VISCOUNT SYSTEMS INC
Form 10-K
March 30, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2011**

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: **000-49746**

VISCOUNT SYSTEMS, INC.

(Name of registrant as specified in its charter)

NEVADA	**88-0498181**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4585 Tillicum Street, Burnaby, British Columbia, Canada	**V5J 5K9**
(Address of principal executive offices)	(Zip Code)
Issuer s telephone number:	**(604) 327-9446**
Securities registered pursuant to Section 12(b) of the Act:	**None**
Securities registered pursuant to Section 12(g) of the Act:	**Common Stock, $.001 per share**
	(Title of class)

Check whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [ ] No [X]

Check whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.
Yes [ ] No [X]

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Check whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no disclosure will be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Check whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [**X**]
Check whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES [ ] NO [X]

State issuer s revenues for its most recent fiscal year: $3,470,848 ($3,529,852 in Canadian dollars converted at an exchange rate of US$1.0170/CDN$ 1.000) .

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter: $9,176,850 as at June 30, 2011.

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: 76,733,750 shares of common stock as at March 15, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K, which Proxy Statement is to be filed within 120 days after the end of the Registrant's fiscal year ended December 31, 2011.

Form 10-K

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FORM 10-K

VISCOUNT SYSTEMS, INC.

PART I.

FORWARD-LOOKING STATEMENTS

ALL STATEMENTS IN THIS DISCUSSION THAT ARE NOT HISTORICAL ARE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. STATEMENTS PRECEDED BY, FOLLOWED BY OR THAT OTHERWISE INCLUDE THE WORDS "BELIEVES", "EXPECTS", "ANTICIPATES", "INTENDS", "PROJECTS", "ESTIMATES", "PLANS", "MAY INCREASE", "MAY FLUCTUATE" AND SIMILAR EXPRESSIONS OR FUTURE OR CONDITIONAL VERBS SUCH AS "SHOULD", "WOULD", "MAY" AND "COULD" ARE GENERALLY FORWARD-LOOKING IN NATURE AND NOT HISTORICAL FACTS. THESE FORWARD-LOOKING STATEMENTS WERE BASED ON VARIOUS FACTORS AND WERE DERIVED UTILIZING NUMEROUS IMPORTANT ASSUMPTIONS AND OTHER IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE IN THE FORWARD-LOOKING STATEMENTS. FORWARD-LOOKING STATEMENTS INCLUDE THE INFORMATION CONCERNING OUR FUTURE FINANCIAL PERFORMANCE, BUSINESS STRATEGY, PROJECTED PLANS AND OBJECTIVES. THESE FACTORS INCLUDE, AMONG OTHERS, THE FACTORS SET FORTH BELOW UNDER THE HEADING "RISK FACTORS." ALTHOUGH WE BELIEVE THAT THE EXPECTATIONS REFLECTED IN THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, WE CANNOT GUARANTEE FUTURE RESULTS, LEVELS OF ACTIVITY, PERFORMANCE OR ACHIEVEMENTS. MOST OF THESE FACTORS ARE DIFFICULT TO PREDICT ACCURATELY AND ARE GENERALLY BEYOND OUR CONTROL. WE ARE UNDER NO OBLIGATION TO PUBLICLY UPDATE ANY OF THE FORWARD-LOOKING STATEMENTS TO REFLECT EVENTS OR CIRCUMSTANCES AFTER THE DATE HEREOF OR TO REFLECT THE OCCURRENCE OF UNANTICIPATED EVENTS. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS. REFERENCES IN THIS FORM 10-K, UNLESS ANOTHER DATE IS STATED, ARE TO DECEMBER 31, 2007. AS USED HEREIN, THE "COMPANY," "VISCOUNT," "WE," "US," "OUR" AND WORDS OF SIMILAR MEANING REFER TO VISCOUNT SYSTEMS, INC.

Currency of Financial Information and Exchange Rate Table

The Company maintains its books of account in Canadian dollars and references to dollar amounts herein are to the lawful currency of Canada unless otherwise indicated.

The following table sets forth, for the periods indicated, certain exchange rates based on the noon buying rate in New York City for cable transfers in Canadian dollars. Such rates are the number of Canadian dollars per one (1) U.S. dollar and are the inverse of rates quoted by the Federal Reserve Bank of New York for U.S. dollars per CDN$1.00. The high and low exchange rates for each month during the previous six months were as follows:

	High	Low
February 2012	1.0158	0.9960
January 2012	1.0034	0.9713
December 2011	0.9945	0.9594
November 2011	0.9945	0.9504
October 2011	1.0109	0.9383
September 2011	1.0271	0.9540

The following table sets out the exchange rate information as at each of the years ended December 31, 2011 and 2010.

	Year Ended December 31	
	2011	2010
Rate at end of Period	1.0170	0.9946
Average Rate during Period	0.9891	1.0299
Low	0.9428	0.9931
High	1.0607	1.0848

Item 1. BUSINESS

GENERAL

The Company is a manufacturer, developer and service provider of access control security products. In 2011, commercial sales of its MESH product line accounted for over 50% of its total sales. MESH (Multimedia Embedded Security Hub) was a new technology developed by Viscount that converged voice (intercom, emergency communications), data (access control, elevator control, alarm) and some video to provide increased security at a reduced cost of hardware, cabling and installation and with simplified database management.

In addition to MESH, the Company s current access control and security product lines include the following: Enterphone 2000, a building intercom; Entercheck, a card access system; RadioClik and InfraClik, radio frequency and infrared remote controls; Elektra, liquid crystal display intercom panels; EmerPhone, emergency telephone entry systems; and various accessories. The Company also has a service division that provides service for the MESH and Enterphone 2000 systems. We currently have 1,428 service agreements in place.

The Company s website address is www.viscount.com. All periodic and current reports are available, free of charge, on the Company s website as soon as reasonably practicable after such material is electronically filed with, or furnished to, the U.S. Securities and Exchange Commission. Electronic or paper copies of the Company s filings are also available, free of charge, upon request.

BUSINESS OVERVIEW

The Company designs, manufactures and services access control and security products, including intercom and door access control systems and emergency communications systems. These systems use telecommunications wiring to control access to buildings and other facilities for security purposes. Much of the Company s current revenues are now derived from sales of the MESH product line. Service sales from the Company s existing 1,428 service agreements also continue to provide a significant source of revenues.

MESH is now the Company s leading sales product, accounting for 51% of total sales for the year ended December 31, 2011. MESH technology is based on a proprietary software platform that can be used for a variety of security and access control applications as well as communication functions. The technology represents a departure from traditional access control and security systems. Traditional systems use controllers that have a capacity to control from 1 to 8 access points per controller. A building access system using the MESH technology can control several hundred points of access from a single remote hardware and software platform. The technology also allows several previously independent building control systems to be hosted on a single hardware and software platform. The Company s proprietary MESH software is designed to be modular, permitting additional applications to be added as modules, each operating other building and area control systems and high technology requirements.

Enterphone sales have not shown any growth over the past few years, due to the emergence of MESH, accounting for 11% of total sales for the year ended December 31, 2011. Enterphone is a building access control system that uses a building s internal phone wiring thereby avoiding use of telephone utility services. The Company s products include

access control panels that use the Enterphone technology. The Company s control panels are typically installed at entrances to apartment buildings, government facilities, and other buildings and facilities where security concerns require access control systems. The control panels are sold in various formats and with varying features and capabilities. The Company s Enterphone technology control panels are sold through an established distribution network, and can be found installed in approximately 35,000 buildings throughout North America. The Company also packages and sells access control and security products that are complementary to its Enterphone product, including card access systems, radio frequency remote controls, intercom monitors and closed circuit cameras.

COMPANY HISTORY

The Company s current business is operated primarily through its wholly owned subsidiary Viscount Communication and Control Systems Inc. The business of the Company s subsidiary began operations in 1969 as a manufacturer of video switching equipment. In 1970, the business was acquired by B.C. Telecom Inc. (BC Tel), which was acquired by Telus Corporation in 1999. BC Tel was the telephone utility for British Columbia, Canada controlled by GTE Corporation (now Verizon Communications Inc.). Under BC Tel, the business operated as an electronics research laboratory and manufacturing facility. Among the products manufactured were central office telephone test equipment, telephone demarcation blocks, and a satellite based kiosk system used to provide information at airports and other public facilities. Responsibility for the manufacture of the Enterphone system was transferred into the business in 1984 from BC Tel. BC Tel contracted to sell the business in 1997 to Blue Mountain Technologies Inc., a company that purchases and installs the Company s products. Blue Mountain Technologies Inc. simultaneously assigned its contractual rights to acquire all of the business assets, except for certain leasehold interests, to the Company s subsidiary, Viscount Communication. BC Tel consented to the assignment and accordingly the business was acquired by the Company s subsidiary, Viscount Communication and Control Systems Inc.

The Company was incorporated on May 24, 2001 under the laws of the State of Nevada under the name OMW4 Corp. The Company s subsidiary, Viscount Communication was incorporated in 1997 under the laws of British Columbia, Canada, for the purposes of carrying on the present access control business. The Company acquired all of the issued and outstanding shares in the capital of Viscount Communication on July 27, 2001, in exchange for 10,000,000 shares of the Company s common stock, thereby making it our wholly owned subsidiary. As a result of the acquisition, the former shareholders of Viscount Communication obtained a controlling interest in OMW4 Corp. In connection with the acquisition, the Company changed its name to Viscount Systems Inc. effective August 27, 2001.

In 2003, the Company acquired certain inventory and 2,165 service agreements from Telus Corporation. The service agreements related to the maintenance Enterphone installations throughout Western Canada. The inventory was comprised of various products and components for installation and repair of these Enterphone installations. Enterphone is a specialized telephone switch used to provide intercom and access control functions in buildings. It was originally developed by BC Tel in 1965. Mirroring the increased security awareness in buildings over the past few years, the Company has been providing a more comprehensive package of complementary products. Products packaged, using third party technologies for this purpose, include card access systems, radio frequency remote controls, intercom display panels and closed circuit cameras.

The MESH product line, which has been under development since 1998, is an integrated platform for building access control and management. MESH continues to be the focus of the Company s corporate development.

INDUSTRY OVERVIEW

The Company competes in the building intercom and access control systems industry. The intercom and access control industry is sometimes referred to as a segment of the low voltage systems industry. The Company s intercom and access control systems are designed to automate the control of access to buildings or other restricted access areas. Intercom systems and access control systems are complementary; however they can also be used independently depending on user requirements. For example, most modern residential apartment or condominium buildings have an intercom system for visitors wishing to communicate with residents. Residents, on the other hand, are issued access cards that can be used in conjunction with card readers installed beside doors or elevators in order to gain access.

Access control systems provide two functions for a building. Building tenants use access cards and readers that control access through doors, gates or elevators, while visitors use telephone intercoms to be granted admission by a building occupant or manager. The systems also provide sophisticated alarm functions such as identifying doors left open or forced entry. The sophistication of systems ranges from controlling a single door where records are kept manually, to large enterprise systems covering hundreds of buildings from a dedicated security facility.

The building control industry has traditionally been highly segmented based on function. This has meant that makers of heating/ventilation and air-conditioning systems and security card access systems essentially manufacture input/output systems, while intercom makers manufacture voice systems, and security camera makers manufacture closed circuit video systems. Stated otherwise, audio, video, environment and access control systems are traditionally all separate building control systems that are independently controlled. There has been strong convergence of technologies in the computer and telephone related industries based on digital standards; however the building control industry has not as yet undergone a similar convergence of technologies. Traditionally, where systems need to be compatible, the industry has relied on integration instead of convergence. Integration is the use of a host computer to tie separate and distinct systems, typically from different manufacturers, together on a common software platform. Convergence, in the case of building control systems, is the provision of a new service that is designed to operate multiple systems using homogenous control parameters. Convergence is generally considered preferable to integration, as fewer distinct systems means lower operational and maintenance costs.

Along with certain other industry participants, the Company has turned to current high-technology solutions in order to reduce costs of ownership of security systems, while improving functionality. The Company has developed new system platforms that will permit convergence of the control of various building functions, such as access control, intercom, closed circuit television, and heating/ventilation and air-conditioning. These systems can be operated on a single commercially available host server and can operate using standard communications techniques. As a result of using a single full service system to replace the three or more separate dedicated systems, each requiring its own host server, the overall cost of ownership of a security and control system has been reduced.

Access Control Systems Technology

The access control industry has traditionally used a technology known as Wiegand. Approximately 90% of the worlds installed access systems are based on Wiegand technology. Today, these systems are commonly found in residential, commercial and industrial buildings in the form of access control cards and card readers. Wiegand was initially developed in 1970 by Senso Engineering as an access card technology. The card technology uses a special patented process whereby wires are imbedded in a plastic access card to encode its data. When passed through a magnetic field generated by a card reader, the card generated a signal which is received and interpreted by the card reader. If the signal is recognized, the reader will transmit the information to a host controller to activate a switch, which for example purposes, may release a lock or open an elevator to permit building access to the cardholder. A host controller is essentially computer hardware that is programmed to receive information from the card reader in order to permit access to a building. Wiegand technology has established itself as the industry standard as it is viewed as being reliable and difficult to counterfeit the access cards.

Other products that use the Wiegand principals for access control are magnetic strip cards and radio frequency cards. These products function similarly by providing a card reader with a signal that the reader interprets and transmits to a host controller in order to grant or deny access.

Wiegand access control technology requires card readers that are connected to a host controller. Each host controller can operate between 1 to 8 doors. Accordingly, a building with a large number of controlled access points could require a large number of host controllers, resulting in greater hardware costs. Host controllers can in turn be connected to a central server that monitors the host controllers and collects information on access point usage.

The underlying technology that operates these traditional access control systems is approximately 30 years old. The readers are considered dumb readers as they simply receive information from the access card and transmit it to a host controller. The host controller processes the information in order to determine whether to grant or deny access. If access is granted, the host controller then transmits a signal to activate a switch to open the access point where the reader is located. This is a simple input/output type relay system which requires a separate host controller for approximately every eight access points.

As a result of the limitations and hardware requirements of the traditional access control systems, some security industry manufacturers are developing and marketing intelligent access control and communications systems. Intelligent systems allow several previously independent building control systems, such as intercom, access control, video, and climate control, to be controlled by a single server. These systems are based on software designed to control hundreds of readers from a single computer server, combined with smart chips installed in readers at each control point. Smart chips are programmable computer chips that permit access card readers to grant or deny access without the need to relay a signal to and from a central host controller. Smart chips can be programmed to perform tasks for a diverse range of building control systems, such as fire alarm systems, heating/ventilation and air conditioning, and building access and elevator controls. As the smart chip is programmed to make its own decisions on a given application, this reduces the load on the central host computer. The host computer accordingly performs primarily a monitoring and information collection function.

The Company is participating in this advance in the access control industry with its proprietary MESH intelligent access control and communication technology system. Intelligent systems, including smart chip readers and cards have replaced reliance on systems based on Wiegand technology.

PRODUCTS

The Company is a manufacturer, developer, reseller and service provider of intercom and access control systems based on telephone, new and traditional access card and reader technologies. The Company s intercom and access control systems are installed throughout North America for various applications including: condominium/apartment building access and intercom; residential intercom; gated home/community access and intercom; seniors/government housing access, tracking and intercom; elevator access and tracking; garage or perimeter gate control, and emergency communications.

For the year ended December 31, 2011, approximately 12% of total sales of the Company s products and services were generated in the United States and 88% in Canada. This represents a change from 2010, where sales to the United States and Canada were 17% and 83%, respectively. Information on the Company s existing products can be viewed on our website at www.viscount.com.

Enterphone Access Control Products

Historically, the Company s principal product was the Enterphone intercom and access control system. Enterphone is the Company s patented building entry control system that uses a building s internal phone wiring to allow access control for tenants and intercom and access control between visitors and tenants. The use of a building s internal phone wiring by the Company s Enterphone system provides an option to using telephone company wiring, thereby bypassing monthly telephone charges. It also does not require tenants to pay for an individual phone line to operate their intercom and door access system and is not affected by interruptions in telephone company service. This makes the Company s Enterphone system distinct from other dial-up telephone entry systems that use telephone company lines. Sales of products based on the Enterphone system account for approximately 11.0% of total sales in fiscal 2011. This is up from approximately 9.0% in fiscal 2010, due in part to the development of other sources of sales, including Enterphone maintenance contracts, new product lines such as MESH Freedom Bridge, and original equipment manufactured (OEM) product lines. OEM products lines are products or components that are purchased by the Company and resold under the Company s brand name.

The Enterphone system is sold as a central control panel which is installed in a building s telephone control room. The control panel connects an intercom panel located at an entrance to the building with the telephone of building tenants. A visitor wishing to gain access to the building dials a 1 to 4 digit number at the entrance panel. The call is directed from the entrance panel, through the common control equipment and up to the tenant s telephone. The tenant hears a unique ring and can unlock the entrance door by pressing a number on the telephone s numeric keypad. The tenant does not need to rent a telephone line from the telephone company. Each control panel can process connections to as

many as 840 suites.

The Company also manufactures electronic entry access panels that can operate using either the Enterphone system, or dial-up telephone company lines. The Company s panels are manufactured in various sizes and with various features in order to accommodate varying purposes and building types. For example, the Company manufactures panels that provide intercom and access control from 1 suite to up to 1000 suites; or panels that provide on-screen name search capabilities; or panels that are streamlined in shape or small in size. All panels that the Company manufactures incorporate the Enterphone technology, however most panels can also be installed to use telephone company lines.

Enterphone panels can also be combined with other technologies such as access tracking and control, closed circuit monitors, infrared and radio frequency remotes, and Wiegand cards and card readers. The Company purchases these technologies from other manufacturers and resells them under the Company s brand names. Most of the products that the Company resells can be integrated into our Enterphone access control system.

Our MESH Access Control System

Overview

MESH is a software-based building management system designed to replace traditional systems that are more hardware intensive. The Company continues to develop technology that was initially conceptualized in 1998. MESH was commercially released in late 2003.

MESH is a software platform that communicates with a network of intelligent input/output devices, such as card readers or building environment sensors. As such, the intelligence of the system can be said to be distributed among the input/output devices. This is contrasted with the traditional access control industry, which uses dumb readers that require information to be processed at a central host computer. An intelligent reader or input/output device uses a pre-programmed smart chip which allows it to process information on its own, and does not require the host computer to make action decisions, such as to grant or deny access to a door or to activate air-conditioning. The use of intelligent devices accordingly reduces the load on the host computer which allows the host computer to allocate its resources to a greater number and diversity of tasks. The networked distribution of intelligent devices also means reduced cost resulting from reduced hardware requirements, easier training of control system operators, and the use of commercially available host computer hardware and communication techniques.

The conceptual basis for MESH is simple. Virtually every low voltage building technology, except building access, has evolved using intelligent addressable network devices. This includes fire alarms and heating/ventilation and air-conditioning. An addressable network is one in which devices can constantly communicate with a host server controller or can be polled for information. For example, if a smoke detector on a non-addressable fire alarm system fails, a fire in that location may go undetected since there is no way to identify the failure without actually testing the device. In contrast, the smart chip in an addressable smoke detector may be able to notify the fire panel of a problem immediately and call for service. Access control systems, however, continue to be based on a 30-year-old standard called Wiegand. The limitations of this standard continue to plague the industry due to the slow data transmission speed (9600 baud) between the reader and the host controller, the high cost and quantity of specialized and dedicated hardware, and the inability of the host computer to process voice or video signals. For example, buildings requiring elevator access control have traditionally required a significant amount of expensive dedicated hardware. The MESH network with intelligent readers can accomplish these functions without dedicated hardware, resulting in cost reductions, both in terms of the actual hardware required and the labor, cable and conduit costs associated with installation.

The MESH system bypasses the need for specialized and dedicated hardware. Instead, MESH provides a software-based platform that operates on an industrial computer server connected to intelligent readers transmitting data at high speed rates of up to 156,000 baud, while simultaneously running voice and video applications. The benefits and functionality derived from this approach can be significant.

MESH Structure

The MESH network consists of a main control computer server communicating with a series of intelligent readers, panels, and input/output devices. The key to the technology is the smart chip , known as the MPNode computer chip, a programmable chip. The Company purchases the MPNode chips and programs them to perform certain functions upon detecting certain data. For access control applications, the chip is installed into a card reader. When data from an access card is received by the card reader, the chip processes the data and makes a decision to grant or deny access. Information on the transaction is passed along to the host computer for data storage and analysis purposes. Traditional Wiegand style card readers require an intermediate controller for every two or three reading devices. An intermediate controller is connected between the host computer and the group of readers controlled by it. In contrast, the MESH system allows intelligent readers to be installed in series, or daisy-chain fashion, without the need for intermediate controllers. Small interface modules are used instead to maintain data flow. This reduces hardware costs as only one host computer is required.

MESH panels, located at entrance doors for visitor access, can operate independently or as slaves off the MESH server. The basic MESH panel that the Company has commercially released is a full color screen industrial computer. Panels may be located at entrance doors for visitor access or can be on-site managed by security guards as they manage the MESH network. The slave/master architecture of MESH panels reduces cost, simplifies programming, and improves data base management.

In designing MESH, much consideration has been made of the many dissimilar applications requiring a MESH network. In cases where building control is accomplished with on-site security and concierge staff, limited MESH hardware or possibly only software may be needed to perform the required functions. For example, MESH software may be sold as a simple visitor tracking system for commercial or gated residential sites.

In general, MESH has been designed to allow simple installations to be performed by small independent alarm contractors. However, provision has also been made for direct involvement by the Company s staff in large campus wide and enterprise wide installations.

MESH has many additional benefits, both in terms of building security and particularly relative to the legacy Wiegand protocol. It is the Company s belief that addressable networks pose a serious threat to the continued use of the Wiegand format.

MESH is a modular product, meaning that the software can accommodate add-on features or upgraded features. The Company has developed various modules for our MESH technology, and intends to develop further modules which will be released in a series of phases. Some of these product enhancement modules are described below:

- The MESH server provides new opportunities to host video on the unified platform with voice and data. This product enhancement would represent an entirely new concept in the security industry.
- The nature of the MESH server makes MESH telephony products inherently Internet enabled. Future MESH appliances may include the MESH television line, which allows residents to view visitors at the door. MESH panels will be able to connect to web enabled set top boxes being promoted as part of the web TV market. MESH may be able to connect to videoconferencing telephones that would compete in the large offshore video intercom business but at a fraction of the cost by saving on conduit and cable.
- The distributed intelligence of MESH makes the product suited to the growing emergency call/nurse call industry.
- MESH networks are built on a proprietary architecture platform which is functional to integrate with any existing automation network.
- A new and emerging market segment tracks not just people, but equipment. A typical application is the embedding of anti-theft chips in computers, which integrate with card reader systems.

Enterphone X

The next generation of Enterphone systems, called Enterphone X, EPX , was released during the second quarter of 2008. The EPX product line has replaced the EP2000 product line. EPX, also a no phone line system like EP2000, is the next generation of Enterphone. EPX is more cost effective because it requires less assembly and material input costs. EPX improves compatibility with MESH and other newer telephony technologies. EPX sales are classified as a source of MESH revenue.

The Enterphone 2000 design dates back to 1990 and the architecture has created complications for both manufacturing and installation. The new universal controller eliminates the need for Viscount to manufacture and carry inventory for 10 different circuit boards. Overall, EPX reduces cost, produces higher margins, and improves the Company s ability to market MESH.

MESH Freedom

MESH Freedom is the new IT platform developed and released during the last quarter of 2010. This IT platform can turn any card reader into an IP device by connecting the Freedom IP device with built-in I/O to a POE switch and then every card usage is processed on a redundant MESH server either in your building or anywhere in the world. The software component of MESH Freedom is the MESH web browser security operating platform. Unlike control panels, the user database and the door control software is written in IT language located on a server(s), thereby future proofing systems from the traditional issue of proprietary hardware version obsolescence and improving scalability by eliminating the need for additional hardware every time a reader is added to the system.

Other products

Other products include RadioClick and InfraClik. These are remote control access control products for doors and parking gates. They are sold separately or as complementary to the Enterphone, Entercheck and MESH systems. The Company also manufactures and sells EmerPhone, an intercom system that is sold in elevator phone, emergency phone and entry phone applications.

OTHER SERVICES

In addition to sales of the Enterphone, MESH and OEM products, the Company also services approximately 1,482 existing Enterphone installations within Western Canada.

PRODUCTION

Viscount has facilities for circuit board manufacture and mechanical assembly. The Company uses a range of processes to produce its products. Some products including Enterphone, InfraClik, and Axess are completely manufactured in-house. MESH, EPX, MESH Freedom and Emerphone use outsourced circuit boards with final assembly and software installed at Viscount. Some access control, card readers, Elektra panels, Infraclik and various product accessories are purchased from other manufacturers and resold under the Company s brand-names. The Company maintains full facilities to assemble through-hole circuit boards and limited facilities for assembling surface mount circuits. The Company has a policy of supporting old products as long as parts are available for servicing and replacement. We have designed EPX to be backwards compatible with the 2000 series to improve the longevity and serviceability of both products.

The MESH software platform is loaded on standard industrial computer chassis. The Company is not developing hardware internally for MESH, since the required hardware controllers are commercially available at quality and price levels that make internal development uneconomical. In addition, by using off-the-shelf components, the Company improves time to market, eliminate hardware debugging and increases the Company s ability to be technologically flexible in the future. The Company is primarily executing final mechanical assembly of the MESH systems.

RESEARCH AND DEVELOPMENT

Research and development continues to be focused on enhancing the MESH product line. A number of these enhancements were identified in the MESH Structure and Other products section of this document. Specific custom MESH applications are being considered, evaluated and implemented. An example of this process would be active directory integration. Expenditures in connection with research and development during the last two fiscal years

totaled $824,334.

MARKET AND MARKETING

The Market

The intercom and access control market is serviced by a number of large and small competitors. The Company s traditional products compete in a mature market place that largely uses the 30 year old Wiegand technology. The Company believes that there currently exists an opportunity in the building and access control market for innovative products that use current technologies to reduce user costs. The Company has positioned its MESH technology to take advantage of this opportunity.

The access control market can generally be described as the market for any equipment used to control passage through a door, gate or other portal. A portion of this market is comprised of mechanical and electronic door locks that typically control access through single doors. Many of the single door systems have been engineered for low security levels for customers who do not desire a full access control host. The access control market that the Company competes in involves computerized access control systems that typically control access through multiple access points, such as the Enterphone system. MESH was designed to present a new technology to this computerized market niche. In particular, in large high-rises with a full MESH system, individual tenants may use the MESH server to control access to one or two doors.

The Company s traditional market for the Enterphone product was apartment and condominium buildings. While the market for telephone entry type systems amounts to about US$100 million, in the past 10 years there has been a strong trend towards increased building security resulting in much more sophisticated integrated installations. For example, in 1990, a typical condominium building would be equipped with an intercom to admit visitors. Today, a typical new building installation includes telephone entry, card access, closed circuit cameras, individual burglar alarms and panic stations. This puts pressure on manufacturers to provide a comprehensive package and represents an opportunity for significant revenue growth per system. MESH is the Company s first in-house product that addresses these multiple requirements. The modular nature of MESH also provides the Company with an excellent opportunity to design additional products on the MESH platform to provide enhanced options for a comprehensive building security package.

In addition to apartment entrances, MESH is also designed to provide access control for the rapidly growing gated community market. Monitor style directory panels are also used in thousands of commercial high-rises. The MESH panel provides features previously unavailable for this market. The overall effect of these system advances has enhanced the Company s core business, while allowing the Company to find applications where the new features expand the traditional market for such systems.

The Company is targeting upgrades and retrofits to existing apartments and various government agencies that use traditional telephone wire intercom access control systems. New construction projects are also part of the MESH installation market. The low hardware costs and increased functionality of the MESH system continue to be marketed to building management companies, along with its turnkey installation as a replacement to existing access control systems for most modern buildings.

While complete MESH networks will typically be installed, the modular nature of MESH allows additional segmentation based on product application and end-user need. The nature and scope of a MESH installation depends on the level of security required, the product alternatives, the number of buildings, and the level of system management required. The nature and scope of an installation can be described in terms of a user spectrum ranging from price sensitive users to users requiring enhanced services. At one end of this spectrum is price. For these applications MESH has been competing with traditional Wiegand systems. The Company believes the cost reduction aspects of MESH have provided it with a competitive advantage over traditional Wiegand systems. For example, a typical condominium developer does not manage a building after construction. Therefore, the developer is looking for a very affordable, reliable access control system. Unless a more sophisticated product will help sell suites, the

developer tends to keep the system simple. At the middle of the spectrum are customers who will adopt MESH mainly due to system benefits. For a commercial high-rise this may be the flexibility derived from a new user profile approach MESH uses for programming. On the enhanced service end of the spectrum the Company finds customers who need to develop a much closer relationship due to the level of sophistication of their needs. At this level, the Company anticipates additional revenue opportunities for custom programming, data mining and hosting, and direct installations for national accounts.

While the core function is controlling access/egress, through the planned development of various MESH technology modules, the Company has been actively targeting all of these segments. For example, a MESH add-on module can be developed to provide an asset tracking system to prevent computer theft. The inherent alarm functions of MESH allow it to be used as an integrated theft/burglar alarm system for large facilities. The MESH telephony video capture function will allow government agencies to track alcohol and drug problem tenants of controlled housing complexes or other regulatory monitoring functions. Finally, MESH, along with the EmerPhone, can function to combat vandalism and to secure parking lots.

The Company ranks controlling access/egress and securing parking facilities as the primary concerns of its traditional core multi-residential business.

Distribution Plan

The Company currently has approximately 500 dealers for its existing products throughout North America. When the existing business was acquired from BC Tel, the Company relied primarily on exclusive and semi-exclusive dealers in certain major metropolitan areas. The Company s distribution network is not static and the Company is constantly seeking additional sales channels. In October and November of 2003, the Company signed a distributor deal with Tri Ed, the security distribution subsidiary of Tyco. The agreement placed the Company s security products in 27 Canadian and U.S. Tyco branches, including Denver, Dallas, Phoenix, Seattle and six locations in California.

As previously noted MESH can serve several different markets and the type of dealer serving each may vary. Simple installations may be performed by small independent dealers, but as the overall scope of the project increases, the technical ability of the dealer becomes increasingly important. At the extreme, employees may be directly involved with the customer in designing, installing and servicing the product. In other cases, personnel may be involved on a co-op basis with large national security, building automation and heating/ventilation and air-conditioning contractors.

These distribution deals, along with the existing dealer base, gave the Company immediate access to the largest networks of dealers in the US, Canada and Mexico.

During the past year, the Company has been targeting its existing markets for the sale of MESH technology, as well as targeting the international marketplace. Internationally, the Company has sold MESH in China, India, France, and New Zealand. In particular, we have formed a business relationship with an established company in Mumbai, India to establish a market share for the MESH Freedom Bridge. MESH is designed to accommodate foreign languages with minimal modifications to the software. This is in contrast to other products of its type which require a heavy software investment to provide alternative language software. With MESH, the core software can be applied in all languages with only the on screen text displays needing to be translated. Translation can be accomplished using commercially available translation software.

MESH Marketing Strategy

The Company has been using its established distribution channels, as well as new distribution channels to access its target markets for the MESH technology. As a unique technology, however, end-users as well as dealers must be educated about MESH benefits. It is the Company s experience that a stronger initial emphasis on end-user decision-makers and large national system integrators will be the most effective in developing the MESH market.

Advertising

Products are advertised on an ongoing basis in various print publications, which the Company will continue to do. We have been testing new publications on a regular basis to evaluate response, sales and readership. All leads are followed up and magazines are rated based on a dollar sale per advertising dollar spent ratio. While the sales cycle is sometimes fairly long, this approach has given the Company a very accurate measure of the effectiveness of various publications

and individual ads.

Trade Shows

During 2011, the Company increased its participation at tradeshows to increase the awareness of MESH and MESH Freedom. During 2012, we will continue to attend tradeshows to keep up the exposure for MESH and MESH Freedom.

Direct Marketing

The Company continued educating customers about MESH technology by holding MESH training seminars throughout the U.S. and at our head office, via the internet.

Pricing Strategy

The MESH technology is built on an architecture which can reduce user costs significantly. The modular nature of the technology amplifies this effect the larger the system becomes.

With a unique product and a position of product leadership, the Company has devised a strategy of building market share. This strategy involves selling MESH at reasonable 50-60% margins. With the telephony component, the Company has been targeting a price which provides MESH panels at a price that is competitive with similar products, but with newer enhanced features.

COMPETITION

Competitive Summary

The security and building control industry is undergoing a rapid period of consolidation. Large multi-national companies are integrating vertically by acquiring equipment providers to build house brands. Recent examples are the purchase of Cardkey by Johnson Controls, Guardall by Chubb and ADI/Northern Computers by Honeywell. The access control industry is very segmented with no company having a dominant market position. Canada has approximately six access control product manufacturers, while the U.S. has at least fifty. There is a certain amount of vertical integration in the business and several large multinational companies own their own house brands. Many branches of these multinational companies often have their own brand preferences and buy outside their internal distribution channels.

Almost all manufacturers build control hosts based on Wiegand technology. Due to these limitations, most research and development is focused on cost reducing hardware and making the control hosts more network capable. In all cases, the manufacturers using traditional Wiegand technology are limited from 1 to 8 doors per host.

Competitive Threats

The Company has a strong dealer and distribution plan in place and MESH has positioned it in a market dominated by much larger players. The higher security MESH applications are also somewhat outside of the traditional scope of business and therefore, the Company is rapidly trying to develop a market for MESH and in the process, educating users of MESH through training seminars. The Company believes that marketing strategies and training seminars will provide benefits that will help it achieve market share that will allow it to remain competitive. There is no guarantee that the Company will be able to successfully compete against its larger competitors.

While MESH is still a new product in an established growing market, technological change can be met with resistance. Some buyers are nervous about new products, and new protocols even more so. Most buyers are familiar with the benefits of addressable fire alarms and the Company has marketed MESH from this point of view; that is to stress the inevitability of all access control systems evolving this way.

A key concern is the ability of competitors to imitate the product and the ability of large imitators to more easily commercialize their product. We have estimated that the Company still has a three-year market lead. Fortunately, the wide range of MESH software applications should provide the Company with an ongoing lead, as long as it is aggressive with research and development.

INTELLECTUAL PROPERTY

The Company will rely on a combination of non-disclosure and other contractual agreements, and technical measures to protect the confidential information, know-how, and proprietary rights relating to Enterphone, MESH and other Viscount products. The Company has contractual rights with respect to registered North American trademark and trade name for Enterphone (word alone). The Company is still considering registering North American trade names for MESH.

The Company has registered active Internet domain names for www.viscount.com , www.enterphone.net, and www.enterphone.org.

Standard employment agreements and license agreements contain provisions that protect the confidentiality of proprietary technology. All our employees and sales agents are required to sign these agreements prior to their employment or engagement.

To date the Company has not received notification that its services or products infringe the proprietary rights of third parties. Third parties could however make such claims of infringement in the future. The Company cannot be certain that others will not develop substantially equivalent or superseding proprietary technology, or that equivalent services will not be marketed in competition with the Company s services, thereby substantially reducing the value of its proprietary rights. Furthermore, there can be no assurance that any confidentiality agreements between the Company and its employees or any license agreements will provide meaningful protection for its proprietary information in the event of any unauthorized use or disclosure of such proprietary information.

GOVERNMENT REGULATIONS

Some of the Company s products are still under government regulation. The Enterphone is an interposition technology which in U.S. states can only be installed where the local public service commission has designated the original point of entry of a building as the demarcation point between the telephone company and building owner s responsibility. Conversely, it can also be installed where the telephone company has given consent to allow Enterphone to share the telephone backbone.

The history of government deregulation for the Company mainly relates to the demarcation point in a building. Until government deregulation came to the access control industry, Enterphone type systems could only be installed by telephone companies.

After the break-up each regional telephone company began to make its own decisions. As a result of this, Chicago, New York, and Boston became strong markets for the Enterphone. Another result of government deregulation was that many telephone companies withdrew from the access control systems industry, which resulted in the Company using direct dealers in those regions.

SOURCES OF REVENUES

The majority of the Company s revenues were derived from the MESH and Enterphone product lines. In fiscal 2011, MESH sales represented 51% of total revenue, while Enterphone product sales represented 11% of total revenue. The balance of the Company s revenues were derived from service agreements, and other products such as access tracking and control, closed circuit monitors, infrared and radio frequency remotes.

EMPLOYEES

Viscount employs twenty six staff at its production facility and head office located in Burnaby, British Columbia, Canada.

Item 1A. RISK FACTORS

Risks related to the business and the Company s shares:

Other companies with greater resources than we have are currently developing or have commercially available products that use similar technology to MESH product and the company may lose potential market share as a result.

The MESH access control product is based on intelligent access modules, which use commercially available programmable microchip technology. Due to increasing availability and decreasing price of programmable microchips, the development and commercialization of intelligent access control systems is not unique to the Company. There are other companies that have developed or are developing similar products that use intelligent cards and card readers that will be competing with the Company in the access control industry. These competitors may have substantially greater financial, technical, marketing and management resources than the Company has. The Company s ability to compete successfully will depend on its ability to educate and use existing sales channels and develop new sales channels. To the extent that competitors have more resources to market products based on similar technology, the Company may lose market share which would decrease the value of an investment in its common stock, or may cause the value of an investment in the Company s common stock to decrease.

The loss or unavailability of Stephen Pineau, the Company s President, Principal Executive Officer, and Principal Financial Officer for an extended period of time could adversely affect business operations and prospects.

The Company s success depends, to a significant degree, upon the effort and skill of Stephen Pineau, president and chief executive officer. The Company does not maintain key man insurance on Mr. Pineau. Due to his knowledge of operations and products, the loss, incapacity, or unavailability of Mr. Pineau could have a material adverse effect on the business, financial condition or results of operations, which would likely result in a decrease in the value of an investment in our common stock.

Because common stock trades at prices below US$5.00 per share, and because the Company is not listed on a national exchange, there are additional regulations imposed on broker-dealers trading in the Company s shares that may make it more difficult for you to resell the Company s shares.

Because of rules that apply to shares with a market price of less than US$5.00 per share, known as the penny stock rules , investors in this offering will find it more difficult to sell their securities. The penny stock rules currently apply to trades in the Company s shares. These rules in most cases require a broker-dealer to deliver a standardized risk disclosure document to a potential purchaser of the securities, along with additional information including current bid and offer quotations, the compensation of the broker-dealer and its salesperson in the transaction, monthly account statements showing the market value of each penny stock held in the customer s account, and to make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser s written agreement to the transaction.

Directors and officers hold approximately 56% of the Company s common stock and acting together may have the ability to control management and affairs of Viscount and to deter changes in control.

The Company s directors and officers collectively hold approximately 21% of our current issued and outstanding voting shares. As a result, such persons, acting together, may have the ability to control most matters submitted to our

stockholders for approval, including the election and removal of directors, and to control the management and affairs of Viscount. In addition, Articles of Incorporation include provisions that management can use to retain control over Viscount. Accordingly, such concentration of ownership, coupled with management friendly anti-takeover provisions, may have the effect of delaying, deferring or preventing a change in control of Viscount, impeding a merger, consolidation, takeover or other business combination or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company, which limits the ability of stockholders to participate in opportunities that may increase the value of their stock.

Item 2. DESCRIPTION OF PROPERTY

PROPERTY

The Company s executive office and central factory is located in Burnaby, British Columbia, where the Company currently leases 12,040 square feet. The Company leases this space under an industry standard operating lease with a term expiring May 31, 2013, renewable at the option of Viscount. Current monthly lease obligations are $11,528. The Company believes that its current facilities are adequate and are suitable for its current use, and that suitable additional facilities will be available, when needed, upon commercially reasonable terms. The Company s facilities are adequately insured against perils in a manner consistent with industry practice.

Item 3. LEGAL PROCEEDINGS

None.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II.

Item 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND PURCHASES OF EQUITY SECURITIES

Trades in the Company s common shares are quoted on the Over-the-Counter Bulletin Board (OTC Bulletin Board) which is a quotation service administered by the Financial Industry Regulatory Authority (FINRA). The Company s trading symbol on this service is VSYS .

The OTC Bulletin Board has a limited and sporadic trading market and does not constitute an established trading market. The Company s shares began trading on February 12, 2002. The following table sets forth the range of high and low price information of the common shares as reported on the OTC Bulletin Board for the last three fiscal years and the subsequent period ending March 14, 2012. The price information available reflects inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

		High (U.S. $)	Low (U.S. $)
2012	First Quarter (through February 28, 2012)	$0.06	$0.04
2011	Fourth Quarter	0.09	0.05
	Third Quarter	0.14	0.06
	Second Quarter	0.57	0.12
	First Quarter	0.34	0.23
2010	Fourth Quarter	0.25	0.10
	Third Quarter	0.20	0.10
	Second Quarter	0.18	0.12
	First Quarter	0.19	0.14

As of February 28, 2012 there were 82 holders of record of the Company s common stock, holding a total of 76,733,750 shares, and an unknown number of beneficial holders.

The Company has not declared any dividends in the last two fiscal years.

The following table sets forth information detailing the Company s compensation plans as at December 31, 2011, under which shares of our common stock are authorized to be issued.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Stock Options Warrants	9,748,125 37,482,650	US$0.06 US$0.09	0 0
Equity compensation plans not approved by security holders	N/a	N/a	N/a
Total	47,230,775		0

Item 6. SELECTED FINANCIAL DATA

Not applicable.

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discusses the Company s financial condition and results of operations based upon its consolidated financial statements which have been prepared in conformity with accounting principles generally accepted in the United States of America. It should be read in conjunction with the Company s financial statements and the notes thereto included elsewhere herein. All dollar amounts are in Canadian dollars unless otherwise noted.

RESULTS OF OPERATIONS

Sales revenues for the years ended December 31, 2011 and 2010 were $3,470,848 and $3,916,924, respectively, a decrease of $446,076 or 11.4% . This decrease in sales for the year ended December 31, 2011 resulted from decreased sales of MESH systems due to the slower U.S. and Canadian economies. MESH sales for the years ended December 31, 2011 and 2010 were $1,770,202 and $2,125,142, respectively, a decrease of $354,940 or 16.7% . MESH sales for the year ended December 31, 2011 were 51.0% of total sales, as compared to 54.3% of total sales for the year ended December 31, 2010. MESH is a convergent technology developed by Viscount that increases security at a reduced cost of hardware, cabling and installation, and with simplified database management. Enterphone 2000 sales for the years ended December 31, 2011 and 2010 were $394,039 and $353,573, respectively, an increase of $40,466 or 11.4% . Enterphone 2000 sales for the year ended December 31, 2011 were 11.4% of total sales, as compared to 9.0% of total sales for the year ended December 31, 2010. As an older technology, Enterphone sales are no longer a significant part of our total sales. MESH EPX is the replacement for our old Enterphone system. MESH EPX is the next generation of Enterphone systems but with features that are compatible with high speed internet and other newer technologies. The Company has also introduced MESH Freedom, the new IT platform, developed and released during the last quarter of

2010. This IT platform can turn any card reader into an IP device by connecting the Freedom IP device with built-in I/O to a POE switch and then every card usage is processed on a redundant MESH server either in your building or anywhere in the world. The software component of MESH Freedom is the MESH web browser security operating platform. Unlike control panels, the user database and the door control software is written in IT language located on a server(s), thereby future proofing systems from the traditional issue of proprietary hardware version obsolescence and improving scalability by eliminating the need for additional hardware every time a reader is added to the system.

The Company also provides Enterphone support and maintenance services pursuant to service contracts that were assigned to the Company from Telus Corporation in 2003. Sales from the 1,428 existing service contracts continue to be steady. On average, each service contract represents ongoing revenues of approximately $38 per month, inclusive of parts and labor. Typical customers include strata management and building owners as well as various residential, business and industrial users of Enterphone access control and security systems. During the twelve months ended December 31, 2011, customer service contracts and new equipment sales generated aggregate sales revenues of $1,117,522, as compared to $1,246,835 for the year ended December 31, 2010, a decrease of $129,313 or 10.4% . This decrease was due to a slower Canadian economy.

The intangible assets held by the Company are comprised primarily of service contracts for our Enterphone 2000 product line. The number of service agreements held by the Company was 1,428 at December 31, 2011, as compared to 1,482 at December 31, 2010. During the first three quarters of 2011, the Company performed a test for impairment and evaluated the status of service agreements. Management determined that no charge for impairment was required but the continuing reduction in the number of service contracts held, indicated that the intangible asset should be deemed to have a definitive life. Accordingly, the Company continued to amortize the cost of the service agreements on a straight-line basis over an estimated useful life of 10 years, which became effective as of April 1, 2005. At December 31, 2011, the cost of the service agreements, net of accumulated amortization, was $67,900.

The cost of sales as a percentage of sales was 42.4% for the year ended December 31, 2011, as compared with the cost of sales as a percentage of sales of 45.4% for the year ended December 31, 2010. Costs of sales as a percentage of sales has decreased slightly as a result of a decline in sales as well as through the use of lower cost input materials in the MESH and Freedom Bridge products. Management has continued to focus on controlling the input costs by using multiple suppliers to ensure that the best and most cost effective raw materials are used in all of our products.

Gross profit for the year ended December 31, 2011 was $1,997,663, as compared to $2.138,357 for the year ended December 31, 2010, a decrease of $140,694 or 7.0% . This decrease corresponds with a decreased sales and consistent cost of sales for the year ended December 31, 2011.

Selling, general and administrative expenses for the years ended December 31, 2011 and 2010 were $3,379,100 and $2,628,495, respectively, an increase of $750,605 or 28,6%. This increase was mainly due to increased marketing expenses to promote the new MESH Freedom product and various selling, general and administrative expenses. Also included in selling, general and administrative expenses for the year ended December 31, 2011 was stock-based compensation expense of $426,427, compared to $456,647 in the corresponding period in 2010. For the years ended December 31, 2011 and 2010, selling, general and administrative expenses, as a percentage of sales, were 97.4% and 67.1%, respectively. The year ended December 31, 2011 saw significant increases in advertising, travel, tradeshow, consulting fees, and various office expenses as part of the Company s increased marketing and promotional efforts.

Research and development costs were $460,520 for the year ended December 31, 2011, as compared to $363,816 for the year ended December 31, 2010. Research and development costs increased by $96,704 or 26.6% . Research and development have increased during these two comparative periods, as we have been developing the new MESH Freedom system.

Net loss before income tax for the year ended December 31, 2011 was $2,883,304, as compared to a net loss before income tax of $1,340,053 for the year ended December 31, 2010, an increased loss of $1,543,251. This increase in loss was the result of increased advertising, travel, tradeshow, consulting fees, and various office expenses. The increase in loss was also a result of a fair value adjustment of certain outstanding warrants that are accounted for as derivative financial instruments. The fair value adjustment has no cash flow impact and the charge to net loss was $1.014,834 credited to net income for the year ended December 31, 2011.

LIQUIDITY, CAPITAL RESOURCES AND GOING CONCERN

Cash as of December 31, 2011, as compared to December 31, 2010 was $169,322 and $820,344, respectively, a decrease of $651,022. On December 7, 2010, the Company completed a private placement of 4,000,000 units (12,000,000 units on a post 3:1 forward-stock-split basis) at a price of $0.15 per unit for total proceeds of $600,000. Each unit consisted of one common share and one share purchase warrant of the Company, with each warrant exercisable to acquire an additional share of the Company at a price of $0.24 ($0.08 on a post forward-stock-split basis) for a period of 5 years, expiring December 7, 2015. On March 3, 2011, the Company completed a private placement of 3,650,000 units (10,950,000 units on a post 3:1 forward-stock-split basis) at a price of $0.15 per unit for total proceeds of $547,500. Each unit consisted of one common share and one share purchase warrant of the Company, with each warrant exercisable to acquire an additional share of the Company at a price of $0.24 ($0.08 on a post forward-stock-split basis) for a period of 5 years, expiring March 3, 2016.

At December 30, 2011 the Company s credit facility of which the lesser of $500,000 or 75% of accounts receivable less than 90 days at the prime lending rate plus 1.75% could have been drawn was suspended due to the bank s assessment of the Company s financial position. At December 31, 2011, $nil was drawn on this facility.

At December 31, 2011, working capital was $133,449 as compared to a working capital of $984,984 at December 31, 2010. Working capital has decreased by $851,535. The current ratio at December 31, 2011 was 1.14 to 1.0, as compared with 2.05 to 1.0 at December 31, 2010.

The Company has been working to finance operations and future growth through a stock-based equity injection of up to $2 million. The Company has received term sheets and is expecting to close the financing by April 2012.

The Company s financial statements have been prepared on a going concern basis, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company has an accumulated deficit of $5,769,027, reported a loss in 2011 of $2,883,304 and has working capital of $133,449 at December 31, 2011. Cash flows used in operating activities for the year ended December 31, 2011 were $1,138,544. Although management is confident that the company can access, sufficient working capital to maintain operations and ultimately generate positive cash flow from operations, the ability to sustain the current level of operations is dependent upon growing sales and achieving profits. Management has determined that the Company will need to raise a minimum of $500,000 before the end of the second quarter of fiscal 2012, by way of debt or equity financing, to continue normal operations for the next twelve months. Management has been actively seeking new investors and developing customer relationships, however a financing arrangement has not yet completed. Short-term loan financing is anticipated from related parties, however there is no certainty that loans will be available when required These factors raise substantial doubt about the ability of the Company to continue operations as a going concern.

The accounts receivable turnover ratio at December 31, 2011 was 51 days, as compared 73 days at December 31, 2010. The decrease at December 31, 2011 was the result of receiving payment in its entirety by one large accounts receivable from a large customer. The accounts receivable reserve was $133,389 at December 31, 2011, as compared to $97,642 at December 31, 2010. The accounts receivable reserve has increased by $35,747 or 36.6%, since the year ended December 31, 2010. Management continues to follow-up on customer accounts to improve cash flow and to minimize bad debts. There had been no significant or material business conditions that would warrant further increases to the reserve at this time.

The Company is subject to significant liquidity risk. At December 31, 2011, the Company s current assets consist principally of trade accounts receivables and inventory. The Company must liquidate inventories and rapidly increase collection periods on its receivables to ensure that sufficient cash is available to settle payables and operating costs as they come due.

For the year ended December 31, 2011, there were no significant capital expenditures.

To date, the Company has not invested in derivative securities or any other financial instruments that involve a high level of complexity or risk. The Company expects that in the future, any excess cash will continue to be invested in high credit quality, interest-bearing securities.

The Company will likely require additional funds to support the development and marketing of its new MESH product. There can be no assurance that additional financing will be available on acceptable terms, if at all. If adequate funds are not available, the Company may be unable to develop or enhance its products, take advantage of future opportunities, respond to competitive pressures, and may have to curtail operations.

There are no legal or practical restrictions on the ability to transfer funds between parent and subsidiary companies.

The Company does not have any material commitments for capital expenditures as of December 31, 2011.

Related Party Transactions

None.

Critical Accounting Policies:

The Company s discussion and analysis of its financial condition and results of operations, including the discussion on liquidity and capital resources, are based upon the Company s financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management re-evaluates its estimates and judgments, particularly those related to the determination of the allowance for doubtful accounts, inventory obsolescence, the provision for future warranty costs, the estimated useful lives of equipment and intangible assets, the deferred tax valuation allowance, and assumptions used to determine the fair value of stock-based compensation. Details are provided for critical estimates are as follows:

The Company follows the cost reduction method of accounting for investment tax credits and recognizes the estimated net recoverable amount when reasonable assurance exists as to their collectability. Investment tax credits claimed are ultimately subject to finalization of a review by Canada Customs and Revenue Agency. No assurances can be provided that the Company s investment tax credit claims will be accepted as filed.

The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the uncollectability of the Company s trade accounts receivable balances. If the Company determines that the financial conditions of any of its customers deteriorated, whether due to customer specific or general economic issues, increases in the allowance may be made.

The Company reviews its intangible assets on an annual basis for impairment. The intangible assets are comprised of Enterphone service contracts. Management specifically reviews the number of contracts on hand and if there will be significant future cash flows to be generated from these contracts. If the Company determines that there is impairment, then a write-down will be made.

The Company maintains an allowance for inventory obsolescence. Management reviews the inventory on a quarterly basis by directly testing for obsolete inventory. The Company increased its provision for obsolete inventory by approximately $187,000 during the fourth quarter of 2010 as a result of a revised estimate by management.

Income taxes are accounted for under the asset and liability method. Under this method, to the extent that it is not more likely than not that a deferred tax asset will be recovered, a valuation allowance is provided. In making this determination, the Company considers estimated future taxable income and taxable timing differences expected to reverse in the future. Actual results may differ from those estimates.

Derivative financial instruments that are not classified as equity and are not used in hedging relationships are measured at fair value. Susequent changes to fair value are recorded in the statement of operations.

RECENTLY ISSUED ACCOUNTING STANDARDS

Adoption of new accounting pronouncements

In January 2010, the Company adopted an amendment to Financial Accounting Standards Board (or FASB) Accounting Standards Codification (or ASC) 810, Consolidations, that eliminates certain exceptions to consolidating qualifying special-purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This amendment also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity s status as a variable interest entity, a company s power over a variable interest entity, or a company s obligation to absorb losses or its right to receive benefits of an entity must be disregarded. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. During February 2010, the scope of the revised standard was modified to indefinitely exclude certain entities from the requirement to be assessed for consolidation. The adoption of this amendment did not have an impact on the Company s consolidated financial statements.

On January 21, 2010, the FASB issued ASU 2010-06, which amends ASC 820 to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. The ASU also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair values. Further, the ASU amends guidance on employer s disclosures about postretirement benefit plan assets under ASC 715 to require that disclosure be provided by classes of assets instead of by major categories of assets. The ASU is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this standard had no impact on the Company s consolidated financial statements.

Recent accounting pronouncements

In October 2009, the FASB issued authoritative guidance on revenue recognition which was effective beginning July 1, 2010. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued authoritative guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. Adoption of this new guidance has not had a material impact on the financial statements.

Other recently issued pronouncements are not expected to be applicable to the Company or have significant impact on the Company s financial statements.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements are attached to this report following the signature page.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

Item 9A. CONTROLS AND PROCEDURES

Management s Evaluation of Disclosure Controls and Procedures

The Company s management, including its principal executive officer who is also our principal financial officer, evaluated the effectiveness of disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based on that evaluation, the principal executive officer and principal financial officer concluded that as of the end of the period covered by this report, the Company has maintained effective disclosure controls and procedures in all material respects, including those necessary to ensure that information required to be disclosed in reports filed or submitted with the SEC (i) is recorded, processed, and reported within the time periods specified by the SEC, and (ii) is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow for timely decision regarding required disclosure.

There have been no changes in internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Management s Report on Internal Control over Financial Reporting

The Company s management is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the *Securities Exchange Act of 1934*. The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2010 using the criteria set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2010, the Company s internal control over financial reporting was not effective based on those criteria. Based on the assessment, management has found the following material weaknesses and significant deficiencies in internal controls:

Material Weaknesses:

a. The Audit Committee and Board of Directors are both wholly composed of members of management. As a result, the Board and the Audit Committee are not independent. In addition, none of the members of the Board or Audit Committee are professionally designated financial experts.
b. Job roles in the accounting department are not adequately segregated to effectively reduce the risk of fraud.
c. Complex financial information and journal entries created during the financial closing process are not reviewed in sufficient detail by senior management or the Board

Significant Deficiencies:

a. Management has not implemented a formalized risk assessment process to address fraud risks as they relate to financial reporting.
b. The compensation committee is wholly composed of members of management.
c. Roles and responsibilities for the financial reporting process are not documented in a formalized manner.
d. All employees have full access to inventories. Inventories are not adequately secured from employees who do not need access.
e. The accounting department has unrestricted access to all parts of the G/L and access to inventory.

f. Management has not implemented a formalized IT policy.
g. Physical access to IT infrastructure is not adequately restricted.
h. Management does not have a data retention policy.

Management is in the preliminary stages of addressing known material weaknesses and significant deficiencies. It plans to remain vigilant and to add additional staff and system improvements as resources permit.

Item 9B. OTHER INFORMATION

Not applicable.

PART III.

Items 10 14

Information with respect to Items 10 through 14 is set forth in the Proxy Statement to be filed with the Securities and Exchange Commission on or before April 30, 2011 and is incorporated herein by reference. If the definitive Proxy Statement cannot be filed on or before April 30, 2011, the issuer will instead file an amendment to this Form 10K disclosing the information with respect to Items 10 through 14.

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Exhibit No.	Description of Exhibit	Manner of Filing
3.1	Articles of Incorporation	Incorporated by reference to Exhibit 3.1 to the Form SB-2 of the Company, SEC File No. 333- 68998 (the Form SB-2)
3.2	Amendment to the Articles of Incorporation	Incorporated by reference to Exhibit 3.2 to the Form SB-2
3.3	Bylaws	Incorporated by reference to Exhibit 3.1 to the Form SB-2
10.1	Employment Agreement with Stephen Pineau	Incorporated by reference to Exhibit 10.2 to the Form SB-2
10.2	Employment Agreement with Greg Chen	Incorporated by reference to Exhibit 10.3 to the Form SB-2
10.3	2001 Stock Option Plan	Incorporated by reference to Exhibit A to the Proxy Statement on Schedule 14A filed with the SEC on April 30, 2002
10.4	2003 Stock Option Plan	Incorporated by reference to Exhibit A to the Proxy Statement on Schedule 14A filed with the SEC on April 30, 2003
21.1	Subsidiaries of the registrant	Incorporated by reference to Exhibit 21.1 to the Form SB-2
31.1	Certification Pursuant to Rule 13a-14(a) or 15d-14(a) of the U.S. Securities Exchange Act of 1934	Filed herewith
32.1	Section 1350 Certification of the Principal Executive Officer and Principal Financial Officer	Filed herewith

Signatures

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 30, 2012.

VISCOUNT SYSTEMS, INC.

By: /s/ Stephen Pineau
Stephen Pineau
President and Principal Executive Officer

In accordance with the requirements of the Exchange Act, this report has been signed by the following persons on behalf of the registrant and in the capacities indicated on the dates indicated.

	Signature	Title	Date
By:	/s/ Stephen Pineau Stephen Pineau	President, Secretary, Principal Executive Officer, Principal Financial Officer and Director	March 30, 2012

VISCOUNT SYSTEMS, INC.

CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in Canadian Dollars)

DECEMBER 31, 2011

VISCOUNT SYSTEMS, INC.

Consolidated Balance Sheets
(Expressed in Canadian dollars)
As at December 31, 2011 and 2010

	2011	2010
Assets		
Current assets		
Cash	$ 169,322	$ 820,344
Trade accounts receivable, less allowance for doubtful accounts of $133,389 (2010 - $97,642) (note 2)	397,813	560,727
Inventory (note 3)	523,943	539,861
Total current assets	1,091,078	1,920,932
Deposits	1,391	5,891
Equipment (note 4)	29,567	35,188
Intangible assets (note 5)	67,900	88,792
Total assets	$ 1,189,936	$ 2,050,803
Liablilities and stockholders' equity (deficit)		
Current liabilities		
Accounts payable	$ 153,642	$ 203,638
Accrued liabilities	567,271	515,611
Deferred revenue	49,545	44,297
Due to related parties (note 7)	187,171	172,402
Total current liabilities	957,629	935,948
Derivative financial liabilities (note 8)	390,824	974,297
	1,348,453	1,910,245
Stockholders' equity (deficit)		
Capital stock (note 9)		
Authorized:		
300,000,000 common shares with a par value of US$0.001 per share		
20,000,000 preferred shares with a par value of US$0.001 per share		
Issued and outstanding:		
76,473,750 common shares (2010 - 65,523,750)	99,252	88,302
Additional paid-in capital	5,617,313	2,937,979
Obligation to issue shares	20,800	-
Deferred compensation (note 9)	(126,855)	-
Accumulated deficit	(5,769,027)	(2,885,723)
Total stockholders' equity (deficit)	(158,517)	140,558
Total liabilities and stockholders' equity (deficit)	$ 1,189,936	$ 2,050,803
Commitments (note 11)		

See accompanying notes to consolidated financial statements.

VISCOUNT SYSTEMS, INC.

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

Years Ended Decemeber 31, 2011 and 2010

	2011	2010
Sales	$ 3,470,848	$ 3,916,924
Cost of sales	1,473,185	1,778,567
Gross profit	1,997,663	2,138,357
Expenses		
Selling, general and administrative	3,379,100	2,628,495
Research and development	460,520	363,816
Depreciation and amortization	26,513	28,062
	3,866,133	3,020,373
Loss before other items	(1,868,470)	(882,016)
Other items		
Interest income	45	117
Interest expense	(16)	(2,344)
Fair value adjustment of derivative liability (note 8)	(1,014,863)	(455,810)
	(1,014,834)	(458,037)
Net loss and comprehensive loss	(2,883,304)	(1,340,053)
Basic and diluted loss per common share	$ (0.04)	$ (0.07)
Weighted average number of common shares outstanding, Basic and diluted	74,613,750	18,104,986

See accompanying notes to consolidated financial statements.

VISCOUNT SYSTEMS, INC.

Consolidated Statement of Stockholders' Equity (Deficit)
(Expressed in Canadian dollars)

Years Ended December 31, 2011 and 2010

	Common Stock Shares	Amount	Additional paid-in capital	Obligation to issue shares	Deferred Compensation	Accumulated deficit	Total
Balance, December 31, 2009	53,523,750	$ 76,302	$ 2,180,723	$ -	$ -	$ (1,545,670)	$ 711,355
Units issued for cash from private placement	12,000,000	12,000	300,609	-	-	-	312,609
Stock-based compensation	-	-	456,647	-	-	-	456,647
Net loss	-	-	-	-	-	(1,340,053)	(1,340,053)
Balance, December 31, 2010	65,523,750	88,302	2,937,979	-	-	(2,885,723)	140,558
Units issued for cash from private placement	10,950,000	10,950	209,217	-	-	-	220,167
Units to be issued for consulting services		-	-	20,800	-	-	20,800
Stock-based compenastion -options	-	-	292,424	-	-	-	292,424
Stock-based compensation - warrants	-	-	312,001	-	(126,855)	-	185,146
Warrant reclassification (Note 8)	-	-	1,865,692	-	-	-	1,865,692
Net loss	-	-	-	-	-	(2,883,304)	(2,883,304)
Balance, December 31, 2011	76,473,750	$ 99,252	$ 5,617,313	$ 20,800	$ (126,855)	$ (5,769,027)	$ (158,517)

See accompanying notes to consolidated financial statements.

VISCOUNT SYSTEMS, INC.

Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

Years Ended December 31, 2011 and 2010

	2011	2010
Operating activities:		
Net loss	$ (2,883,304)	$ (1,340,053)
Items not involving cash:		
Depreciation and amortization	26,513	28,062
Fair value adjustment of derivative liability	1,014,863	455,810
Stock-based compensation	498,370	456,647
Changes in non-cash working capital balances (note 12)	205,014	828,562
Net cash provided by (used in) operating activities	(1,138,544)	429,028
Financing activities:		
Proceeds from private placement, net of issue costs	487,522	605,640
Repayment of bank indebtedness	-	(218,702)
Repayment of stockholder loan	-	(120,000)
Net cash provided by financing activities	487,522	266,938
Increase (decrease) in cash	(651,022)	695,966
Cash, beginning of period	820,344	124,378
Cash, end of period	$ 169,322	$ 820,344
Supplementary information:		
Interest paid	$ 16	$ 2,344
Income taxes paid	$ -	$ -

See accompanying notes to consolidated financial statements.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

1. Nature and continuance of operations

Viscount Systems Inc. (the Company) was incorporated on May 24, 2001 in the State of Nevada. The Company manufactures, distributes, and provides services for electronic premises access and security equipment primarily through its wholly owned Canadian subsidiary Viscount Communication and Control Systems Inc.

These financial statements have been prepared on a going concern basis, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company has an accumulated deficit of $5,769,027, reported a loss in 2011 of $2,883,304 and has working capital of $133,449. Cash flows used in operating activities for the year ended December 31, 2011 were $1,138,544. Although management is confident that the company can access sufficient working capital to maintain operations and ultimately generate positive cash flows from operations, the ability to sustain the current level of operations is dependent upon growing sales and achieving profits. The Company s bank credit facility was suspended on December 30, 2011 due to the bank s assessment of the Company s financial position. Management has determined that the Company will need to raise a minimum of $500,000 by way of new debt or equity financing to continue normal operations for the next twelve months. Management has been actively seeking new investors and developing customer relationships, however a financing arrangement has not yet completed. Short-term loan financing is anticipated from related parties, however there is no certainty that loans will be available when required. These factors raise substantial doubt about the ability of the Company to continue operations as a going concern.

2. Significant accounting policies

These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

The significant accounting policies adopted by the Company are as follows:

(a) Principles of consolidation

The consolidated financial statements include accounts and results of the Company and its wholly-owned subsidiary, Viscount Communication and Control Systems Inc. (VCCS). Intercompany transactions and balances have been eliminated on consolidation.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

2. Significant accounting policies (cont d)

(b) Use of estimates

Management has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in order to prepare these consolidated financial statements in conformity with GAAP. Significant areas involving estimate include the allowance for doubtful accounts, inventory obsolescence, the provision for future warranty costs, the estimated useful lives of equipment and intangible assets, the deferred tax valuation allowance, and assumptions used to determine the fair value of stock-based compensation and derivative liabilities. Actual results could differ materially from those estimates.

(c) Foreign currency translation

The functional and reporting currency of the Company and its wholly-owned subsidiary is the Canadian dollar. Accordingly, the financial statements are presented in Canadian dollars unless otherwise specified. Monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate in effect at the balance sheet date while non-monetary assets and liabilities denominated in a foreign currency are translated at historical rates. Revenue and expense items denominated in a foreign currency are translated at exchange rates prevailing when such items are recognized in the statement of operations. Exchange gains or losses arising on translation of foreign currency items are included in the statement of operations.

(d) Allowance for doubtful accounts

The Company establishes an allowance for doubtful accounts on a specific account basis based on the credit risk of customers, historical trends and other information that management believes is indicative of future losses on accounts receivable. The allowance for doubtful accounts amounted to $133,389 (2010 $97,642)

(e) Inventory

Raw materials, work in process and finished goods are stated at the lower of average cost and net realizable value. Cost includes direct labor utilized in assembly and an allocation of plant overhead.

(f) Equipment

Equipment is stated at cost and depreciated over the estimated useful lives of the assets:

Asset	Basis	Rate
Computer equipment	declining balance	30%
Office furniture and equipment	declining balance	20%

Leasehold improvements	straight-line	20%

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

2. Significant accounting policies (cont d)

(g) Intangible assets

Intangible assets consist of intercom service agreements that are considered to have a finite useful life. They are recorded at cost and are reviewed annually for impairment. On April 1, 2005, the Company began amortizing the cost on a straight-line basis over an estimated useful life of 10 years.

(h) Impairment of long-lived assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount of an asset, or group of assets, to future net cash flows expected to be generated by the asset or group of assets. If such assets are considered to be impaired, an impairment provision is recorded for the amount by which the carrying amount of the assets exceeds fair value.

(i) Revenue recognition

Revenue is recognized when there is persuasive evidence of a sale arrangement, delivery to the customer has occurred, the fee is fixed and determinable, and collectability is considered probable. Sales or transfers to customers prior to these criteria being met are recorded as deferred revenue. Revenue from the installation of equipment is recognized when the installation has been completed, the fee has been fixed and collectability is considered probable.

Service revenue is recognized on a straight-line basis over the period covered by the service agreement only after there is a signed agreement to provide service, the service fee is fixed or determinable and collectability is probable. Cash received from customers, in advance of the service period, is recorded as deferred revenue.

(j) Research and development costs

Research and development costs have been expensed as incurred.

(k) Derivative financial instruments

Derivative financial instruments that are not classified as equity and are not used in hedging relationships are measured at fair value. Susequent changes to fair value are recorded in the statement of operations.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

2. Significant accounting policies (cont d)

(l) Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recognized for the deferred income tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases (temporary differences). Deferred income tax assets and liabilities are measured using enacted income tax rates expected to be recovered or settled. The effect on deferred income tax assets and liabiliites of a change in tax rates is included in income in the period in which the change occurs. The amount of deferred income tax assets recognized is limited to the amount that is more likely than not to be realized.

(m) Net income (loss) per share

Net income (loss) per common share is computed by dividing the net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per common share reflects the potential dilution that could occur if stock options were exercised.

The weighted average number of common shares outstanding for computing basic and diluted net loss per common share was 74,638,723 (2010 18,104,986).

For the year ended December 31, 2011, 9,748,125 (2010 3,363,800) shares attributable to the assumed exercise of outstanding options and 37,482,650 (2010 7,677,550) shares attributable to the assumed exercise of outstanding warrants were excluded from the calculation of diluted loss per share because the effect was antidilutive.

(n) Stock-based compensation

The Company has adopted the fair value method of accounting for all stock-based compensation expense. Stock-based compensation expense is recognized in the consoldiated financial statements for granted, modified, or settled stock options and compensation warrants issued to employees for services.

(o) Comprehensive income (loss)

The Company has no items of other comprehensive income (loss) in any year presented. Therefore, net income (loss) presented in the consolidated statements of operations equals comprehensive income (loss).

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

2. Significant accounting policies (cont d)

(p) Recently issued, accounting pronouncements

In June, 2011, the FASB issued ASU No. 2011-05, which amends ASC Topic 220, Comprehensive Income. Under the amendment, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in this ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this ASU should be applied retrospectively.

Additionally, the FASB issued a second amendment to ASC Topic 220 in December 2011, ASU No. 2011-12, which allows companies the ability to defer certain aspects of ASU 2011-05. For public entities, these amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments do not require any transition disclosures.

On September 15, 2011, the FASB issued ASU 2011-08, Intangibles Goodwill and Other, which simplifies how an entity is required to test goodwill for impairment. This ASU will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under the ASU, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The ASU includes a number of factors to consider in conducting the qualitative assessment. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

3. Inventory

	2011	2010
Raw materials	$ 297,741	$ 210,442
Work in process	2,679	106,852
Finished goods	223,523	222,567
	$ 523,943	$ 539,861

4. Equipment

2011	Cost	Accumulated depreciation	Net book value
Computer equipment	$ 110,838	$ 98,133	$ 12,705
Office furniture and equipment	77,269	61,082	16,187
Leasehold improvements	46,814	46,139	675
	$ 234,921	$ 205,354	$ 29,567

2010	Cost	Accumulated depreciation	Net book value
Computer equipment	$ 110,838	$ 96,088	$ 14,750
Office furniture and equipment	77,269	58,362	18,907
Leasehold improvements	46,814	45,283	1,531
	$ 234,921	$ 199,733	$ 35,188

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

5. Intangible assets

On May 16, 2003, the Company entered into an agreement for the purchase of certain assets of Telus Corporation (Telus). The assets comprised primarily, service agreements for a product sold by Telus known as Enterphone 2000 . At December 31, 2003, the Company had acquired 2,215 service agreements for which it paid a total of $208,921. At December 31, 2011, the Company held 1,428 service agreements (December 31, 2010 1,482) at a carrying cost, net of accumulated amortization of $141,021 (December 31, 2010 - $120,129), of $67,900 (December 31, 2010 - $88,792).

The expected amortization expense for each of the next four fiscal years is as follows:

Year ending December 31:

2012	$	20,892
2013		20,892
2014		20,892
2015		5,224

6. Bank indebtedness

The Company s bank credit facility was suspended on December 30, 2011 due to the bank s assessment of the Company s financial position. This credit facility would have allowed it to borrow up to a maximum of $500,000 or 75% of its accounts receivable, less than 90 days old. Amounts outstanding under the bank credit facility were subject to interest at the bank s prime lending rate plus 1.75% and were repayable on demand.

7. Due to related parties

Amounts due to stockholders in the amount of $172,402 (2010 - $172,402) are non-interest bearing, unsecured and have no fixed terms of repayment.

Amounts due to related parties for director fees and travel expenses are $14,769 (2010 - $nil).

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

8. Derivative liabilities

Derivate financial liabilities consist of warrants that were originally issued in private placements that have exercise prices denominated in United States dollars, which differs from the Company s functional currency. The table below provides a summary of the changes in fair value, including net transfers, in and/or out, of financial liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

Fair Value Measurements Using Level 3 Inputs

	Derivative liability - warrants
Balance, December 31, 2009	$ 225,456
Fair value of warrants issued in December 2010	293,031
Total fair value adjustment	455,810
Balance December 31, 2010	974,297
Total fair value adjustment	1,014,864
Fair value of warrants issued in March 2011	267,355
Transfers out to Equity	(1,865,692)
Balance, December 31, 2011	$ 390,824

During the year ended December 31, 2011, the Company recognized a charge to operations of $1,014,864 (2010 $455,810) being the change in the fair value of the derivative warrants during the year.

Number of Warrants	Expiry Date	Exercise Price	Amended Exercise Price	Fair Value at Amended Exercise Price
813,000	April 16, 2012	US$ 0.080	$ 0.080	$ 64,421
9,250,002	December 7, 2015	US$ 0.080	$ 0.080	1,034,905
6,000,000	March 3, 2016	US$ 0.080	$ 0.080	766,366
16,063,002				$ 1,865,692

During the three month period ended June 30, 2011, the Company obtained the consent of 16,063,002 warrant holders to change the exercise currency of their warrants from United States dollars to Canadian dollars. The change in the exercise currency of the warrants constitutes an extinguishment of the existing instruments and constitutes a new instrument.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

8. Derivative liabilities (cont d)

As the exercise price of these warrants no longer differs from the Company s functional currency, their fair value was reclassified to equity on the date of conversion. The total amount reclassified to additional paid-in capital totaled $1,865,692.

The fair value of these warrants was determined using the Black-Scholes option pricing model using the following assumptions:

	December 31, 2011	December 31, 2010
Volatility	180%	175% - 201%
Dividend yield	-	-
Risk-free interest rate	0.30% - 2.24%	0.29% - 2.01%
Expected life	0.54 4.17 yrs	1.29 4.94 yrs

9. Capital stock

Common stock:

Each share of common stock has the same rights, privileges and preferences. The holders of the outstanding common stock are entitled, in the event of liquidation, to a pro rata share of net assets, subject to any rights that may be applicable on any preferred stock. The Board of Directors has the authority to determine and amend the designation, preferences, limitations and relative rights of preferred stock. There was no preferred stock issued and outstanding at December 31, 2011 and 2010.

Effective April 18, 2011, the Company completed a three for one forward-stock-split of its common stock with a corresponding increase in its authorized common stock from 100,000,000 shares of common stock to 300,000,000 shares of common stock. All common stock, option, warrant and per share amounts are stated retroactively to reflect the forward- stock-split.

On December 7, 2010, the Company completed a private placement of 12,000,000 units, at a price of US$0.05 per unit, for gross proceeds of CDN$605,640 (US$600,000). Each unit consisted of one common share of the Company and one common share purchase warrant. Each share purchase warrant entitles the holder to acquire one additional common share of the Company for US$0.08 per share until December 7, 2015. $293,031 of the proceeds were allocated to the warrants and recorded as a derivative liability. The fair value was determined using the Black-Scholes option pricing model, adjusted for market liquidity and allocated on a relative basis.

VISCOUNT SYSTEMS, INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)
December 31, 2011

9. Capital stock (cont d)

Common stock (cont d):

On March 3, 2011, the Company completed a private placement of 10,950,000 units at a price of US$0.05 per unit for total proceeds of $542,272 (US$547,500). Each unit consisted of one common share and one share purchase warrant of the Company, with each warrant exercisable to acquire an additional share of the Company at a price of US$0.08 for a period of 5 years, expiring March 3, 2016. Upon issuance of the units, $267,355 of the proceeds were allocated to the warrants and recorded as a derivative liability and the balance of $220,167, which is net of share issuance costs of $54,750, was allocated to common stock and additional paid-in capital. The fair value of the warrants was determined using the Black- Scholes option pricing model using the following assumptions: volatility of 177%; a dividend yield rate of 0%; a risk-free interest rate of 2.24% and an expected life of five years, adjusted for market liquidity and allocated on a relative basis.

On November 10, 2011, the Company entered into a consulting agreement for business relations, research services and consulting for equity placements, whereby the Company was required to issue 260,000 common shares at a price of $0.08, the stock price at the agreement date. The shares were issued on January 6, 2012. As at December 31, 2011 an obligation to issue shares was recorded in the amount of $20,800 as the shares had not yet been issued..

Stock options:

The Company has the following stock option plans which serve as equity incentive programs for management, qualified employees, members of the Board of Directors and independent advisors or consultants outstanding as at December 31, 2011:

(i) The 2001 Stock Option Plan (the 2001 Plan), which became effective on December 21, 2001, permits, at any one time, up to 4,500,000 shares of common stock to be reserved for issuance. The maximum term during which a vested option may be exercised is ten years from the date of grant. The vesting period and the option price are determined by the compensation committee. The option price may be set at a discount to the closing price on the date of grant unless it is an incentive stock option. As at December 31, 2011, the total number of stock options outstanding under the 2001 Plan is 416,400.

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9. Capital stock (cont d)

Stock options (cont d):

(ii) The 2003 Stock Option Plan (the 2003 Plan), which became effective on January 3, 2003 and amended on July 10, 2007 permits, at any one time, up to 8,806,530 shares of common stock to be reserved for issuance. The maximum term during which a vested option may be exercised is ten years from the date of grant. The vesting period and the option price are determined by the compensation committee. The option price may be set at a discount to the closing price on the date of grant unless it is an incentive stock option. As at December 31, 2011, the total number of stock options outstanding under the 2003 Plan is 7,100,625.

On April 11, 2011, the Company granted 2,325,000 fully vested stock options to various employees. The options have an exercise price of US$0.08 each and expire on April 11, 2016. The Company recorded stock-based compensation expense of $292,424, being the estimated fair value of this grant. The fair value was determined using the Black-Scoles option pricing model with the following assumptions: expected life of 5 years; volatility of 180%; risk-free interest rate of 2.24%; and a dividend rate of 0%. As at December 31, 2011, 93,900 of the options granted on April 11, 2011 had been cancelled.

During the year ended December 31, 2010, the Company recorded stock-based compensation of $456,647 relating to the issuance of 1,000,000 warrants each to the President of the Company and an employee. The stock-based compensation reflects the issue date fair value of the warrants. Each warrant is exercisable into a common share of the Company at a price of US$0.08 per share for a period of 5 years expiring December 23, 2015. To determine the fair value of these warrants the Company used the Black-Scholes option pricing model with the following weighted average assumptions: average expected stock price volatility of 174%, expected dividend yield of 0%, risk-free interest rate of 2.09% and an expected option life of 5 years.

A summary of the stock option activity during the year ended December 31, 2011 is as follows:

	Number of options	Weighted average Exercise price
Outstanding at December 31, 2010	10,091,400	US$0.10
Granted	2,325,000	US$0.08
Expired/cancelled	(2,668,275)	US$0.10
Outstanding at December 31, 2011	9,748,125	US$0.06

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9. Capital stock (cont d)

Stock options (cont d):

A summary of the stock options outstanding and exercisable at December 31, 2011 is as follows:

Exercise Price	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Aggregate Intrinsic Value
US$ 0.040	6,206,250	2.11 years	US$ 0.040	US$ 124,125
0.080	2,325,000	4.28 years	0.080	-
0.060	33,750	3.95 years	0.060	-
0.133	982,500	0.59 years	0.133	-
0.150	22,500	3.98 years	0.150	-
0.183	15,000	3.98 years	0.183	-
0.200	7,500	3.98 years	0.200	-
0.217	155,625	1.71 years	0.217	-
	9,748,125	2.43 years	US$ 0.060	US$ 124,125

The aggregate intrinsic value in the preceding table represents the total intrinsic value, based on the Company s closing stock price of US$0.06 per share as of December 31, 2011 (December 31, 2010 US$0.077), which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options vested and exercisable as of December 31, 2011 was 6,206,250 (December 31, 2010 6,240,000).

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9. Capital stock (cont d)

Warrants:

A summary of warrant activity during the twelve months ended December 31, 2011 is as follows:

	Number of warrants		Weighted average Exercise price
Outstanding at December 31, 2010	23,032,650	$	0.08
Issued as part of private placement	10,950,000		0.08
Issued as compensation to consultant	2,500,000		0.15
Issued as compensation to board of directors	1,000,000		0.10
Outstanding at December 31, 2011	37,482,650	$	0.09

On December 7, 2010, the Company issued 12,000,000 warrants as part of the 12,000,000 unit private placement for total proceeds of $600,000. Each warrant is exercisable into one share of the Company at a price of US$0.08 for a period of 5 years expiring December 7, 2015.

On December 23, 2010, the Company granted 1,000,000 compensation warrants each to the President of the Company and an employee. Each warrant is exercisable into a common share of the Company at a price of US$0.08 per share for a period of 5 years expiring December 23, 2015.

On June 22, 2011, the Company issued 2,500,000 warrants to a consultant in connection with a professional services agreement (Note 11). These warrants have an exercise price of $ 0.15 and expire on June 22, 2014. The agreement has a minimum term of twelve months. The Company estimated the fair value of these warrants at grant to be $260,858 using the Black-Scholes option pricing model with the following assumptions: expected life of 3 years; volatility of 180%; risk-free interest rate of 2.24%; and a dividend rate of 0%. For the year ended December 31, 2011, the Company recorded stock-based compensation expense of $134,003, respectively, with the remainder of the fair value $126,855 recorded in deferred compensation in equity which will be amortized over a twelve month term.

All warrants issued vested upon granting.

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9. Capital stock (cont d)

Warrants (cont d):

On December 5, 2011, the Company issued 250,000 compensation warrants to each of the four new members of the board of directors brought in during 2011, totaling 1,000,000 compensation warrants. Each warrant is exercisable into a common share of the Company at a price of $0.10 and expire on December 5, 2014. The Company estimated the fair value of these warrants at grant to be $51,143 using the Black-Scholes option pricing model with the following assumptions: expected life of 3 years; volatility of 180%; risk-free interest rate of 2.24%; and a dividend rate of 0%.

A summary of the warrants outstanding and exercisable at December 31, 2011 is as follows:

Weighted Average Exercise Price	Number	Weighted Average Remaining Contractual Life
US$ 0.083	4,219,650	0.29 years
$ 0.083	813,000	0.29 years
US$ 0.080	2,749,998	3.94 years
$ 0.080	9,250,002	3.94 years
US$ 0.080	4,950,000	4.18 years
US$ 0.080	6,000,000	4.18 years
$ 0.080	6,000,000	3.98 years
$ 0.150	2,500,000	2.44 years
$ 0.100	1,000,000	2.93 years
$ 0.086	37,482,650	3.40 years

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10. Income taxes

(a) The provision for income taxes differs from the amount that would have resulted in applying the combined Canadian federal and statutory income tax rates as follows:

		2011		2010
Net income (loss) before income tax rates	$	(2,883,304)	$	(1,340,053)
Statutory income tax rate		26.5%		28.5%
Expected income tax expense (recovery) at statutory income tax rate	$	(764,076)	$	(381,915)
Non-deductible expenses and other items		382,970		(9,558)
Change in valuation allowance		381,106		426,709
Recognized investment tax credit		-		(35,236)
Income tax expense	$	-	$	-

(b) Temporary differences that give rise to the following deferred income tax assets are as follows:

		2011		2010
Equipment	$	20,137	$	18,732
Intangible assets		17,778		15,171
Derivative liability		97,706		243,574
Investment tax credits (non-refundable)		914,027		689,857
Losses		234,986		-
Research and development costs		588,950		476,098
Warranty provision		51,628		109,428
		1,925,212		1,552,860
Valuation allowance		(1,925,212)		(1,552,860)
Net deferred income tax assets	$	-	$	-

The Company has non-refundable federal investment tax credits of $631,991 (2010 - $346,717) which will expire over a period up to 2031 and provincial investment tax credits of $282,037 (2010 - $171,122), which will expire over a period up to 2021.

The Company has unutilized scientific research and development costs of $2,355,799 (2010 - $1,926,707) which may be available to reduce taxable income and income taxes payable in future years.

Management has determined that the realization of the potential deferred tax assets resulting from these tax pools and other temporary differences is uncertain at this time, and cannot be viewed as more likely than not. Accordingly, the Company has recorded a full valuation allowance for the potential deferred tax asset.

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10. Income taxes (cont d)

The Company files income tax returns in Canada and the United States of America. The Company s Canadian income tax returns for 2007 through 2011 are open tax years. The Company s United States tax returns are open from 2008 through 2011. The Company has reviewed its tax filings for these years to identify the existence of any uncertain tax positions that would require recognition in the Company s financial statements. The Company may from time to time be assesed interest or penalties by tax filing jurisdictions, although any such assessments historically have been minimal and immaterial to the Company s financial results.

11. Commitments

The Company is committed to minimum annual payments for leases on its premises, automobiles, and office equipment as follows in each of the next five years:

Year ending December 31:

2012	$	167,373
2013		85,057
2014		26,414
2015		13,305
2016		4,528

Rent expense included in the statements of operations is $137,582 (2010 - $135,757).

On June 22, 2011, the Company entered into a professional services agreement with a consultant for business development and strategic initiatives. As consideration, the Company will compensate the consultant at $8,500 per month, pay commissions of 8% on new sales and issued warrants for 2,500,000 shares (Note 9). Additionally for providing specific involvement in a future M&A transaction or Capital raise transaction, the consultant will be compensated at 7% or 10%, respectively, of the transaction value. The agreement may be terminated by 30 days written notice, after an initial term of 8 months. The commission arrangement extends for 12 months beyond termination.

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12. Changes in non-cash working capital balances

	2011	2010
Trade accounts receivable	$ 162,914	$ 621,707
Inventory	15,918	86,705
Deposits	4,500	-
Lease receivable	-	-
Accounts payable	(49,996)	47,798
Accrued liabilities	51,661	67,733
Deferred revenue	5,248	4,619
Due to related parties	14,769	-
	$ 205,014	$ 828,562

13. Segment information

(a) Operating segments:

The Company organizes its business into two reportable segments: manufacturing and servicing. The manufacturing segment designs, produces and sells intercom and door access control systems that utilize telecommunications to control access to buildings and other facilities for security purposes. The servicing segment provides maintenance to these intercom and door access control systems.

The segments accounting policies are described in Note 2. Management evaluates performance based on profit or loss from operations before income taxes and nonrecurring gains and losses, if any. Retail prices are used to report intersegment sales.

December 31, 2011	Manufacturing	Servicing	Total
Sales to external customers	$ 2,353,326	$ 1,117,522	$ 3,470,848
Depreciation and amortization	5,621	20,892	26,513
Interest expense	16	-	16
Segment income (loss) before other items	(2,024,791)	349,502	(1,675,289)
Total assets	$ 1,122,036	$ 67,900	$ 1,189,936

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13. Segment information (cont d)

December 31, 2010	Manufacturing	Servicing	Total
Sales to external customers	$ 2,670,089	$ 1,246,835	$ 3,916,924
Depreciation and amortization	7,170	20,892	28,062
Interest expense	2,344	-	2,344
Segment income (loss) before other items	(1,253,812)	371,796	(882,016)
Total assets	$ 1,962,011	$ 88,792	$ 2,050,803

(b) Of the total sales for the year ended December 31, 2011, $412,371 (2010 - $570,210) was derived from U.S.-based customers and $3,058,477 (2010 - $3,346,714) from Canadian-based customers.

Substantially all of the Company's operations, assets and employees are located in Canada.

(c) Major customers:

No customer represented more than 10% of total sales in either of the years presented.

(d) Products:

Enterphone sales represented 11% of total sales during the year ended December 31, 2011 (2010 9%). MESH sales represented 51% of total sales during the year ended December 31, 2011 (2010 54%). The balance of the Company s sales are derived from service agreements and other products such as access tracking and control, closed circuit monitors, infrared devices and radio frequency remotes.

14. Financial instruments

The Company s financial instruments include cash, trade accounts receivable, accounts payable, accrued liabilities, and amounts due to stockholders. It is management s opinion that the Company is not exposed to significant interest, currency, business concentration or credit risks arising from these financial instruments. The Company s financial instruments also include derivative liabilities which are measured at fair value and are impacted by changes in interest rates, foreign exchange rates and the price of the Company s shares.

The fair values of all other financial instruments approximate their carrying values based on their liquidity and short-term nature.

The Company is subject to significant liquidity risk. At December 31, 2011, the Company s current assets consist principally of trade accounts receivables and inventory. The Company must liquidate inventories and rapidly increase collection periods on its receivables to ensure that sufficient cash is available to settle payables and operating costs as they come due.