YANGAROO Inc.

Audited Financial Statements

For the Years Ended December 31, 2012 and 2011

(Expressed in Canadian Dollars)

Collins Barrow
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INDEPENDENT AUDITORS' REPORT

To the Shareholders of YANGAROO Inc.

We have audited the accompanying financial statements of YANGAROO Inc. which comprise the statements of financial position as at December 31, 2012 and December 31, 2011 and the statements of comprehensive loss, changes in equity and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of YANGAROO Inc. as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2(c) in the financial statements which indicates that the Company has material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern.

Collins Barrow Toronto LLP

Licensed Public Accountants
Chartered Accountants
April 30, 2013
Toronto, Ontario

YANGAROO Inc.

Statements of Financial Position
As at
(Expressed in Canadian dollars)

	December 31 2012	December 31 2011
Assets		
Current		
Cash and cash equivalents	**$ 493,427**	$ 316,717
Accounts receivable	**562,470**	280,469
Prepaid and sundry assets	**149,957**	230,270
	1,205,854	827,456
Property and equipment (note 4)	**131,651**	123,352
	$ 1,337,505	$ 950,808
Liabilities		
Current		
Trade and other payables (note 6)	**$ 595,637**	$ 642,664
Accrued interest on debentures (note 7)	**-**	423,479
Deferred revenue	**13,095**	16,267
Debentures (note 7)	**-**	4,108,380
Finance lease obligation (note 4)	**17,355**	6,245
	626,087	5,197,035
Finance lease obligation (note 4)	**27,509**	13,651
Accrued interest on debentures (note 7)	**191,600**	-
Debentures (note 7)	**5,451,733**	-
	6,296,929	5,210,686
Shareholders' Deficiency		
Share capital (note 8)	**23,828,456**	23,285,199
Warrant capital (note 11)	**1,060,551**	873,455
Contributed surplus	**2,531,803**	1,726,650
Deficit	**(32,380,234)**	(30,145,182)
	(4,959,424)	(4,259,878)
	$ 1,337,505	$ 950,808

Going concern (note 2(c))
Commitments and contingencies (note 13)

Approved by the Board **“Cliff Hunt”** Director **“Howard Atkinson”** Director

See accompanying notes, which are an integral part of these financial statements

YANGAROO Inc.

Statements of Comprehensive Loss
For the years ended December 31
(Expressed in Canadian dollars)

	2012	2011
Revenue	**$ 2,690,214**	$ 1,449,891
Expenses		
Salaries and consulting (note 10)	**2,532,430**	2,767,611
Marketing and promotion	**213,445**	137,061
General and administrative	**829,314**	695,962
Technology development	**14,275**	(29,573)
Settlement of lawsuit (note 13(c))	**-**	600,000
Depreciation of property and equipment	**69,465**	82,213
	3,658,929	4,253,274
Loss from operations	**(968,715)**	(2,803,383)
Finance income (expenses)		
Interest income	**1,766**	4,201
Interest expense	**(1,268,103)**	(1,017,889)
Loss on extinguishment of debt	**-**	(796,224)
	(1,266,337)	(1,809,912)
Net loss and comprehensive loss	**$ (2,235,052)**	$ (4,613,295)

Loss per share (note 12)	**$ (0.02)**	$ (0.04)

See accompanying notes, which are an integral part of these financial statements

YANGAROO Inc.

Statements of Changes in Equity
For the years ended December 31
(Expressed in Canadian dollars)

	Share capital	Warrants	Contributed surplus	Equity portion of convertible debentures	Deficit	Total
Balance at January 1, 2011	$22,338,694	$ 761,298	$ 1,541,896	$ 29,890	$(25,531,887)	$ (860,109)
Issuance of common shares	946,505	-	-	-	-	946,505
Issuance of warrants	-	112,157	-	-	-	112,157
Share-based payments	-	-	141,072	-	-	141,072
Equity portion of convertible debenture	-	-	-	69,693	-	69,693
Debt extinguishment	-	-	43,682	(99,583)	-	(55,901)
Loss for the period	-	-	-	-	(4,613,295)	(4,613,295)
Balance at December 31, 2011	**23,285,199**	**873,455**	**1,726,650**	**-**	**(30,145,182)**	**(4,259,878)**
Private placement (notes 8&9)	543,257	741,449	-	-	-	1,284,706
Issuance of warrants in connection with amendment of debentures (note 7)	-	154,437	-	-	-	154,437
Expiry of warrants (note 11)	-	(708,790)	708,790	-	-	-
Share-based payments (note 10)	-	-	96,363	-	-	96,363
Loss for the period	-	-	-	-	(2,235,052)	(2,235,052)
Balance at December 31, 2012	**$23,828,456**	**$1,060,551**	**$2,531,803**	**$ -**	**$(32,380,234)**	**$(4,959,424)**

See accompanying notes, which are an integral part of these financial statements

YANGAROO Inc.

Statements of Cash Flows
For the years ended December 31
(Expressed in Canadian dollars)

	2012	2011
Cash flow from operating activities		
Cash flow used in operating activities:		
Net loss for the period	**$(2,235,052)**	$(4,613,295)
Items not affecting cash:		
Depreciation of property and equipment	**69,465**	82,213
Bad debt expense	**8,032**	5,916
Share-based payments	**96,363**	141,072
Gain on disposal of property and equipment	**-**	(225)
Accretion interest	**387,010**	549,034
Accrued interest on debentures	**191,600**	423,479
Loss of extinguishment of debt	**-**	796,224
Debentures issued for settlement of accrued interest	**687,301**	44,911
Changes in non-cash operating working capital:		
Accounts receivable	**(290,033)**	(123,633)
Prepaid and sundry assets	**80,313**	(53,873)
Trade and other payables	**(47,027)**	(190,745)
Deferred revenue	**(3,172)**	(17,305)
Net cash used in operating activities	**(1,055,200)**	(2,956,227)
Cash flow from investing activities		
Acquisition of property and equipment	**(46,204)**	(44,804)
Proceeds from disposal of property and equipment	**-**	650
Net cash used in investing activities	**(46,204)**	(44,154)
Cash flow from financing activities		
Proceeds from issuance of common shares, net of issuance costs	**1,284,706**	-
Proceeds from issuance of debentures, net of issuance costs	**-**	3,135,462
Operating loan	**-**	(20,000)
Payment of finance lease obligation	**(6,592)**	(968)
Net cash received from financing activities	**1,278,114**	3,114,494
Net increase / (decrease) in cash and cash equivalents	**176,710**	114,113
Cash and cash equivalents at January 1	**316,717**	202,604
Cash and cash equivalents at December 31	**$493,427**	$316,717

Cash interest paid	**$3,045**	$1,353
Capital lease additions	**$31,560**	$20,864

See accompanying notes, which are an integral part of these financial statements

1. Nature of Operations

YANGAROO Inc. ("Company") is a technology company that is the provider of user friendly and secure business to business distribution of media via the Internet. The Company's patented Digital Media Distribution System (DMDS) is a secure B2B digital delivery solution for the music and advertising industries. DMDS is a Web based delivery system that pioneers secure digital file distribution by incorporating biometrics, high value encryption and watermarking. DMDS replaces the physical distribution of audio and video content for music, music videos, and advertising to television, radio, media, retailers, award shows and other authorized recipients with more accountable, effective, and far less costly digital delivery of broadcast quality media via the Internet.

YANGAROO Inc. is a publicly listed company incorporated on July 28, 1999 under the laws of Ontario as Musicrypt.com Inc. and changed to its present name on July 17, 2007. YANGAROO trades on the TSX Venture Exchange (TSX-V) under the symbol YOO and in the U.S. under TCBB: YOOIF.

The address of the Company’s corporate office and principal place of business is 18 Mowat Avenue, Toronto, Ontario M6K 3E8.

2. Basis of Preparation

(a) Basis of compliance

These audited financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The financial statements were authorized for issue by the Board of Directors on April 18, 2013.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis except certain financial instruments recorded at fair value through profit and loss. Where there are assets and liabilities calculated on a different basis, this fact is disclosed in the relevant accounting policy.

The financial statements are presented in Canadian dollars, which is also the Company’s functional currency.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company’s accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in the following notes:

2. Basis of Preparation (continued)

(b) Basis of measurement (continued)

(i) Share-based payments

Share-based payments which include stock options granted to employees, officers and directors and warrants to the extent that they are not measured at the fair value of the services received are based on the fair value at the date of the award. These share-based payments are valued using Black-Scholes option pricing model. The assumptions used on the inputs to the model are provided in note 10.

(ii) Impairment of intangible assets

The Company assesses the carrying value of long-lived assets each reporting period to determine whether any indication of impairment exists. The calculation of recoverable amount requires the use of estimates and assumptions such as discount rates and operational performance of the Company.

(iii) Fair value of financial instruments

The Company estimated the fair value of the debentures using an estimated market interest rate derived from comparable companies.

(c) Going concern

The Company will have to raise additional capital to fund operations until such point that revenues from their technology are able to fund operations. If the Company is not able to raise sufficient capital then there is the risk that the Company will not be able to realize the value of its assets and discharge its liabilities.

At December 31, 2012, the Company had working capital of $579,767 and deficit of $32,380,234. To date, the Company has been successful raising capital. Refer to note 7 and note 9.

3. Significant Accounting Policies

The accounting policies set below have been applied consistently to all years presented in these financial statements.

(a) Cash and cash equivalents

Cash and cash equivalents includes demand deposits with financial institutions and other short term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and subject to an insignificant risk of change in value.

3. Significant Accounting Policies (continued)

(b) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise of accounts receivable, cash and cash equivalents, trade and other payables, accrued interest on debentures, and finance lease obligation. Non-derivatives financial instruments are recognised initially at the fair value plus, for instruments not at fair value through profit and loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

(ii) Financial instruments at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. The Company has designated cash and cash equivalents as fair value through profit and loss.

(iii) Other

Other non-derivative financial instruments, such as accounts receivable, trade and other payables, accrued interest on debentures, convertible debentures, debentures, operating line of credit and finance lease obligation are measured at amortized cost using the effective interest method, less any impairment losses

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Financial assets and liabilities:

In establishing fair value, the Company uses a fair value hierarchy based on the levels as defined below:

- Level 1 fair value measurements are based on unadjusted quoted market prices.
- Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.
- Level 3 fair value measurements are those with inputs for the asset or liability that are not based on observable market data.

Cash and cash equivalents are classified as Level 1 in the fair value hierarchy.

3. Significant Accounting Policies (continued)

(c) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditure that is directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment, and are recognized net within general and administrative expenses in the statement of comprehensive loss.

(ii) Subsequent costs

The cost of replacing a part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in the statement of comprehensive loss as incurred.

(iii) Depreciation

Depreciation is calculated as the cost of the asset less its residual value.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets.

The estimated useful lives for the current and comparative periods are as follows:

- Office furniture and equipment - 5 years
- Computer equipment - 3 years
- Computer software - 3 years
- Leasehold improvements - over the term of the lease
- Website and other technology - 3 years

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

3. Significant Accounting Policies (continued)

(d) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the statement of comprehensive loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the statement of comprehensive loss.

(ii) Non-financial assets

Impairment tests on intangible assets with indefinite useful economic lives are undertaken annually at the financial year-end. Other non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of its value in use and fair value less costs to sell, the asset is written down to its recoverable amount.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets. The Company has one cash-generating unit for which impairment testing is performed.

An impairment loss in respect of other assets is assessed at each reporting date for any indications that the loss has decreased or no longer exists. 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

3. Significant Accounting Policies (continued)

(d) Impairment (continued)

(ii) Non-financial assets (continued)

exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(e) Research and development

Research costs are charged to income when incurred. Development costs are expensed in the year incurred unless they meet the criteria under International Financial Reporting Standards (“IFRS”) for deferral and amortization. Amortization commences with the successful commercial production or use of the product or process.

Investment Tax Credits ("ITCs") earned as a result of incurring Scientific Research and Experimental Development ("SRED") expenditures are recorded as a reduction of the related current period expense, the related deferred development costs or related capital assets. Management records ITC's when there is reasonable assurance of collection. In the year ended December 31, 2012, management recorded a reduction of technology development expense of $96,635 relating to ITC's of which $60,000 was accrued for fiscal 2012 and was included in prepaid and sundry assets and $36,635 was an adjustment for 2010 and 2011 ITC’s received in the last quarter of fiscal 2012. Included in prepaid and sundry assets as at December 31, 2011, management had recorded $135,000 relating to ITC's which has been recorded as a reduction to technology development expense in fiscal 2011.

(f) Leases

Leases in which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized in finance expenses in the statement of comprehensive loss.

Operating lease payments are recognized as an operating expense in the income statement on a straight-line basis over the lease term.

3. Significant Accounting Policies (continued)

(g) Convertible debentures

The Company accounts for its convertible debentures in accordance with the substance of the contractual arrangement on initial recognition. Therefore, as a result of the conversion feature of the debentures, the Company's convertible instruments have been segregated between debt and equity based on the fair value of the debt components. The difference between the estimated fair value of the debt at issuance and the face amount is reflected as "Equity portion of convertible debentures" in shareholders' equity and as a discount in that amount to the liability portion of the debenture. This discount is being accreted to the principal face amount as additional interest expense over the term of the liability using the effective interest rate method.

(h) Share capital – common shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects. When the Company issues equity units, the proceeds are allocated among equity components using the residual method in which the proceeds are allocated first, based on the fair value of the warrants and the remainder allocated to the shares.

(i) Warrants

For transactions involving the issuance of warrants, the Company measures these transactions at the fair value of the goods or services received, unless the fair value cannot be estimated reliably. In cases where the fair value cannot be estimated reliably, the Company measures these transactions by reference to the fair value of the equity instruments granted.

(j) Share-based payments

The grant date fair value of options awarded to employees, directors, and service providers who perform employee-like services is measured using the Black-Scholes option pricing model and recognised in the statement of comprehensive loss, with corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest. Upon exercise of the option, consideration received, together with the amount previously recognised in contributed surplus, is recorded as an increase to share capital.

3. Significant Accounting Policies (continued)

(k) Revenue

(i) Audio/video delivery

Revenue is recorded when persuasive evidence of an agreement exists, usually in the form of an executed sales agreement, the significant risks and rewards of ownership have been transferred to the buyer, price is fixed and determinable, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, the distribution of the media has occurred and collectability is reasonably assured and the amount of revenue can be measured reliably. If it is probable that discounts will be granted and the amount can be measured reliably, then the discount is recognized as a reduction of revenue as the sales are recognized.

(ii) Awards management

The Company recognizes revenue related to awards management projects based on the percentage of completion of certain milestones during the project. These milestones are mutually set by the Company and its customers. Due to percentage of completion of certain milestones, there could be differences between the timing of billings and the amount of work completed at a point in time. Work performed on contracts where the contract milestones have not been met are recognized as work in process or unbilled revenue. Billings which exceed the amount of work performed at a point in time are recognized as deferred revenue. Deferred revenue consists of customer advances for Company services to be rendered that will be recognized as income in future periods.

(l) Finance income and expenses

Finance expenses comprise interest expense on borrowings, changes in the fair value of financial assets at fair value through profit or loss and impairment losses recognized on financial assets.

Interest income is recognised as it accrues in profit or loss, using the effective interest method.

(m) Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net income except for items recognized directly in equity or in other comprehensive loss.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

3. Significant Accounting Policies (continued)

(m) Income taxes (continued)

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in statutory tax rates is recognized in net earnings in the year of change.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. At the end of each reporting year the Company reassesses unrecognized deferred tax assets. The Company recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

(n) Loss per share

Basic loss per share is computed by dividing the net income or loss applicable to common shares of the Company by the weighted average number of common shares outstanding for the period.

Diluted loss per share is computed by dividing the net income or loss applicable to common shares by the sum of the weighted average number of common shares issued and outstanding and all additional common shares that would have been outstanding, if potentially dilutive instruments were converted. When there is a loss, no potential shares are included in the computation as they are anti-dilutive.

(o) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(p) Contingent liability

A contingent liability is a possible obligation that arises from past events and of which the existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company; or a present obligation that arises from past events (and therefore exists), but is not recognized because it is not probable that a transfer or use of assets, provision of services or any other transfer of economic benefits will be required to settle the obligation, or the amount of the obligation cannot be estimated reliably.

3. Significant Accounting Policies (continued)

(q) Statement of cash flows

The Company prepares its Statement of Cash Flows using the indirect method. The Company classifies interest received and paid as part of operating activities in the statement of cash flows.

(r) Foreign currency

Transactions in foreign currencies are translated to the functional currency of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognized in the statement of income.

(s) New standards and interpretations not yet adopted

The following accounting standards, amendments and interpretations have been issued but are not yet effective for the Company. Management is currently assessing the impact of the new standards on the Company's accounting policies and financial statement presentation.

- IFRS 7 *Financial Instruments: Disclosure* was amended by the IASB in December 2011 to provide additional information about offsetting of financial assets and financial liabilities. Additional disclosures will be required to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. The amendments are effective for annual periods beginning on or after January 1, 2013.

- IFRS 9 *Financial Instruments* was issued by the IASB in October 2010 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015.

- IFRS 10 *Consolidated Financial Statements* was issued by the IASB in May 2011. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 replaces the consolidation requirements in SIC-12 *Consolidation—Special Purpose Entities* and IAS 27 *Consolidated and Separate Financial Statements* and is effective for annual periods beginning on or after January 1, 2013.

3. Significant Accounting Policies (continued)

(s) New standards and interpretations not yet adopted (continued)

- IFRS 11 *Joint Arrangements* was issued by the IASB in May 2011. IFRS 11 provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*, and is effective for annual periods beginning on or after January 1, 2013.

- IFRS 12 *Disclosure of Interests in Other Entities* was issued by the IASB in May 2011. IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013.

- IFRS 13 *Fair Value Measurement* was issued by the IASB in May 2011. IFRS 13 establishes new guidance on fair value measurement and disclosure requirements for IFRSs and US generally accepted accounting principles (GAAP). The guidance, set out in IFRS 13 and an update to Topic 820 in the FASB's Accounting Standards Codification (formerly referred to as SFAS 157), completes a major project of the boards' joint work to improve IFRSs and US GAAP and to bring about their convergence. The standard is effective for annual periods beginning on or after January 1, 2013.

- IAS 1 *Presentation of Financial Statements* was amended by the IASB in June 2011 in order to align the presentation of items in other comprehensive income with US GAAP standards. Items in other comprehensive income will be required to be presented in two categories: items that will be reclassified into profit or loss and those that will not be reclassified. The flexibility to present a statement of comprehensive income as one statement or two separate statements of profit and loss and other comprehensive income remains unchanged. The amendments to IAS 1 are effective for annual periods beginning on or after July 1, 2012.

(Expressed in Canadian dollars)

4. Property and Equipment

	Office furniture and equipment	Computer equipment	Computer software	Leasehold improvements	Website and other technology	Total
Carrying amount - end of year - December 31, 2010	$ 11,921	$ 58,720	$ 60,036	$ 4,947	$ 4,698	**$ 140,322**
Additions	7,540	49,229	8,899	-	-	**65,668**
Disposals	(425)	-	-	-	-	**(425)**
Depreciation expense	(4,542)	(40,109)	(31,901)	(2,827)	(2,834)	**(82,213)**
Carrying amount - end of year - December 31, 2011	$ 14,494	$ 67,840	$ 37,034	$ 2,120	$ 1,864	**$ 123,352**
Additions	1,407	45,581	30,776	-	-	**77,764**
Depreciation expense	(4,372)	(36,049)	(25,859)	(2,120)	(1,065)	**69,465**
Carrying amount - end of year - December 31, 2012	**$ 11,529**	**$ 77,372**	**$ 41,951**	**$ -**	**$ 799**	**$ 131,651**

December 31, 2012	**Cost**	**Accumulated Amortization**	**Net**
Office furniture and equipment	**$ 44,611**	**$ 33,082**	**$ 11,529**
Computer equipment	**496,135**	**418,763**	**77,372**
Computer software	**143,558**	**101,607**	**41,951**
Leasehold improvements	**14,791**	**14,791**	**-**
Website and other technology	**18,176**	**17,377**	**799**
	$ 717,271	**$ 585,620**	**$ 131,651**

December 31, 2011	Cost	Accumulated Amortization	Net
Office furniture and equipment	$ 43,204	$ 28,710	$ 14,494
Computer equipment	450,554	382,714	67,840
Computer software	112,782	75,748	37,034
Leasehold improvements	14,791	12,671	2,120
Website and other technology	18,176	16,312	1,864
	$ 639,507	$ 516,155	$ 123,352

(Expressed in Canadian dollars)

4. Property and Equipment (continued)

Obligation under finance lease

The Company has assumed finance lease obligations until 2015. The monthly lease payments consist of principal repayment and interest and the weighted average imputed interest rate is 6.3%. The minimum payments under the finance lease are as follows:

2013	$	19,249
2014		17,856
2015		10,518
		47,623
Less: imputed interest		(2,759)
		44,864
Less: current portion		(17,355)
Long term portion	**$**	**27,509**

Included in property and equipment are items under finance leases with a cost of $52,424 (2011 -$20,864). Accumulated depreciation for items under finance lease is $10,069 (2011-$1,739).

5. Operating Line of Credit

The Company has available an operating line of credit of $20,000. Borrowings under the operating line of credit are due on demand and bear interest at prime plus 2.5% per annum and are secured by a general security agreement. For the year ended December 31, 2012, the Company had a balance outstanding of $Nil (December 31, 2011 - $Nil) on this line of credit.

6. Trade and Other Payables

		December 31 2012		December 31 2011
Trade payables	**$**	**292,275**	$	294,647
Non-trade payables		**303,362**		348,017
	$	**595,637**	$	642,664

7. Debentures

On June 23, 2011, the Company issued $2,500,000 principal amount of senior secured 18% non-convertible debentures (the "New Debenture). As well on June 23 2011, the Company amended its previously issued $818,000 principal amount 12% convertible debentures maturing March 31, 2012 (the "March 2012 Debentures") and $1,125,000 principal amount convertible debentures maturing July 31, 2012 to reflect the terms of the New Debentures (the "July 2012 Debentures" and together with the March 2012 Debentures, the "Amended Debentures"). $44,911 of interest that accrued on the March 2012 Debentures was added to the principal amount of the amended March 2012 Debentures.

Pursuant to their terms, the New Debentures and the Amended Debentures (collectively, the "Debentures") are, among other things, non-convertible and repayable upon demand, after the first anniversary of their issuance, subject to the requisite determination of the holders of the outstanding Debentures to make demand for repayment. In addition, in the event of an asset sale in excess of $3,000,000, the Company would be required to offer to repurchase a minimum of 50% of the outstanding Debentures, plus all accrued and unpaid interest due. Debenture holders would also have a right of first refusal to participate in future offerings by the Company, subject to the satisfaction of certain conditions. In turn, the Company may redeem the Debentures in the event that it has first raised a minimum of $4 million of "net new cash", which would include the proceeds raised from the issuance of the New Debentures but would exclude, among other things, the proceeds from the repayment of any debentures that, in turn, are used to fund the purchase of new securities of the Company. The non-convertible debentures are secured by all tangible and intangible assets of the Company.

In accordance with the rules of the TSX Venture Exchange, the Company also issued an aggregate of 13,521,504 "Bonus" common shares to purchasers of the New Debentures and holders of the previously issued debentures. Market value of $0.07 per share was used to value the "Bonus" common shares for an aggregate value of $946,505.

The securities issued and issuable pursuant to the transaction were subject to a hold period that expired on October 24, 2011.

The Company incurred cash financing costs of $374,969, "Bonus" common shares of $946,505 and 2,066,000 warrants with a fair value of $78,281 (note 11) in connection with the transaction. These costs were allocated between the New Debentures and the previously issued convertible debentures on a pro rata basis resulting in $606,011 of these costs being included in the loss on extinguishment of debentures and $793,744 recorded against the carrying value of the New Debentures.

7. Debentures (continued)

The New Debentures were being accreted to their face value at a weighted average effective interest rate of 39.72%. The amendment to the debentures was accounted for as an extinguishment of the previously issued convertible debentures as they had yet to mature when the terms were modified on June 23, 2011. Also, the terms between current debentures and the previously issued convertible debentures are considered to be substantially different. Accordingly, the Company recorded a loss on the extinguishment of debentures of $796,224 inclusive of the financing costs outlined above in the statement of comprehensive loss for the year-ended December 31, 2011.

As mentioned in note 9 below, as a result of closing the Private Placement on October 3, 2012 and achieving the minimum threshold of $1,250,000 in financing, the existing debenture holders of the Company have consented to the amendment of their existing debenture agreements. The key amendments include lowering the interest rate from 18% to 14% and extending the repayment date of the existing debentures for an additional three years, all as of the closing date of the Private Placement. Accrued interest recorded up to the date of the amendment of $687,301 was added to the principle of the Amended Debentures. The remaining interest will accrue at 14% throughout the amended term and is payable with the redemption of the principal portion of the debenture.

As part of the amended debenture agreement, the Company was required to issue bonus warrants to the debenture holders as soon as practicable following the execution of the agreement and receipt of approval from the TSX Venture Exchange. The amended agreement also outlined that there was to be approximately 8,900,000 bonus warrants issued to the debenture holders. However, only 3,600,000 warrants were actually approved for issuance. The Company issued 3,600,000 bonus warrants to the holders of the debentures. The amendment to the debentures is accounted for as an extinguishment since the amendments to the debt terms has resulted in a change in value of more than 10%. The difference between the fair value of the debentures and its face amount was $154,437 which was ascribed to the bonus warrants. The debentures are being accreted to its face amount of $5,598,692 using an effective interest rate of 15%.

The amended debenture agreement includes a cash sweep whereby the Company is to repay to the debenture holders if the cash balance in any fiscal quarter end exceeds certain thresholds. In the event that the cash balance of the Company exceeds $1,000,000, the Company is required to repay 25% of the amount over $1,000,000 up to $250,000. If the cash balance at any quarter end exceeds the $2,000,000, in addition to the $250,000 payable above, the Company is also required to pay to the debenture holders 50% of the amount over $2,000,000. No amount is repayable as of December 31, 2012.

As outlined in the amended debenture agreement, because the TSX Venture Exchange did not approve the bonus warrants, the Company was required to increase the percentage used to estimate the cash sweep over $1,000,000 to be 35% up to a maximum of $350,000.

(Expressed in Canadian dollars)

8. Share Capital

The Company is authorized to issue an unlimited number of common shares.

The following is a summary of changes in common share capital from January 1, 2011 to December 31, 2012:

	Number of shares	Value
Balance at January 1, 2011	118,047,615	$ 22,338,694
Issuance of "Bonus" common shares on June 23, 2011 (a)	13,521,504	946,505
Balance at December 31, 2011	131,569,119	23,285,199
Issued for cash on September 7, 2012 (b)	6,875,652	160,050
Issued for cash on October 3, 2012 (c)	18,500,000	268,708
Issued for cash on December 13, 2012 (d)	6,300,000	114,499
Balance at December 31, 2012	**163,244,771**	**$ 23,828,456**

(a) The Company issued 13,521,504 units of "Bonus" common shares to purchasers of the debentures issued on June 23, 2011 and holders of the previously issued convertible debentures (note 7).

(b) The Company issued 6,875,652 units for gross proceeds of $343,783 by way of a private placement. Each unit consists of one common share at a price of $0.05 per unit and one warrant entitling the holder to purchase one additional common share at $0.10 within 36 months of closing. Share issuance costs of $32,469 have been netted against share capital and $151,264 has been allocated to warrants (notes 9 & 11).

(c) The Company issued 18,500,000 units for gross proceeds of $925,000 by way of a private placement. Each unit consists of one common share at a price of $0.05 per unit and one warrant entitling the holder to purchase one additional common share at $0.10 within 36 months of closing. Share issuance costs of $260,207 have been netted against share capital and $396,085 has been allocated to warrants (notes 9 & 11). Included in share issuance costs is $11,624 which represents the value of 738,000 warrants issued to agents in connection with the private placement.

(d) The Company issued 6,300,000 units for gross proceeds of $315,000 by way of a private placement. Each unit consists of one common share at a price of $0.05 per unit and one warrant entitling the holder to purchase one additional common share at $0.10 within 36 months of closing. Share issuance costs of $22,211 have been netted against share capital and $178,290 has been allocated to warrants (notes 9 & 11). Included in share issuance costs is $4,186 which represents the value of 184,000 warrants issued to agents in connection with the private placement.

9. Share Issuance

On April 17, 2012, the Company announced a Private Placement of a minimum of $1,250,000 and up to a maximum of $2,000,000 in units. Each unit consists of one common share in the capital stock of the Company and one warrant, entitling the subscriber to purchase an additional share at $0.10 per share within 36 months of closing. The Company would issue the units at $0.05 per unit, resulting in the issue of a minimum of 25,000,000 shares and up to a maximum of 40,000,000 shares upon closing, non-diluted.

The Company closed the first phase of the above mentioned Private Placement on September 7, 2012 and the second and final phase on October 3, 2012, raising aggregate gross proceeds of $1,268,783 with 25,375,652 units between Phase 1 and Phase 2, with $375,000 invested by the Company's insiders. Fraser Mackenzie Limited acted as the agent for the Private Placement and received in consideration for its services a cash commission and advisory fees equal to $91,900 and 738,000 warrants entitling them to purchase 738,000 common shares at an exercise price of $0.10 per share, for a period of two years from the closing date of Phase 2. As a result of closing the Private Placement on October 3, 2012 and achieving the minimum threshold of $1,250,000, the existing debenture holders of the Company have consented to the amending of their existing debenture agreements. See note 7.

On December 6, 2012, the Company announced that it had received additional commitments to the above mentioned Private Placement and would issue the units with the same terms. On December 13, 2013, the Company closed the additional Private Placement, raising $315,000 with 6,300,000 units, of which $140,000 was invested by the Company's insiders. Fraser Mackenzie Limited acted as the agent for this additional Private Placement and received in consideration for its services a cash commission of $9,200 and 184,000 warrants entitling them to purchase 184,000 common shares at an exercise price of $0.10 per share, for a period of two years from the closing date of this additional Private Placement.

10. Share-Based Payments

The Company has an Incentive Stock Option Plan (the "Plan"). The Plan provides for options to be granted to the benefit of employees, directors and third parties. The maximum number of shares allocated to and made available to be issued under the Plan is 11,804,761. In 2007, the board of directors adopted a new option pricing policy such that the exercise price of options granted under the Stock Option Plan is priced as the greater of the three months weighted average trading price prior to the grant and the closing trading price for the common shares for the last trading day prior to the grant. The term of any option granted shall not exceed the maximum permitted time period under applicable regulations. Unless otherwise provided in the Stock Option Plan, the options shall be cumulatively exercisable in installments over the option period at a rate to be fixed by the Board of Directors. Certain options become exercisable upon achieving predetermined performance milestones and are specific to the respective employee's agreement. The Company will not provide financial assistance to any optionee in connection with the exercise of options.

(Expressed in Canadian dollars)

10. Share-Based Payments (continued)

On December 6, 2012 the Company granted stock options in accordance with its Stock Option Plan to certain of its directors and officers for their outstanding services to the Company. An aggregate of 3,577,742 Options were granted, whereby each Option entitles the holder to purchase one common share of the Company at $0.10, and the Options shall expire 60 months from the date of issuance. Directors were granted 600,000 Options for services rendered to the Company since July 2011. Officers were granted the remaining 2,977,742 Options as incentive for their continued service and commitment to the Company's growth.

The Company had issued stock options to acquire common shares as follows:

	Weighted average exercise price	Outstanding options	Vested options	Weighted average remaining life (years)
Balance at January 1, 2011	$ 0.12	7,335,000		
Granted	0.10	4,614,761		
Cancelled	0.10	(27,000)		
Forfeited	0.14	(248,000)		
Expired	0.23	(135,000)		
Balance at December 31, 2011	$ 0.11	11,539,761	3,553,310	3.57
Granted	$ 0.10	3,577,742		
Cancelled	0.10	(3,915,035)		
Forfeited	0.10	(1,054,468)		
Expired	0.28	(595,000)		
Balance at December 31, 2012	**$ 0.10**	**9,553,000**	**3,885,513**	**3.58**

For the year ended December 31, 2012, the fair value of the options granted was $146,652 (December 31, 2011 - $277,232). The weighted average exercise price of vested options at December 31, 2012 is $0.11 (December 31, 2011 - $0.14).

(Expressed in Canadian dollars)

10. Share-Based Payments (continued)

The Company had the following stock options outstanding at December 31, 2012:

Number of options	Number of non-vested options	Number of vested options	Exercise price	Expiry date
100,000	-	100,000	$0.14	January 9, 2013
250,000	-	250,000	$0.22	April 18, 2013
360,000	-	360,000	$0.10	November 19, 2013
25,000	-	25,000	$0.10	August 19, 2014
450,000	-	450,000	$0.11	November 18, 2014
400,000	-	400,000	$0.10	April 20, 2015
1,000,000	666,667	333,333	$0.10	August 23, 2015
1,480,000	850,000	630,000	$0.10	February 11, 2016
1,910,258	573,078	1,337,180	$0.10	August 18, 2016
600,000	600,000	-	$0.10	December 13, 2017
2,768,281	2,768,281	-	$0.10	December 20, 2017
209,461	209,461	-	$0.10	December 21, 2017
9,553,000	5,667,487	3,885,513	$0.11	

The estimated fair value of the options is expensed over the vesting period. The fair value of the compensation and contributed surplus relating to the stock options for the year ended December 31, 2012 was $96,363 (December 31, 2011 - $141,072). The fair value of all the Company's stock options was estimated using the Black-Scholes option pricing model. Stock options granted in fiscal 2012 and 2011 used the following assumptions:

	December 31 2012	December 31 2011
Volatility (based on historical share prices)	**134%**	132%
Risk-free interest rate	**1.38%**	1.92%
Expected life (years)	**5**	5
Dividend yield	**Nil**	Nil
Forfeiture rate	**0%**	13%
Underlying share price	**$0.05**	$0.07

(Expressed in Canadian dollars)

11. Warrants

	Number of warrants		Amount		Weighted average exercise price
Balance at January 1, 2011	30,713,000	$	761,298	$	0.10
Warrants issued	2,666,000		112,157		0.10
Balance at December 31, 2011	33,379,000	$	873,455	$	0.10
Warrants issued	32,597,652		741,449		0.10
Bonus warrants (note 7)	3,600,000		154,437		0.10
Warrants expired	(29,963,000)		(708,790)		0.10
Balance at December 31, 2012	**39,613,652**	**$**	**1,060,551**	**$**	**0.10**

The Company had the following warrants outstanding and exercisable at December 31, 2012:

Number of warrants		Exercise price	Expiry date
750,000	(i)	$0.10	August 24,2014
600,000	(ii)	$0.10	February 11, 2013
2,066,000	(iii)	$0.10	June 23, 2013
6,875,652	(iv)	$0.10	September 7, 2015
18,500,000	(v)	$0.10	October 3, 2015
738,000	(vi)	$0.10	October 3, 2014
6,300,000	(vii)	$0.10	December 13, 2015
184,000	(viii)	$0.10	December 13, 2014
3,600,000	(ix)	$0.10	October 3, 2015
39,613,652			

(i) These warrants were issued for services related to digital media workflow solutions. The warrants became exercisable after various phases of digital media workflow solution were completed.

(ii) These warrants were issued to agents in connection with the issuance of convertible debentures. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 129%; (III) a risk free interest rate of 1.90% and (IV) an expected life of 2 years.

(iii) These warrants were issued to agents in connection with the issuance of debentures. The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 121%; (III) a risk free rate of 1.45%; and (IV) an expected life of 2 years.

11. Warrants (continued)

(iv) These warrants were issued as part of the private placement of units (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 119%; (III) a risk free rate of 1.25%; and (IV) an expected life of 3 years.

(v) These warrants were issued as part of the private placement of units (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 116%; (III) a risk free rate of 1.14%; and (IV) an expected life of 3 years.

(vi) These warrants were issued to agents in connection with the issuance of the private placement (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 115%; (III) a risk free interest rate of 1.08% and (IV) an expected life of 2 years.

(vii) These warrants were issued as part of the private placement of units (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 114%; (III) a risk free rate of 1.19%; and (IV) an expected life of 3 years.

(viii) These warrants were issued to agents in connection with the issuance of the private placement (note 7). The fair value of the warrants issued were estimated at the date of grant using the Black-Scholes model with the following weighted average assumptions: (I) dividend yield of 0%; (II) expected volatility of 118%; (III) a risk free interest rate of 1.12% and (IV) an expected life of 2 years.

(ix) These warrants were issued in connection with the amendments to the debentures. The Company issued 3,600,000 bonus warrants to the holders of the debentures. See note 7.

Warrants issued to agents and related to financings were not measured at the fair value of the services received as the fair value of such services was not reliably measurable.

(Expressed in Canadian dollars)

12. Loss per Share

	December 31 2012	December 31 2011
Numerator:		
Net loss and comprehensive loss for the period	**$ (2,235,052)**	$ (4,613,295)
Denominator:		
Weighted average number of common shares	**138,624,517**	125,160,297
Basic and diluted loss per share	**$ (0.02)**	$ (0.04)

For the above-mentioned periods, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of dilutive net loss per share in the periods presented, as their effect would have been anti-dilutive. Such outstanding securities consist of the following:

	December 31 2012	December 31 2011
Options	**9,553,000**	11,539,761
Warrants	**39,613,652**	33,379,000

13. Commitments and Contingencies

(a) Technology license agreement

Pursuant to a licensing agreement dated June 28, 2007, the Company was granted a non-exclusive license to integrate a patented biometric technology (the "Intellectual Property") with their DMDS. The initial term of the License is for six years, automatically renewing for successive terms of one year after the initial five-year term and may be terminated by either party upon 180 days notice prior to the renewal date of the agreement. The Company must pay an additional annual maintenance fee based on the number of annual users, which at the Company's current usage results in a fee of $5,400 per year.

(b) Litigation

On November 14, 2000, the Company filed a claim against a former employee and shareholder, and related shareholders, seeking a rescission of their 1,250,000 common shares and damages in the amount of $100,000. A counterclaim was brought against the Company by these defendants for various relief including damages of approximately $850,000, a declaration that the defendants are shareholders and orders that they be bought out or the Company be wound up.

(Expressed in Canadian dollars)

13. Commitments and Contingencies (continued)

(b) Litigation (continued)

In May 2001, the Company successfully defeated a motion by the defendants that sought condensed interim costs and security for costs. The Company was awarded its costs for this motion. The Company continues to defend the action. The amount cannot be estimated reliably, therefore no provision is recorded.

(c) Settlement of patent infringement

On June 24, 2011, the Company resolved all litigation with a competitor that had been ongoing since 2005. In consideration of the settlement, the Company agreed to pay its competitor a lump sum amount totalling $600,000. As part of the settlement, the Company retained the patents and the rights and granted the competitor certain intellectual property rights relating to the two patents held by the Company that were the subject matter of the dispute. As well, neither party will pursue legal fees, court costs or royalties pursuant to the above mentioned disputes. The payment was made during the year ended December 31, 2011.

(d) Customer claim

During December 2012, a claim in the amount of $119,995 was filed against the Company. The Company has submitted a claim with its insurance company for reimbursement.

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

(e) Leases

Total future annual lease payments for the premises are as follows:

	Premises
2013	$ 84,495
2014	84,495
2015	84,495
2016	84,495
2017	63,371
	$ 401,351

14. Capital Risk Management

The Company includes equity; comprised of share capital, warrant capital, contributed surplus, share proceeds received in advance and deficit, in the definition of capital.

The Company's primary objective with respect to its capital management is to ensure that it has sufficient cash resources to further develop and market its digital media distribution systems, and to maintain its ongoing operations. To secure the additional capital necessary to pursue these plans, the Company may attempt to raise additional funds through the issuance of equity and warrants, debt or by securing strategic partners.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the year ended December 31, 2012.

15. Financial Risk Management

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk and interest rate risk), credit risk and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance.

Risk management is carried out by management under policies approved by the Board of Directors. Management is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated in accordance with the approved policies.

(a) Market risk:

Market risk is the risk that the fair value of the future cash flows of a financial instrument will fluctuate because of changes in the market prices. Market prices are comprised of two types of risk:

(i) Currency risk:

The Company operates internationally and is exposed to foreign exchange risk from various currencies, primarily United States dollars and Australian dollars. Foreign exchange risk arises from purchase transactions as well as recognized financial assets and liabilities denominated in foreign currencies.

Balances in foreign currencies at December 31, 2012 are as follows:

	USD	**AUD**
Accounts receivable	371,295	34,037
Accounts payable and accrued liabilities	311,183	-

(Expressed in Canadian dollars)

15. Financial Risk Management (continued)

(a) Market risk: (continued)

(ii) Interest rate risk:

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk is limited to potential decreases on the interest rate offered on cash and cash equivalents held with chartered Canadian financial institutions and potential increases on the prime rate applied on the line of credit available to the Company. The Company considers this risk to be immaterial. In interest on the debentures and convertible debentures are not subject to cash flow interest rate risk as these instruments bear interest at fixed rates.

(b) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments which are potentially subject to credit risk for the Company consists primarily of non-payment of accounts receivable. The Company mitigates this risk by monitoring the credit worthiness of its customers and by offering an ecommerce service to smaller customers. As at December 31, 2012, approximately 24% (December 31, 2011 - 38%) of accounts receivable and 22% (December 31, 2011 - 20%) of revenue are from one customer (2011 - two customers).

Aging of trade receivables that are past due, but not impaired:

	December 31 2012	December 31 2011
0 to 30 days past due	**$ 109,122**	$ 77,796
31 to 60 days	**78,312**	69,592
Over 60 days	**97,760**	42,986
Total past due	**$ 285,194**	$ 190,374

(Expressed in Canadian dollars)

15. Financial Risk Management (continued)

(b) Credit risk: (continued)

Continuity of allowance for doubtful accounts:

	December 31 2012	December 31 2011
Balance, beginning of year	**$18,113**	$15,472
Less: Accounts written off to impairment loss	**(14,703)**	(3,275)
Charge during the year	**9,108**	6,810
Less: Amounts previously provided, recovered during the year	**(4,343)**	(894)
Balance, end of year	**$8,175**	$18,113

(c) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's policy is to ensure that it will always have sufficient cash to allow it to meet its liabilities when they become due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation. The key to success in managing liquidity is the degree of certainty in the cash flow projections. The Company manages its liquidity risk by forecasting cash flows from operations and anticipating investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

Typically, the Company ensures that it has sufficient cash on demand to meet expected operational expenses. To achieve this objective, the Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary.

The Company monitors its risk of shortage of funds by monitoring the maturity dates of existing trade and other accounts payable.

As at December 31, 2012, the Company has trade and other payables of $595,637 (December 31, 2011 - $642,664), due within 12 months, and has cash and cash equivalents and accounts receivable of $1,055,897 (December 31, 2011 - $597,186) to meet its current obligations. As disclosed in note 2(c), the Company will have to raise additional capital to fund further development of their product and operations.

(Expressed in Canadian dollars)

15. Financial Risk Management (continued)

(d) Fair value:

The Company has determined that the carrying value of its short-term financial assets and liabilities, including cash and cash equivalents, accounts receivable, trade and other payables and accrued interest on debentures and debentures, approximate their fair value because of the relatively short period to maturity of the instruments or in the case of the line of credit, the fair value approximates its carrying value as it bears interest at floating rates. The fair value of the convertible debentures approximate its carrying value due to the effective interest rates implicit in the debt.

16. Income Taxes

(a) Income tax expense:

The following table reconciles income taxes calculated at combined Canadian federal/ provincial tax rates with the income tax expense in these financial statements:

	December 31 2012	December 31 2011
Loss before income taxes	**$ (2,235,052)**	$ (4,613,295)
Statutory rate	**26.5%**	28.25%
Expected income tax recovery	**$ (592,000)**	$ (1,303,000)
Amounts not deductible for tax and other	**(14,000)**	196,000
Loss on extinguishment of debt	**-**	125,000
Deferred tax assets not recognized	**1,239,000**	1,017,000
Change in expected tax rates	**(633,000)**	(35,000)
Income tax expense	**$ -**	$ -

(b) Deferred income taxes:

The temporary differences that give rise to deferred income tax assets and deferred income tax liabilities are presented below:

	December 31 2012	December 31 2011
Amounts related to tax loss and credit carryforwards	**$ 7,084,000**	$ 5,987,000
Share issuance costs	**176,000**	147,000
Capital and intangible assets	**840,000**	783,000
Debentures	**(39,000)**	(95,000)
Net deferred tax asset	**$ 8,061,000**	$ 6,822,000
Deferred tax assets not recognized	**(8,061,000)**	(6,822,000)
	$ -	$ -

(Expressed in Canadian dollars)

16. Income Taxes (continued)

(b) Deferred income taxes: (continued)

The Company has ITCs of approximately $736,000 and unused expenditures of approximately $2,436,000 related to scientific research and experimental development costs. The Company also has non-capital losses of approximately $22,250,000 available to apply against future taxable income. If not utilized, the non-capital losses will expire as follows:

2014	$	2,630,000
2015		1,389,000
2026		1,861,000
2027		2,618,000
2028		2,885,000
2029		2,425,000
2030		2,998,000
2031		3,470,000
2032		1,974,000
	$	**22,250,000**

The potential tax benefit relating to these losses has not been reflected in these financial statements.

17. Related Party Transactions

Key management personnel are comprised of the Company's directors and executive officers. In addition to their salaries, key management personnel also participate in the Company's share option program (note 10).

Key management personnel compensation is as follows:

	December 31 2012	December 31 2011
Salaries and short-term employee benefits (i)	**$ 970,409**	$ 914,903
Share-based payments	**88,761**	104,333
Termination benefits	**-**	223,615
	$ 1,059,170	$ 1,242,851

(i) Short-term employee benefits include bonuses and vacation pay

Legal fees of $234,650 were incurred to a law firm of which one partner became a Director of the Company during the year.