Company still holds the distribution rights.

On December 31, 2012, the Company decided that the distribution agreement, expiring on March 6, 2013, will not be renewed under the terms set out in the existing agreement.

During the year ended December 31, 2013, management performed a review of the carrying value of these assets and an impairment loss of $Nil (2012 - $83,787) was recognized.

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 $1,835,702. As at June 30, 2014, cost of distribution agreements consisted of:

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

During the year ended December 31, 2013, management reassessed the useful life of the ESM intellectual property to be 13.5 years (2012 – 10 years), and the useful life of the worldwide distribution rights to be 13.5 to 15 years (2012 – 10 to 15 years).

No impairment was recorded in 2013 and 2012, 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 Venture 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) was due in scheduled instalments over four years with the last payment due on July 16, 2012. These instalments were 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. During the year ended December 31, 2012, all parties agreed to accrue interest on the full outstanding balance at Royal Bank of Canada prime rate plus 4% effective on January 1, 2012.

On December 10, 2013, the parties agreed to reduce the outstanding balance of $886,714 (£508,217) including interest of $145,181 (£83,217) to $339,325 (£194,500) (note 8).

During the year ended December 31, 2013, management reassessed the useful life of the distribution rights from TECC to be 9.5 years (2012 – 9 years).

d. *Intangible assets from Smartcool UK*

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

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 was 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 three and six months ended June 30, 2014, total amortization of $74,729 (June 30, 2013 - $143,877) and $149,075 (June 30, 2013 - $282,630), respectively, were recorded against the asset costs.

In 2011, management performed a review of the carrying value of these assets. As discrepancies between revenue projections and actual operating results in 2011 have 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 the year ended December 31, 2011	**$1,854,428**

During the year ended December 31, 2013, management reassessed the useful life of the intangible assets from Smartcool UK to be 12 years (2012 – 5 years).

No impairment losses were recorded in 2013 and 2012, and the impairment loss recognized in 2011 was not reversed.

7. Short-term Loan

On May 20, 2013, the Company obtained a short term loan of $125,000 from an investor. The loan had annual interest rate of 6% and matured in three months, on August 20, 2013. The loan's maturity date has been extended to December 31, 2013 and interest rate reset to 8%. The Company is the process of renegotiating certain terms related to the short-term loan.

Interest expense for the three and six months ended June 30, 2014 were $1,427 (June 30, 2013 - $833) and $3,927 (June 30, 2013 - $833), respectively. As at June 30, 2014, the outstanding balance was $65,038 (December 31, 2013 - $131,111), including accrued interest.

8. Obligations Under Acquisition Contracts

TECC Services

On July 11, 2008, the Company acquired the exclusive rights to distribute the ESMTM in the United Kingdom, Spain, Portugal, and the Middle East from T.E.C.C. 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 remaining balance of $1,204,680 (£600,000) was due in scheduled instalments over four years with the last payment due on July 16, 2012. 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 in 2009 and again in 2012 to accrue interest at Royal Bank of Canada prime rate plus 4% and to adjust timing and amount of repayments (note 6).

As at December 10, 2013, the balance of $886,714 (£508,217), including accrued interest of $145,181 (£83,217), was outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $226,798 (£130,000) and $112,527 (£64,500), are non-interest bearing, unsecured, and will be paid in annual installments over 5 years starting December 15, 2014 (note 6).

The fair values of the new obligations have been determined to be $155,182 (£88,950) and $73,317 (£42,025) based on discounting the future payments at 16%. 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.

Balance – January 1, 2012	**$717,495**
Payment	(38,525)
Accretion	33,461
Accrued interest	47,169
Foreign exchange	17,011
Balance – December 31, 2012	**$776,611**
Accrued interest	45,968
Foreign exchange	64,135
Debt reduction	(658,215)
Balance – December 10, 2013	**$228,499**
Accretion	2,154
Foreign exchange	2,372
Balance – December 31, 2013	**$233,025**
Accretion	19,330
Foreign exchange	8,363
Balance – June 30, 2014	**$260,718**
Less; Current portion	(83,677)
Balance	**$177,041**

This debt settlement resulted in a gain of $658,215 which has been recognized in the statement of operations for the year ended December 31, 2013 (2012 - $Nil).

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 6). 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. The Company was unable to make the first quarterly payment as scheduled.

As at December 10, 2013, principal balance of $1,744,600 (£1,000,000) and accrued interest of $285,274 (£163,517) were outstanding. The Company was able to negotiate a debt reduction; the existing obligation was extinguished and replaced with two new obligations. These new obligations have principal amounts of $130,845 (£75,000), which is non-interest bearing, secured, and will be paid in installments over 6 months, and $53,210 (£30,500), which is non-interest bearing, unsecured, and will be paid in installments over 5 years. Fees of $2,291,510 (£1,300,000) will be payable by the Company if it defaults on any of the repayment terms with respect to the obligation with a principal amount of £75,000. As at June 30, 2014 three installments totaling £45,000 have not been made as scheduled and the Company is the process of negotiating an extension of the term.

Their fair values have been determined to be $126,048 (£72,250) and $40,230 (£23,060), respectively, based on discounting the future payments at 10%. 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.

Balance – January 1, 2012	**$1,593,856**
Accretion	6,439
Accrued interest	118,549
Foreign exchange	40,902
Balance, December 31, 2012	**1,759,746**
Accrued interest	122,072
Foreign exchange	148,056
Balance, December 10, 2013	**2,029,874**
Debt reduction	(1,863,596)
Balance, December 10, 2013	**166,278**
Accretion	980
Foreign exchange	1,724
Balance, December 31, 2013	**168,982**
Payment	(55,148)
Accretion	6,362
Foreign Exchange	6,437
Balance, June 30, 2014	**$126,633**
Less: Current portion	(89,439)
Balance	**$37,194**

This debt settlement has resulted in a gain of $1,863,596 which has been recognized in the statement of operation for the year ended December 31, 2013 (2012 - $Nil).

TECC and Smartcool UK Modified Acquisition Obligations	TECC 1	TECC 2	UK 1	UK 2	Total
New Balance, December 10, 2013	**$155,182**	**$73,317**	**$126,048**	**$40,230**	**$394,777**
Accretion	1,463	691	743	237	3,134
Foreign exchange	1,611	761	1,307	417	4,096
Balance – December 31, 2013	**158,256**	**74,769**	**128,098**	**40,884**	**402,007**
Payment			(55,148)		(55,148)
Accretion	13,133	6,197	4,241	2,121	25,692
Foreign exchange	5,674	2,689	4,969	1,468	14,800
Balance – June 30, 2014	**$177,063**	**$83,655**	**$82,160**	**$44,473**	**$387,351**
Less: Current portion	(71,536)	(12,141)	(82,160)	(7,279)	(173,116)
Balance	**$105,527**	**$71,514**	**$-**	**$37,194**	**$214,235**

9. Vehicle Finance

In February 2014, the Company purchased a new vehicle for $17,224 (£9,495) and obtained a loan of $17,232 (£9,500) to finance the purchase. The loan has implied annual interest rate of 11%, 48-month term and monthly payment of £242.48. The loan will expire in March 2018.

Interest expense for the three and six months ended June 30, 2014 were $266 and $355, respectively. As at June 30, 2014, the carrying value of the loan was $15,931.

10. Debentures

In 2010, the Company issued 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 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 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 were allocated 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 was credited to equity, Share Purchase Warrants.

The liability component was measured at amortized cost.

The Company did not make quarterly principal payments under the terms of the debentures and in January 2013 approached all holders of these units requesting an extension of up to two years. The debenture holders have agreed to extend the debentures effectively March 1, 2013 under these terms:

1) Two additional interest payments ($300 per unit) as specified by the original terms will be added to outstanding principal balance.
2) Interest of 12% on outstanding principal amount will be paid quarterly commencing June 1, 2013.

With respect to the debentures maturing on March 1, 2014 (46 units), the new principal balance will be repaid in equal quarterly installments in an amount equal to 25% of the principal amount outstanding as at March 1, 2013. These quarterly principal payments will commence on June 1, 2013. With respect to the debentures maturing on March 1, 2015 (71 units), 50% of the new principal balance outstanding as at March 1, 2013 will be repaid in equal quarterly instalments commencing on March 1, 2014 and the remaining 50% will be repaid in one lump sum on March 1, 2015. 3,000 share purchase warrants will be issued for each unit. These warrants have an exercise price of $0.15 and expire on March 1, 2015.

The Company has received approval from the TSX Venture exchange. The debentures' maturity dates were extended and 351,000 new warrants were issued under the above terms.

Debentures Principal Amount	
Outstanding principal balance, December 31, 2012	$ 308,490
Add: Additional interest payments	$ 36,600
New outstanding principal balance, March 1, 2013	**$ 345,090**

Debentures Carrying Amount	
Balance at January 1, 2012	**$497,008**
Accrued interest	53,467
Principal payments	(128,755)
Interest payments	(73,200)
Balance at December 31, 2012	**$348,520**
Accrued interest, January 1 to February 28, 2013	13,364
Interest payments, January 1 to February 28, 2013	(24,400)
Balance at March 1, 2013 before extension	**$337,484**
Loss on debt extinguishment	$7,606
Balance at March 1, 2013 before measurement of warrants	**$345,090**

The terms of the debenture extension were significantly different from the original terms which resulted in a loss on debt extinguishment of $7,606, which has been recorded in the statement of operations for the year ended December 31, 2013.

The new principal amount has been split between financial liability component and equity component using the residual method. The fair values of debentures and share purchase warrants are as follows:

New principal amount, March 1, 2013	$ 345,090
Liability component, March 1, 2013	$292,397
Equity component	$52,693

The equity component of $52,693 has been credited to reserve for equity settled share based transactions (note 11(c)).

The liability component is measured at amortized cost.

Maturity date	March 1, 2014	March 1, 2015	Total
Balance at March 1, 2013	$77,768	$214,629	$292,397
Accrued interest	12,014	45,172	57,186
Interest payments	(5,668)	(22,722)	(28,390)
Principal payments	(52,129)	(19,981)	(72,110)
Balance at December 31, 2013	**$31,985**	**$ 217,098**	**$ 249,083**
Accrued interest	1,343	25,684	27,027
Interest payments	(1,133)	(7,222)	(8,355)
Principal payments	(32,195)	-	(32,195)
Balance at June 30, 2014	**$ -**	**$ 235,560**	**$235,560**
Less: Current portion	-	(235,560)	(235,560)
Balance	**$ -**	$ -	$ -

During the three and six months ended June 30, 2014, total interest expenses were $12,534 (June 30, 2013 - $13,698) and $27,027 (June 30, 2013 - $38,102). Interest payments totaling $8,356 were made during the six months ended June 30, 2014 (June 30, 2013 - $35,176) and principal payments totaling $32,195 (June 30, 2013 - $41,062) were paid during the period.
Interest payments totaling $7,223 due on June 1, 2014 were not made as scheduled. The Company is in the process of renegotiating the terms of two principal payments totaling $60,192 scheduled for March 1 and June 1, 2014.

As at June 30, 2014, the outstanding principal balance was $240,785 (December 31, 2013 - $272,980) and the carrying amount of these debentures was $235,560 (December 31, 2013 - $249,083).

11. 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, 2012	**61,608,726**	**$29,465,469**
Issued for cash via private placements (i)	2,678,571	375,000
Share issuance costs	-	(5,077)
Balance, December 31, 2012	**64,287,297**	**$29,835,392**
Issued for cash via private placements (ii)(iii)	15,000,000	500,000
Share issuance costs	-	(26,317)
Balance, December 31, 2013	**79,287,297**	**$30,309,075**
Issued for cash via private placements (iv)	9,730,000	430,600
Share issuance costs	-	(6,262)
Balance, June 30, 2014	**89,017,297**	**$30,733,413**

i. On January 20, 2012 the Company 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. Cash issuance costs of $5,077 were allocated to common shares.

ii. On June 7, 2013, the Company completed a non-brokered private placement consisting of 10,000,000 common shares at a price of $0.025 per share for aggregate gross proceeds of $250,000. Cash issuance costs of $15,911 were allocated to common shares.

iii. On September 30, 2013, the Company completed a non-brokered private placement consisting of 5,000,000 common shares at a price of $0.05 per share for aggregate gross proceeds of $250,000. Cash issuance costs of $10,406 were allocated to common shares.

iv. On April 25, 2014, the Company issued 9,730,000 Units at $0.05 per unit pursuant to a non-brokered private placement for gross proceeds of $486,500. Each Unit consists of one common share and one-half warrant. Cash issuance costs of $6,262 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 June 30, 2014, 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 average exercise price
Balance, January 1, 2012	5,610,000	$0.31
Granted	805,000	0.20
Cancelled	(192,500)	0.38
Forfeited	(1,057,500)	0.31
Expired or exercised	(1,265,000)	0.33
Balance, December 31, 2012	3,900,000	0.28*
Granted	2,880,000	0.05
Forfeited	(120,000)	0.53
Expired or exercised	(225,000)	0.23
Balance, December 31, 2013	**6,435,000**	**$0.08**
Granted	1,200,000	0.05
Cancelled	(410,000)	0.10
Balance, June 30, 2014	**7,225,000**	**$0.07**

* 0.13 after repricing

As at June 30, 2014, 7,225,000 (December 31, 2013 – 6,435,000) options were outstanding. These options have vesting periods of up to 5 years and weighted average exercise price of $0.07 (December 31, 2013 - $0.08). During the six months ended June 30, 2014, no options were granted (December 31, 2013 – 2,730,000, weighted average fair value $0.035) to officers and employees and 1,200,000 options with weighted average fair value of $0.035 (December 31, 2013 – 150,000, weighted fair value $0.035) to consultants. The options granted in the period had an exercise price ($0.05) lower than the stock price ($0.06) at the date of the grant.

Share-based payments for the three months ended June 30, 2014 was $26,486 (June 30, 2013 - $35,408) of which $16,391 (June 30, 2013 – $31,849) was related to employees and $10,095 (June 30, 2013 - $3,559) was related to consultants. Share-based payments for the six months ended June 30, 2014 was $67,592 (June 30, 2013 - $42,575) of which $36,762 (June 30, 2013 – $37,710) was related to employees and $30,830 (June 30, 2013 - $4,865) was related to consultants.

c. *Share purchase warrants*

On April 25, 2014 the Company issued 9,730,000 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 $0.10 until April 25, 2015. These warrants are not transferable. A total value of $55,900 was attributed to the warrants. Cash issuance costs of $814 were allocated to these warrants.

As at June 30, 2014, there were 5,466,000 (December 31, 2013 – 851,000) outstanding warrants with weighted average share price of $0.11 (December 31, 2013 - $0.24).

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

	Number	Amount
Balance, January 1, 2012	**9,742,532**	**$955,710**
Expired	(626,667)	(47,000)
Balance, December 31, 2012	**9,115,865**	**$908,710**
Granted (note 13)	351,000	52,693
Expired	(8,615,865)	(834,635)
Balance, December 31,	**851,000**	**$126,768**
Granted	4,865,000	55,086
Expired	(250,000)	(59,000)
Balance, June 30, 2014	**5,466,000**	**$122,854**

Share purchase warrants outstanding as at June 30, 2014 were as follows:

	Number of warrants	Weighted average share price
Balance, January 1, 2012	**9,742,532**	**$0.42**
Expired, exercised or cancelled	(626,667)	0.30
Balance, December 31, 2012	**9,115,865**	**$0.43**
Granted (note 13)	351,000	0.15
Expired, exercised or cancelled	(8,615,865)	0.44
Balance, December 31, 2013	**851,000**	**$0.24**
Granted	4,865,000	0.10
Expired, exercised or cancelled	(250,000)	0.30
Balance, June 30, 2014	**5,466,000**	**$0.11**

Expiry date	Number of shares	Exercise price	Weighted average contractual life (years)
August 28, 2014 (note 8)	250,000	0.30	0.16
March 1, 2015 (note 10)	351,000	0.15	0.67
April 25, 2015	4,865,000	0.10	0.82
Total issued and outstanding, June 30, 2014	**5,466,000**	**$0.11**	**0.78**

12. 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 six months ended June 30, 2014, these liabilities were reduced by $21,428 (December 31, 2013 - $31,523) upon the recognition of amortization and impairment costs of these assets.

As at June 30, 2014, deferred tax liability was $424,326.

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**
Amortization of intangible assets	(147,570)
Effect of foreign exchange rate	11,737
Deferred income tax liabilities, December 31, 2012	**477,277**
Amortization of intangible assets	(67,890)
Effect of foreign exchange rate	36,367
Deferred income tax liabilities, December 31, 2013	**$445,754**
Amortization of intangible assets	(38,760)
Effect of foreign exchange rate	17,332
Deferred income tax liabilities, June 30, 2014	**$424,326**

13. Segmented Information

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

	Three months ended June 30 2014		**Three months ended June 30 2013**	
	Amount	**%**	**Amount**	**%**
Europe, Middle East, Africa	$ 7,193	4	$114,488	23
Australia	128,530	64	252,324	52
Americas	63,822	32	124,441	25
Total revenue	**$ 199,545**	**100**	**$491,253**	**100**

	Six months ended June 30 2014		**Six months ended June 30 2013**	
	Amount	**%**	**Amount**	**%**
Europe, Middle East, Africa	$ 286,849	41	$ 185,325	29
Australia	259,397	38	252,324	40
Americas	147,493	21	197,206	31
Total revenue	**$ 693,739**	**100**	**$634,855**	**100**

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

14. 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 services
Windstone Financial Corp.	Consulting services
Richards Buell Sutton LLP	Legal services
Accupro	Trademark services

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.

	Three months ended June 30		Six months ended June 30	
	2014	2013	2014	2013
Consulting fees	$10,500	$8,807	$21,000	$29,568
Legal fees	4,019	2,970	4,743	3,939
	$14,519	**$11,777**	**$25,743**	**$33,507**

Due to/from Related Parties

As at June 30, 2014, included in payables is $269,670 (December 31, 2013 - $219,381) due to related parties. Included in trade and other receivables is $5,000 (December 31, 2013 - $5,000) due from the Chief Executive Officer related to an advance for travel expenses.
These amounts are unsecured, non-interest bearing and have no fixed terms of repayment.

	June 30, 2014	December 31, 2013
Chief Executive Officer	62,349	29,470
Chief Financial Officer	41,880	22,014
Director of the Company	2,072	2,072
Executive VP	20,087	19,390
VP of Operations	49,482	21,152
Other related parties	93,800	125,283
Total	**$269,670**	**$219,381**

15. Financial Instruments

Financial Instruments

The Company has classified its financial instruments as follows:

	June 30, 2014	December 31, 2013
Financial assets		
FVTPL , measured at fair value:		
Cash and cash equivalents	$ 38,382	$28,036
Loans and accounts receivable, recorded at amortized		
Trade and other receivables	312,118	245,719
	$ 350,500	**$273,755**
Other financial liabilities, recorded at amortized cost		
Trade payables	$678,800	$594,685
Short-term loan	65,038	131,111
Acquisition obligations, vehicle finance and debentures	638,842	651,090
	$ 1,382,680	**$1,376,886**

Interest income from FVTPL and interest expense from short-term loan, 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, trade and other receivables, obligations under acquisition contract, finance leases, debentures and trade payables 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 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 receivables the Company subjects all major customer accounts to its credit evaluation process.

The Company has $307,118 (December 31, 2013 - $240,719) 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	$ 678,800	$678,800	$-
Premises leases	159,066	115,240	43,826
Short-term loan	65,038	65,038	-
Vehicle loan	10,628	5,314	5,314
Debentures	240,785	240,785	-
Obligations under acquisition contracts	294,003	211,828	82,175
Total	**$ 1,448,320**	**$ 1,317,005**	**131,315**

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, Canadian 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 June 30, 2014, the Company's monetary assets and liabilities denominated in foreign currencies are as follows:

	USD	AUD	GBP	Euro
Assets				
Cash and cash equivalents	$19,239	$-	£-	€12
Trade and other receivables	286,461	-	-	3,339
Total	**$305,700**	**$-**	**£-**	**€3,351**
Liabilities				
Trade payables	$61,166	$7,906	£28,500	€13,818
Acquisition obligations, current	-	-	6,648	-
Total	**$61,166**	**$7,906**	**£35,148**	**€13,818**

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	($30,570)	$-	£-	(€335)
Monetary liabilities	6,117	791	3,515	1,382
Net gain (loss)	**($24,453)**	**$791**	**£3,515**	**€1,047**

Gain (loss) on $0.10 decrease in CAD	USD	AUD	GBP	Euro
Monetary assets	$30,570	$-	£-	€335
Monetary liabilities	(6,117)	(791)	(3,515)	(1,382)
Net gain (loss)	**$24,453**	**($791)**	**(£3,515)**	**(€1,047)**

e. *Interest rate risk*

The Company is not exposed to this risk. TECC and Smartcool acquisition obligations have been modified and are no longer bearing interest based on Royal Bank of Canada prime rate.

16. General and Administrative Expenses

	Three months ended June 30 2014	Three months ended June 30 2013	Change	%
Advertising and promotion	$7,292	$2,731	$4,561	167%
Bad debts	$0	$4,371	($4,371)	(100%)
Consulting	$95,597	$57,153	$38,444	67%
Filing and transfer fees	$3,891	$6,599	($2,708)	(41%)
Insurance	$7,145	$14,665	($7,520)	(51%)
Interest	$3	$1,210	($1,207)	(100%)
Investor relations	$13,473	$98	$13,375	13648%
Product certification	$2,617	$1,202	$1,415	118%
Professional fees	$7,311	$16,274	($8,963)	(55%)
Office and supplies	$19,113	$27,403	($8,290)	(30%)
Rent	$49,418	$59,679	($10,261)	(17%)
Salaries and benefits	$260,387	$321,839	($61,452)	(19%)
Telephone	$9,961	$6,863	$3,098	45%
Travelling	$27,679	$33,361	($5,682)	(17%)
Total selling, general & admin expenses	**503,888**	**553,448**	**(49,560)**	**(9%)**
Share-based compensation	26,486	35,408	(8,922)	(25%)
Research & Development	0	-	0	(0%)
Amortization & depreciation	182,497	261,706	(79,209)	(30%)
Total operating expenses	**$712,871**	**$850,562**	**($137,691)**	(16%)

	Six months ended June 30 2014	Six months ended June 30 2013	Change	%
Advertising and promotion	$17,608	$9,344	8,264	88%
Bad debts	0	4,371	(4,371)	(100%)
Consulting	167,591	115,974	51,617	45%
Filing and transfer fees	10,298	16,221	(5,923)	(37%)
Insurance	16,156	25,958	(9,802)	(38%)
Interest	22	1,210	(1,188)	(98%)
Investor relations	15,393	1,465	13,928	951%
Product certification	2,617	2,385	232	10%
Professional fees	28,214	17,360	10,854	63%
Office and supplies	39,869	56,736	(16,867)	(30%)
Rent	102,057	122,020	(19,963)	(16%)
Salaries and benefits	543,696	712,103	(168,407)	(24%)
Telephone	20,603	20,010	593	3%
Travelling	65,404	78,395	(12,991)	(17%)
Total selling, general & admin expenses	1,029,530	1,183,552	(154,022)	(13%)
Share-based compensation	67,592	42,575	25,017	59%
Research & Development	7,227	21,376	(14,149)	(66%)
Amortization & depreciation	366,487	521,161	(154,674)	(30%)
Total operating expenses	**$1,470,836**	**$1,768,664**	**($297,828)**	**(17%)**

17. 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 June 30, 2014, the principal amount of debenture component was $240,785 (December 31, 2013 - $272,980) and shareholders' equity was $1,931,500 (December 31, 2013 - $2,125,233). The decrease in debentures was attributable to principal payments made during the period and the decrease in shareholders' equity was attributable to operating loss, partially offset by capital obtained through a private placement in April 2014.

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.

To ensure that the Company continues to be a going concern with adequate working capital in the next 12 months steps have been taken to monitor expenses and secure more predictable revenue generation. Additional capital acquisition is also being considered.

The Company is not subject to any external capital restrictions.

18. Supplemental Cash Flow Information

	June 30, 2014	June 30, 2013
Interest paid in cash	$8,356	$38,496
Interest income received in cash	-	-
Inventory received from third party for no consideration	$25,378	-